

## Return on Marketing Investments (ROMI)

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*Impact at JMR*, forthcoming, 2023

**Introduction: the managerial value of ROMI.** Marketing executives make numerous decisions on marketing spending across various spending categories, products and markets. For example, they may choose to invest in online advertising for product A, launch a price promotion for product B and engage in a sponsorship contract for the brand as a whole. Given this complexity, it is not surprising that there is a strong need for a metric that assesses and compares the *productivity* and *accountability* of these various engagements.

*Return on marketing investment (ROMI)* is the logical metric of choice, inspired by the finance discipline. Ideally, ROMI metrics are single numbers that can be easily compared across marketing activities and that allow for benchmarking. For example, a manager wants to be able to state, with confidence, that “my search advertising campaign yielded a return of 60 percent, which is well above average for ad campaigns for our brand, and which exceeds last year’s ROI of 45 percent.” Importantly, such return calculations should be made on *net* marketing contribution, i.e. [revenue increase due to marketing times gross margin - minus marketing investment] / marketing investment.

**The determinants of ROMI.** Unfortunately, the reality of marketing does not lend itself well to using such simple ROMI performance metrics. The main reason for this is that consumer response to marketing activities is *not linear*. Instead, research shows that such response is typically concave (diminishing returns to scale) or S-shaped (increasing, then diminishing returns to scale) (Hanssens, Parsons & Schultz 2001). As a result, the *profit* response to marketing spending is typically inverted-U shaped (Mantrala, Naik, Sridhar & Thorson 2007) and *ROMI depends critically on the level of marketing spending*. In our hypothetical search advertising example, the ROMI could be 150 percent for the first \$10,000 of spending, 40 percent for the next \$10,000, and eventually become negative when the firm overspends. Comparing the ROMI across different marketing campaigns or media is therefore a non-starter, unless of course these campaigns all happened to involve the exact same spending level.

Marketing analysts – both in academia and in practice – have long recognized this challenge. Instead of reporting ROMI in their papers, they focus on reporting top-line productivity metrics such as sales lifts (due to marketing), net profit (or contribution to overhead), or marginal ROMI (i.e. return of the *last* dollar spent). Using these metrics correctly, however, requires some understanding of consumer response patterns and of accounting consequences of spending. In that context, researchers have carefully examined the impact of marketing spending on short-term and long-term profitability, on customer lifetime value and other strategically important metrics. In conclusion, as much as executives favor ROMI as a simple yardstick, research has to focus on the *determinants* of ROMI: top line performance

enhancement, profit margins and marketing costs, and then *derive* ROMI on a case-by-case basis. In so doing, we *should not expect* a simple return metric that can easily be compared to other ROMIs (Farris, Hanssens, Lenskold & Reibstein 2015).

**ROMI for marketing tactics.** Turning to the nature of marketing spending, it is important to distinguish between individual marketing tactics and marketing strategy, the latter referring to combined actions across the marketing mix. The vast majority of marketing effectiveness studies examine *individual marketing actions*, in particular advertising. Some of these studies focus on the direct impact of marketing on sales, so that profit and ROMI implications can be derived directly from the results. With the advent of better intermediate consumer attitudinal data, especially digital metrics such as clicks and likes, ROMI is derived in two steps: 1) estimate marketing's lift on the intermediate metric (e.g. how many clicks does a digital ad generate) and 2) how do these clicks translate into future sales, the so-called conversion rate (Hanssens, Pauwels, Srinivasan, Vanhuele and Yildirim 2014; Dinner, van Heerde and Neslin 2014). These inferences can be made either from historical data (using econometric methods) or from experiments, or from a combination of the two (Krishnamurthi, Narayan and Raj 1986).

In the digital marketing world these models have been extended to full consumer-journey models, allowing advertising to reach the right people at the right time in their personal journey (Danaher and van Heerde 2018). In so doing, it is important to make the distinction between *first-purchasers* (customer acquisition) and *repeat-purchasers* (customer retention, upsell and cross-sell), as their responsiveness has been shown to differ (Deighton, Henderson & Neslin 1994). Combining the two effects leads to estimates of marketing impact on customer life time value (Gupta, Lehmann and Stuart 2004).

**ROMI for marketing strategy.** Last, but not least, we turn to the return on marketing strategy, which typically combines multiple marketing instruments. ROMI in this context needs to focus on *long-term performance impact*, especially sustained growth in business performance (Dekimpe and Hanssens 1999). In this context, Ataman, van Heerde and Mela (2010) have shown that, across the marketing mix, long-run sales growth is much more sensitive to investments in *product and distribution* than advertising and sales promotions. Indeed most ROI results based on sales movements in response to advertising or sales promotions cannot be expected to have a sustained impact. These actions thus require *repetition* for long-term impact.

Another, equally valuable approach to ROMI for marketing strategy is to examine the extent to which marketing investments enhance critical *marketing assets*, which, in turn are known to improve long-term business performance. The latter has been demonstrated by using firm value as a dependent variable, since firm value is the net present value of expected future earnings. Edeling and Fischer (2016) have demonstrated that these assets are much more important in driving firm value than individual marketing actions. For example, the meta-analytic firm-value elasticity of brand strength is 0.33, that of customer relationship strength is 0.72, while that of advertising spending is only 0.04. Edeling and Himme (2018) use these meta-analytic results to recommend the following strategic marketing allocations for the three central

objectives of marketing actions: invest 61% of the budget on building customer-related assets, 28% on building brand-related assets and 11% on increasing market share.

Digging deeper into the customer-relationship asset, we know it relates strongly to customer satisfaction with the brand or firm: indeed movements in customer satisfaction can be related to changes in stock price (Fornell, Morgeson and Hult 2016). When it comes to new products, customer satisfaction is influenced by product reviews, and here we have learned that the return on review quality is much higher (elasticity around 0.7 according to a meta-analysis by Floyd, Freling, Alhoqail, Cho and Freling (2014) than that of advertising (meta-analytic elasticity of 0.11 according to Sethuraman, Tellis and Briesch (2011)). These are important insights that make a critical distinction between return to single marketing actions vs. return to marketing strategy.

**Conclusion.** In conclusion, ROMI is a topic of major interest to both marketing executives and marketing analysts. While executives understandably would like to have one number to gauge the performance of their marketing investments, such oversimplification is dangerous and, in fact, may lead to significant under-investment in marketing. Instead, for individual marketing tactics such as advertising and sales promotions, ROMI should be *derived* from measuring marketing's lift on top-line performance, followed by a marketing cost analysis. The only ROMI that *can* be a unifying metric of return would have to be estimated at the margin (i.e. what is the return of the *last* dollar spent?). The last-dollar ROMI would be positive for underspending, negative for overspending and 0 for right-spending. For more strategic marketing decisions, ROMI should be derived from long-term growth measurement and/or from changes in brand or customer relationship assets that drive long-term performance.

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