

WHAT IS RETURN ON INVESTMENT?

Determining the return on investment is a very important part of any business review.

Whether the company is spending funds to increase infrastructure, train its sales force or fund elements of the marketing program, estimating return on investment will aid the company in choosing where to spend.

Return on investment (ROI) looks at the rate at which you recover your investment. To calculate ROI, simply divide profits (not revenue) by the amount of money invested to get a percentage rate of return on the investment.

$$\text{Profits} \div \text{investment} = \text{rate of return (ROR)}$$

Normally, ROI is measured as a percentage of return over a period of a year. If the rate of return is 33.3% in one year, then it will take 3 years to recover the complete investment ($100\%/33.3\%=3$). If ROR is 50%, then payback is two years; if 200%, then six months.

WHY MEASURE RETURN ON INVESTMENT?

Operating a business is about making a profit and increasing the net worth of the company to stakeholders.

The management is charged with the responsibility to use company resources to maximize the profit on various investment choices.

Estimating ROI for a proposed expenditure will go a long way in aiding management to make a “go” or “no go” decision.

ROI is all about the money a business earns for making investments in specific activities. You can separate ROI into two categories: MICRO and MACRO ROI.

Micro ROI is focused on elements of larger programs a company may become involved in. Most initiatives would take up to a year to complete. These may include such things as:

- A direct mail program
- A print advertising program
- A sales promotion

Micro ROI can include almost anything a company would spend money on where they would expect a positive financial result in less than a year.

Macro ROI concerns the overall performance of major company initiatives. These may include:

- Adding a new assembly line
- Creating the company’s own truck delivery system
- Replacing all incandescent lighting with low-energy fluorescent lighting.

The payout for these types of initiatives is probably more than a year and could extend for several years.

HOW TO MEASURE RETURN ON INVESTMENT

What you need to determine accurate ROI is good data. You need to know what the company defines as investment and profit as well as the number of days over which the activity is going to take place.

Does the investment include just money-funding, or does it include all other costs allocated to the activity (staff involvement, overhead allocations, etc.) plus the costs of promotional materials, discount concessions, etc?

Before figuring out ROI, make sure you have all the fixed and variable costs the customer may be including in the investment...“cost”.

What are the starting and ending dates for the program? Is the period 13 weeks, 365 days, 730 days? Whatever it is, the period affects the annual rate of return on the investment (ROI).

EXAMPLE: THE MEASURING ROI

Period:	90 days
Sales:	\$320,000
Profit:	\$120,000
Program cost:	\$200,000

$$\text{ROI} = (\text{profit}/\text{cost}) \times \text{year days}/\text{period}$$

$$(\$120,000/\$200,000) \times (360/90)$$

$$\text{ROI} = 60\% \times 4 = 240\% \text{ annual rate of return}$$

In this example, the company recouped its initial investment of \$200,000 from its sales of \$320,000 leaving a profit of \$120,000.

Since the promotion was over a 90 day period, the company got 60% return on its investment in 90 days. Annually, the return is 4 times the 60% or 240% for annualized ROI.

If this example had been about a PPC campaign, then Return on Investment for PPC refers to the profit made divided by the cost of the PPC campaign. It might be more useful to compute ROI over a whole program than for an individual product. Sometimes, you deliberately lose money or break even on one product (called a loss leader) to draw customers into a store, only to make more on sales that follow.

Susan's Lemonade Stand



It was a warm early summer day. Susan, a budding entrepreneur, decided to set up a lemonade stand in the neighborhood.

Just like a real bricks and mortar business, Susan needed a place to operate her lemonade stand.

She was smart and researched the neighborhood for the best place to put her stand, where the foot traffic was high.

She chose a spot outside the entrance to one of the playgrounds where the neighborhood kids played and parents congregated.

Susan needed lemons, sugar, water, a pitcher for the lemonade and some cups with straws. She also needed some ice, about \$2 of change plus a sign to advertising her 15 cent lemonade.

She picked 20 lemons from the tree in the backyard, bought sugar, cups and straws at the grocery and borrowed a pitcher from her mother. The ice was in the fridge. She was all set. Her cost of materials totaled \$1.75. She was in business.

She set up her card table with the sign and waited for her customers. They came; she sold 35 cups of lemonade at 15 cents. Total \$5.25.

SUSAN'S ROI

$$\$3.50 \text{ profit} / \$1.75 \text{ cost} = 200\% \text{ ROI for that day.}$$

Susan had the same results on the next three days. So, Susan decided to expand and open three new locations, making a total of 4 locations that would be open afternoons Thursday through Sunday.

Some issues Susan will have to deal with in opening these locations:

- There are no more lemons on the tree in the backyard so now she has to buy lemons for 25 cents each at the grocery.
- Susan's mother only has one pitcher
- Susan can't be in four places at once. She needs to hire 3 people to run the three new lemonade stands.

In the first week, Susan's sales:

Lemonade stand #1	25 cups per day
Lemonade stand #2	18 cups per day
Lemonade stand #3	21 cups per day
Lemonade stand #4	12 cups per day

What is Susan's ROI after the first week?

