

The Return on Marketing Investment or Return on Marketing Communication

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- ### Key Metrics for Marketing Management
- Gross Profit Ratio or Gross Return on Sales or Gross Profit to Sales Ratio = G/R (used as a measure of efficiency and in variable cost pricing formula)
 - Return on Sales or Net Profit Margin or Net Profit Ratio or Net Profit to Sales Ratio = Z/R (used as a measure of efficiency and in BEP pricing formula)
 - Return on Inventory Investment or Profit to Inventory Ratio = Z/I (used in Dupont type profitability analysis)
 - Sales to Advertising Ratio = R/A (used in simple forecasting of the sale effect from advertising)
 - Advertising to Sales Ratio = A/R (used in budget/control)
 - **Return on Marketing Investment or Return on Marketing Expense or Profit to Marketing Expense Ratio = NMC/A (Used for comparing the sales effectiveness of different marketing strategies)**

- ### ROME
- Ratio of the Profit After Direct Marketing Expenses over the Direct Marketing Expenses
 - Example: ROT = Return on Total Promotion
 - ROT = (Profit After Total Promotion, NMC) divided by (Total Promotion, T)
 - ROT = NMC/T

Simple Operating Statement

Revenue	
Total Variable Cost	
Gross Profit	
Total Promotion Expense,	
Profit after Promotion	
Research & Development	
Net Profit	

Simple Operating Statement

Revenue = $P \times Q = R$	
Total Variable Cost = $CoGS = V \times Q$	
Gross Profit Margin = $G = R - CoGS$	
Total Promotion Expense, <small>T = AD+CP+SF+DP</small>	
Profit after Promotion, NMC = $G - T$	
Research & Development, R&D	
Net Profit Z = $NMC - R\&D$	

Classic Percentage of Sales Ratios

Revenue = $\$90 \times 80,000 = R$	7,200,000	Percent of Sales
Total Variable Cost CoGS = $\$30 \times 80,000$	2,400,000	
Gross Profit, $G = R - CoGS$	4,800,000	66.67%
Total Promotion Expense, T <small>T = AD+CP+SF+DP</small>	2,980,000	41.39%
Profit after Promotion, NMC = $G - T$	1,820,000	25.28%
Research & Development, R&D	720,000	
Net Profit, $Z = NMC - R\&D$	1,100,000	15.28%

**Ratio of Gross Profit to Sales
Or
Markup on Price**

Sales Ratios

		Percent of Sales
Revenue = $\$90 \times 80,000 = R$	7,200,000	
Total Variable Cost CoGS = $\$30 \times 80,000$	2,400,000	
Gross Profit, $G = R - \text{CoGS}$	4,800,000	66.67%
Total Promotion Expense, T $T = \text{AD} + \text{CP} + \text{SF} + \text{DP}$	2,980,000	41.39%
Profit after Promotion, $\text{NMC} = G - T$	1,820,000	25.28%
Research & Development, R&D	720,000	
Net Profit, $Z = \text{NMC} - \text{R\&D}$	1,100,000	15.28%

**Net profit Margin or
Return on Sales**

Sales Ratios

		Percent of Sales
Revenue = $\$90 \times 80,000 = R$	7,200,000	
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Research & Development, R&D	720,000	
Net Profit, $Z = \text{NMC} - \text{R\&D}$	1,100,000	15.28%

**Ratio of Promotion to Sales
e.g., advertising to sales ratio**

Sales Ratios

		Percent of Sales
Revenue = $\$90 \times 80,000 = R$	7,200,000	
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Marketing Return on Sales

Sales Ratios

		Percent of Sales
Revenue = $\$90 \times 80,000 = R$	7,200,000	
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Research & Development, R&D	720,000	
Net Profit, $Z = \text{NMC} - \text{R\&D}$	1,100,000	15.28%

