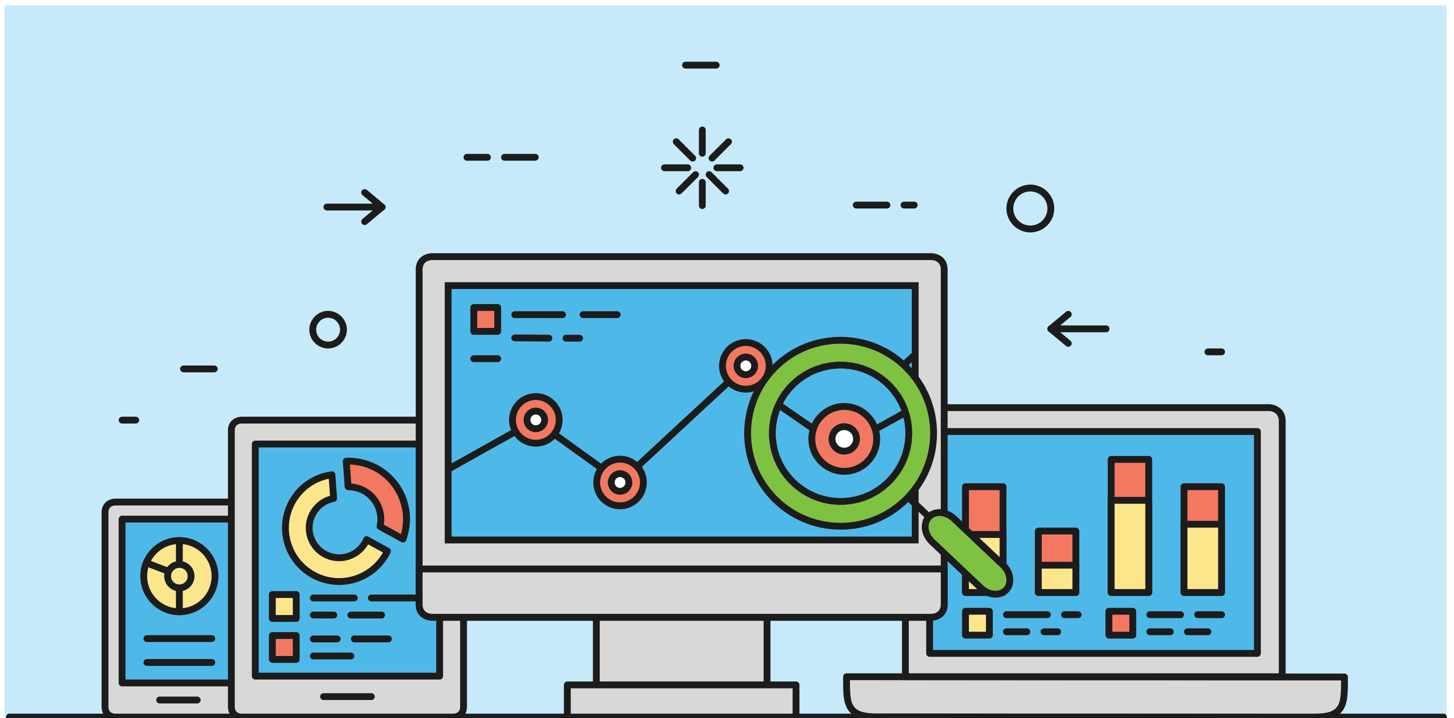
Deloitte.



MROI defined

MROI can be powerful—but its complexities need to be understood, and it shouldn't distract from the broader managerial tasks involved in ensuring marketing effectiveness.

For every marketing practitioner who has a solid understanding of MROI (marketing return on investment; aka ROMI or return on marketing investment), there are probably two or three who have only a vague view of it. Beyond the marketing function, the ratio appears to be even higher.

MROI plays an important role in measuring the success of marketing efforts, but it needs to be deployed in a larger managerial context. Therefore, it's worth refreshing our understanding of MROI, and how it's used, and rearticulating how to manage overall marketing effectiveness.

Many executives would agree that if dollars are committed to marketing, the marketing function should strive to measure and enhance the returns from that spending. Marketing ROI is a valuable measure of the productivity of marketing—showing the output the firm receives from the marketing input it provides.

MROI can be used to assess historical marketing productivity; project future marketing productivity; secure and justify marketing budgets; allocate marketing budget across geographies, markets, customer segments, products, marketing mix elements, and media types; and gain approval for a campaign launch.

MROI calculations use two main methods—response modeling and A/B testing experiments. Response models are created using time series data and regression. A/B testing changes the marketing tactics in market A while not in market B, or presents offer A or offer B to customers, to see how the market responds. As digital marketing has grown, the cost of A/B testing has come down, while the availability of data has gone up. Marketers can use that data to fuel sophisticated marketing mix optimization models and calculate MROI.

$$\frac{\text{(Incremental Financial Value Generated by Marketing – Cost of Marketing Activities)}}{\text{Cost of Marketing}}$$

Complexities of MROI

MROI has several complexities that executives need to be aware of in order to properly interpret and use the results. Executives will be better equipped to ask questions and translate the MROI results into business logic when they understand these complexities:

