Framework for Valuing Marketing Investment

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Marketers need to invest funds wisely as a responsibility to consumers, shareholders, employees and themselves. And so we're proposing a holistic framework for evaluating marketing investment decisions. We've become concerned that marketers are too focused on ROI. ROI is just too narrow and doesn't provide enough information for making high quality marketing investment decisions.

Consider two investments: "A" and "B." Investment "A" has a ROI of $1.1 per dollar invested versus "B" has a ROI of $11.0 per dollar invested. "B" is the better investment per dollar spent, but the ROI masks other important points about the financial value of these investments that should be considered.

ROI as a single metric does not capture enough of the factors to make an informed decision. A rich and more comprehensive framework is required to make better marketing investment decisions. The framework proposed below is holistic and general for all marketers across industries.

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- *Contribution or Lift:* Marketing impacts demand. Any framework must start here. The contribution or lift is a measure of the impact resulting from the marketing effort.
- *Revenue Forecast:* The contribution then must be tied to revenue. Maintaining impact of marketing without an explicit understanding of how it gets to revenue is just an analytical exercise. For example, if lift is defined as new customers then how much do those new customers impact the total revenue? Linking to revenue also provides a measurement benefit. It is a direct link to observable outcomes over time. As such it can be used to monitor and update a model to measure contributions over time.
- *Long-term effects:* Customers don't make a purchase immediately after seeing an ad, even if the ad has an immediate call to action. Any good evaluation of marketing impact must have long-term effects. Including long-term effects will yield an explicit understanding of how marketing is building a foundation for the company, product or brand. This concept is fundamental for understanding marketing as an asset and core competence as opposed to an expense item. Any marketing valuation framework without long-term effects is incomplete.
- *Cash flows:* Taking contribution, including long-term effects, converting to revenue and subtracting production costs yields an estimate of the cash flows generated from the marketing investment now and into the future. The stream of cash flows marketing generates is no different than the stream of cash flows from a new factory or new product. This is how marketing investment can and should be compared to any number of other investments in the business.
- *Present Value:* With a stream of cash flows it's difficult to know how to trade off cash today versus cash a year from now.

Framework for Valuing Marketing Investment, *Cont'd*

"This framework expands discussions ***beyond ROI.****"*

Using standard financial analysis methods that most companies use for valuing capital and project investments, the relative value of cash flow now versus later can be converted to equivalent units of value in time and added over the future. This provides a comparable value for all investments, marketing and non-marketing alike, compared in today's dollars. Further, for marketing this helps overcome hurdles in the conversation about long-term brand-building versus short-term revenue generation. All activities are comparable in today's dollars.

- *Net Present Value:* It's the Present Value less the investment in marketing. This measure brings clarity to understand the value of each activity in absolute terms, avoiding the issue of measuring value relative to investment as with ROI.
- *Marginal ROI:* The incremental Present Value returned for an incremental level of investment is the Marginal ROI. Marginal ROI, as opposed to ROI, provides direct guidance on where we should put or take funds, but at the margin rather than the whole. This explicitly acknowledges diminishing marginal returns and again avoids a problem with ROI. If investing an incremental dollar in an activity will yield incrementally more Present Value then it's an investment that should be taken. If reducing investment will save more than is lost then this is a savings that should be taken.
- *ROI:* ROI is the ratio of present value to investment. In the limited case where a decision is binary as a go-no-go decision, ROI can be used to evaluate the return from these two extremes.
- *Uncertainty:* The metrics above provide a lot of clarity on the returns from marketing investment, but only as a point estimate. In reality all of these have uncertainty, and in most cases high levels of uncertainty. Providing the likely ranges of these metrics provide richer basis to consider the best investment level based on the risk associated with the marketing returns. This last piece brings into focus the reality that investment in marketing is a trade-off between alternatives and risks. It also provides opportunity for a more honest and informed discussion of the quality of information for making these decisions.

With this holistic framework in hand marketers recognize the full impact of their investment in the long and short-term; make trade-offs between these marketing and non-marketing investments; treat marketing as a financial investment; and understand their risks. This framework expands discussions beyond ROI. Marketing investments are motivated based on their holistic impact to the business in the comparative context of other investment alternatives in- and outside of marketing.

Keen's MIDA decision support software employs this framework. The software system automatically calculates all these important metrics so they are considered for every what-if scenario. And we take it further. This framework is at the core of MIDA's marketing optimization algorithm. Using MIDA marketers can efficiently make the right decision to invest the right amount of resources and mix across activities that maximizes the value of their investment.