Quantity sold Q in units	80,000
Revenue = $90 \times Q = R$	7,200,000
Total Variable Cost = $\text{CoGS} = 30 \times Q$	2,400,000
Gross Profit Margin = $G = R - \text{CoGS}$	4,800,000
Markup on Price $M_p = (90 - 30) / 90$	66.67%
Total Promotion Expense, T $T = \text{AD} + \text{CP} + \text{SF} + \text{DP}$	2,980,000
Profit after Promotion, $\text{NMC} = G - T$	1,820,000
Marketing Return on Sales, NMC / R	25.28%
Research & Development R&D	720,000
Net Profit $Z = \text{NMC} - \text{R\&D}$	1,100,000
Return on Sales = $\text{ROS} = Z / R$	15.28%

Return on Marketing 'Investment'

- Relatively New Metric
- Very different from others --- It is **NOT** a ratio of something on sales revenue!
- Should be called **Return on Marketing Expense, ROME**

$$\text{ROME} = \frac{\text{Net Marketing Contribution}}{\text{Total Promotion}}$$

- ROME is considered a measure of marketing effectiveness
- A strategy with a ROME of 200% is a more effective marketing strategy than a strategy with a 50% ROME

ROME does not fit well on the operating statement

Quantity sold Q in units	80,000
Revenue = $\$90 \times Q = R$	7,200,000
Total Variable Cost = $CoGS = 30 \times Q$	2,400,000
Gross Profit Margin = $G = R - CoGS$	4,800,000
Total Promotion Expense, T <small>T = AD+CP+SF+DP</small>	2,980,000
Profit after Promotion, NMC = $G - T$	1,820,000
Return on Marketing Expense, ROME $NMC/T = 1,820,000/2,980,000$	61.07%
Research & Development R&D	720,000
Net Profit Z = $NMC - R\&D$	1,100,000

Problem on page 244-245

- Total Shoe market is \$500,000,000
- Target Segment (ages 17-28) is 35% of the total
- Firm's gross profit to sales ratio is 20%
- Plan 1 spend \$500,000 on promotion and gain 2% of the target market
- What is the ROME for Plan 1?

Part 1 Drawn from page 245

- You are targeting the Youth segment of the total shoe market that is 35% of the total shoe market.
The total market is \$500,000,000 sales annually.
How big is the Youth Segment?
- Home size is
 $35\% \times \$500,000,000 = \$175,000,000$

Part 2 Drawn from page 245

- The Youth Segment is \$175,000,000 in size. Your firm's share is 2%. What is the sales revenue you are getting from the Youth market?
- Your sales revenue from a 2% share is
 $2\% \times \$175,000,000 = \$3,500,000$

Plan 1 has a 2% share for a \$500,000 budget

Revenue, R	3,500,000
Total Variable Cost	
Gross Profit = $Gross\ ROS \times R$????
Total Promotion Expense, T <small>T = AD+CP+SF+DP</small>	500,000
Profit after Promotion, NMC = $G - T$	
Return on Marketing Expense, ROME	????
Research & Development R&D	
Net Profit Z = $NMC - R\&D$	

Part 3 Drawn from page 245

- Your sales revenue from the Youth Segment is \$3,500,000 in size. Your firm has a 20% gross return on sales. What is the gross profit that you are earning from the Youth Market?
- Your gross profit from a 20% ratio of Gross Profit over the Sales Revenue is**
 $20\% \times \$3,500,000 = \$700,000$ gross profit

Plan 1 gets a 2% share for a \$500,000 budget

Revenue , R	3,500,000
Total Variable Cost	
Gross Profit = 20% x 3,500,000	700,000
Total Promotion Expense, T T = AD+CP+SF+DP	500,000
Profit after Promotion, NMC = G - T	????
Return on Marketing Expense, ROME	????
Research & Development R&D	
Net Profit Z = NMC - R&D	

Part 4 Drawn from page 245

- Your gross profit from the Youth Segment is \$700,000. Your firm spent \$500,000 on advertising to generate the profit. What is the net marketing profit that you are earning from the Youth Market?
- Your net marketing contribution is the gross profit minus the advertising expens**
 $\$700,000$ gross profit - $\$500,000 = \$200,000$

Plan 1 gets a 2% share for a \$500,000 budget

Revenue , R	3,500,000
Total Variable Cost	
Gross Profit = 20% x 3,500,000	700,000
Total Promotion Expense, T T = AD+CP+SF+DP	500,000
Profit after Promotion, NMC = G - T	200,000
Return on Marketing Expense, ROME	????
Research & Development R&D	
Net Profit Z = NMC - R&D	