Cost

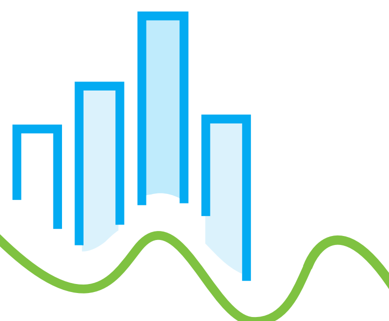
What costs have been included? Just the media budget, or the costs of the staff and infrastructure required to create the idea for the campaign, generate the content, and respond to increased customer inquiries and demand? Some MROI calculations, such as the returns on social media activity, often appear to be extremely high because only incremental media spend has been included as a cost. A further complication is that certain fixed infrastructure (such as call centers) might be at capacity, or under capacity. When at capacity, incremental costs should be included. If under capacity, there may be an argument for not including those costs. In other cases, some marketing investments may involve diverting capital from other uses, so it may be appropriate to include the cost of capital in the cost calculation.

Returns

How were returns calculated? Ideally, returns are calculated as incremental net profit impact. But sometimes profit is hard to calculate and incremental revenue is used instead. That's different from how finance would typically view ROI. Returns can be useful in comparing campaigns, but they don't represent a true MROI financial measure. At times, even incremental revenue is hard to determine, so it needs to be modeled based on understanding the impact of the marketing spend on moving the customer through the purchase funnel, or across stages in the decision journey. In this case, assumptions about the conversion rate from one funnel stage to another, through to purchase, impact the calculation. In other instances, the return is based on cost avoidance—for example, substituting a more affordable tactic for an expensive one to achieve the same market result. Marketing tactics that achieve buzz, go viral, and hence earn free media coverage are often compared to the paid media that would have been required to generate the same market response. All of these return calculations are potentially valid, but they involve assumptions, and executives need to understand what has actually been calculated and how.

Baseline

MROI calculations involve establishing a baseline—what would sales and profits have been without the marketing spend? But "pure" baselines are hard to come by. Historical sales data already reflect some contribution by marketing. It can be difficult to assess whether sales would have dropped further without the marketing spend. For instance, markets in the current year are different than the prior year, due to changes in competitive behavior. A/B markets may differ on other dimensions than just the marketing activity deployed in each market. These challenges in arriving at a baseline, from which to measure lift due to marketing spend, are surmountable, but they involve assumptions that executives need to understand.



Time frame

MROI is often used with a short-term horizon in mind—evaluating a set of tactics deployed in recent months, for example. However, many marketing investments take time to impact the market. Investments to place, say, an insurance brand in a consumer's consideration, set for their downstream purchase, may not pay off until years later, when a trigger occurs to stimulate shopping for insurance. Brand-building investments are typically cumulative over many years, create momentum effects, and generate long-run perception and reputation benefits that are hard to measure. For long-cycle improvements the measure of return may need to change. For example, investments in customer retention that reduce attrition over the long term could consider Customer Lifetime Value (CLV) as a measure of return. For brand investments, not only brand equity valuation but also impact on reducing the firm's cost of capital and enhancing its stock market valuation (e.g., P/E ratio) could be considered.

Systems effects

Marketing tactics do not work in isolation but as a mix. While certain tactics, especially digital, might appear very measurable (e.g., does the search ad generate clicks or not) in practice, even those tactics are interacting with others. How much does the click-through depend on complementary TV advertising? Today's sophisticated marketing mix models do have ways of addressing this attribution problem and estimating the role of elements of the marketing mix. However, executives need to ask about the level of granularity or aggregation used in the MROI calculation and what assumptions have been made. Especially in broad, multi-year, multi-tactic campaigns (such as a corporate brand effort), understanding how the mix of tactics worked together, creating interaction effects and feedback loops becomes important. Simply adding together the tactics with the highest individual MROIs does not ensure the integrated campaign is the most effective.

Ratio, not absolute measure

MROI is, of course, a ratio. It compares the return to the cost to achieve that return. That's superior to an absolute measure such as net present value (NPV), because it is clearly preferable to generate $1 million of NPV from $200,000 of spend than, say, $800,000 of spend. But it is inferior to the absolute measure on another dimension. It is possible to generate increased profitability for the business by making marketing investments that reduce total MROI. If $400,000 of marketing spend can generate $1 million of incremental profit, but $600,000 can generate $1.4 million of incremental profit, the company should increase the spending even though MROI will be reduced. (This is a function of the marketing response curve—how net profit responds to marketing spend is usually not linear.) Total MROI should therefore not be used as a goal because, as a ratio, it is potentially at odds with maximizing profits. Total MROI is a measure of productivity, not profitability. In addition to total MROI (across all marketing spending), it is possible to calculate incremental ROI (is it worth it to spend the extra $200,000?) and marginal ROI (should we put even more spend into this or have we reached diminishing returns or market saturation?), and establish a threshold MROI return (hurdle rate) required to approve such incremental or marginal spending. Executives should be clear about the business decision they are trying to make, and then use an absolute measure, like NPV, or be sure they are using the appropriate incremental or marginal MROI calculation.

Marketing tactics that achieve buzz, go viral, and hence earn free media coverage are often compared to the paid media that would have been required to generate the same market response.

As used in this document, "Deloitte" means Deloitte Consulting LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

Copyright © 2019 Deloitte Development LLC. All rights reserved.