MARKETING MAKES THE ADVERTISING WORK

Although Marketing is the accelerator, you need to know the client's competitive landscape. You cannot develop or recommend a marketing strategy without knowing the client's competitive strengths and weaknesses and the opportunities and threats in the market.

Just knowing how to develop a promotional marketing strategy is not sufficient. You must know your client's business and be able to discuss the business strategy with them. You might get lucky, but you won't be able to maximize the ROI from the efforts.

Take yourself back to your college level courses in marketing. Marketing still consists of four elements: Product/Service, Pricing Strategies, Promotional Strategies, and Placement or distribution strategies.

To be effective as an advisor, you must understand each of these as they pertain to each client.

Unfortunately, we have a passing knowledge of their product, pricing and distribution strategies. We focus on the promotional aspects instead of the whole picture.

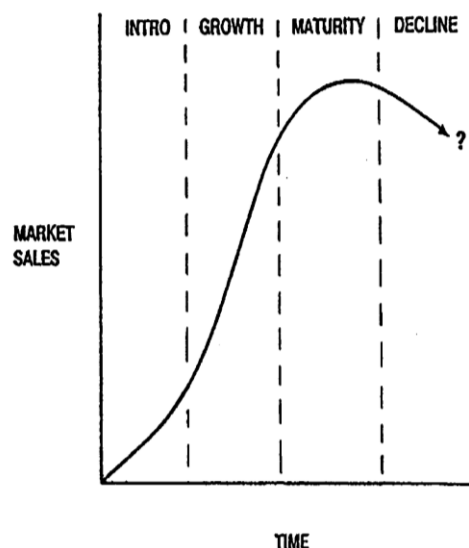
You need to know about all four elements to be effective for your clients. Start with the Product Life Cycle. Understand it and use it.

Why is that important?

Did you know that the stage in a product's life cycle will dictate the type of appeal you will include in your strategy? Did you know it directs the content of the copy in all advertising, promotional and packaging efforts?

If you were to graph market sales against a time line, you would be able to divide the Product Life Cycle into four distinct periods:

The Product Life Cycle



Stage 1: Introduction, "What is it?"

Awareness and education are needed. If possible a trial is important. High advertising costs may be incurred to get the word out. Some vendors opt for an exclusive distribution of their products in a few select outlets at first. Initially companies make frequent product changes as customers' needs become known. The first buyers are called the *innovators*, followed by the *early adopters*. They freely take purchase risks because their personalities or wallets allow them to do so. When companies introduce new products, managers much make difficult pricing decisions because there is frequently no basis for comparison. The level of initial prices and profits has great implications regarding the outcome of future battles with competitors as well as your ability to perform additional research and development.

Stage 2: Growth "Where can I get it?"

Education is still important, but at this stage competition is intensified. As more consumers become familiar with a product they examine the new models to decide *which* to buy, not *whether* they should buy. When buyers get to the store they start comparing features. To make the product more accessible, marketers often choose a *selective*

distribution to gain a greater number and variety of outlets. At this stage it is important to boost your sales volume ahead of the competition in order to reduce costs through production and advertising efficiencies. This helps a company gain the competitive advantage in the next stage of the product life cycle.

Stage 3: Maturity “Why this one?”

At this stage the *late majority* of the mass market buys. Because people are accustomed to buying the product and the differences are few, brand loyalty plays a dominant role. Price competition often becomes heated in stable markets because additional market share comes directly from your competitors. The product’s features that were so important in the growth stage have become standardized. Because there is less differentiation on product attributes, advertising is used as a vehicle to differentiate products. Marketing managers try to segment their target market as much as possible to meet specific unmet consumer segments. All possible channels of distribution are also considered using a *mass market* distribution strategy.

Stage 4: Decline “Who much?”

As a product ages in its product life cycle, it is likely that its competitors offer similar products. Even the most timid consumers, the *laggards*, find it safe to buy the product at this late stage. Consumers turn a deaf ear to advertising because they know that all competing products are the same. At this stage many companies focus on reducing price if the competitive field thins. Trade relations are critical to staying on the retail shelf at this point, because without the excitement of novelty, distributors and retailers would rather allocate space to newer and potentially more profitable products. The effort to sell the trade is popularly called *relationship marketing*.

With some products the maturity phase does not necessarily mean death. Products can be reinvigorated after a period of maturity and a new growth phase can begin. In some cases, lingering

death throes produce large profits for the last manufacturer.

WHAT ARE THE KEY COMPETITIVE FACTORS WITHIN THE INDUSTRY?

The basis of competition in each industry or market tends to be different. It has a major impact on how a business attacks its market. There are five major competitive factors that constitute the battleground in most industries:

- Quality
- Price
- Advertising
- Research and Development
- Service

In the fast food industry, for example, intensive advertising and promotion are key. In industries providing raw materials to others, price and service are key. When developing a marketing plan, you may want to try to change the basis of competition to one that favors your client’s company, but the key underlying competitive factors cannot be ignored.

You must understand Product Life Cycles if you are going to be an effective marketing advisor to your clients, or at the least, understand the conversation and be able to participate.

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