Part 5 Drawn from page 245

- Your net marketing contribution from the Youth Segment is \$200,000. Your firm spent \$500,000 on advertising to generate the profit. What is the Return on Marketing Expense, ROME?
- Your ROME is the ratio of the NMC to the advertising expense**
 $ROME = NMC/A = \$200,000 / \$500,000 = 40\%$

Plan 1 has a 2% share for a \$500,000 budget

Revenue , R	3,500,000
Total Variable Cost	
Gross Profit = 20% x R	700,000
Total Promotion Expense, T T = AD+CP+SF+DP	500,000
Profit after Promotion, NMC = G - T	200,000
Return on Marketing Expense, ROME NMC/T = 200,000/500,000	40%
Research & Development R&D	
Net Profit Z = NMC - R&D	

Plan 2 on page 244-245

- Get 3% share of the Youth segment for a promotion expense of \$1,000,000.

Plan 2 has 3% share for a \$1,000,000 budget

Revenue , R	5,250,000
Total Variable Cost	
Gross Profit = 20% x R	1,050,000
Total Promotion Expense, T T = AD+CP+SF+DP	1,000,000
Profit after Promotion, NMC = G - T	50,000
Return on Marketing Expense, ROME NMC/T = 50,000/1,000,000	5%
Research & Development R&D	
Net Profit Z = NMC - R&D	

	Plan 1	Plan 2
Share of Segment	2%	3%
Revenue , R	3,500,000	5,250,000
Total Variable Cost		
Gross Profit = 20% x R	700,000	1,050,000
Total Promotion Expense, T T = AD+CP+SF+DP	500,000	1,000,000
Profit after Promotion, NMC = G - T	200,000	50,000
Return on Marketing Expense, ROME NMC/T = 50,000/1,000,000	40%	5%
Research & Development R&D		
Net Profit Z = NMC - R&D		

Which is the highest MROI or ROME

- Plan 1 with advertising A has a ROME = 40%
- Plan 2 with advertising B has a ROME = 5%
- But The goal is not to maximize ROME
- ROME is a measure of effectiveness
- Plan 1 is more effective than plan 2

Two Plans with different ads and different expenditures

- Which Plan to Choose?
- Before you can answer you need to know the firm's goal.
- Maximize profit?
- Maximize share?
- Build awareness?

- **Plan 1**
 - Spend \$500,000 in Promotion with ad 1 and make a 2% share and \$250,000 in Profit for a
 - ROME = \$250,000/\$500,000 = 50%
- **Plan 2**
 - Spend \$1,000,000 in Promotion with ad 2 and make a 3% share and \$50,000 in profit for a
 - ROME = \$50,000/\$1,000,000 = 5%

Variations on ROME

- Market share gained per dollar spent
- Share of Voice per dollar spent
- Share of Mind per dollar spent (Awareness)
- Share of Heart per dollar spent (Desire)
- Customer Retention per dollar spent (Satisfaction)
- Insertions, Facings, Prospects, ...

What is ROME good for?

- Should we maximize ROME?
- **NO!!**
- But if the goal is to maximize profit and
- If we have two plans that are equal in profit but have different returns on marketing effort,
- Should we choose the plan with the higher ROME?
- **Maybe!**

Handing out a bonus for greater effectiveness

- Home Market has a profit of \$1,200,000 ROME of 50%
- Domestic Market has a profit of \$800,000 and a ROME of 60%
- Which of the two managers is doing the better job and deserves the bonus?

Two Sales People

- Salesman A is paid \$2,000 a week and brings in a gross profit of \$10,000
- A's ROME = $(10,000 - 2,000) / 2,000 = 400\%$
- Salesman B is paid \$3,000 a week and brings in a gross profit of \$14,000
- B's ROME = $(14,000 - 3,000) / 3,000 = 366\%$

What is ROME good for?

- The incremental change in ROME is far more useful than the average ROME
- The elasticity of ROME indicates if the optimal level of advertising expenditure has yet to be reached or has it been passed.
- Elasticity of ROME is the percentage change in ROME over the percentage change in advertising expense.