How to Calculate Return on Marketing Investments (ROI)

John Wanamaker said, “I know half of my advertising dollars are wasted. I just don’t know which half.” He was a good step ahead of most of us. Do you know which half of your advertising dollars are invested well? Let’s explore how to determine if a particular marketing campaign is worth it or wasted. Whether you are projecting a return before investing in a campaign or calculating actual return after the campaign results are in, the process is the same.

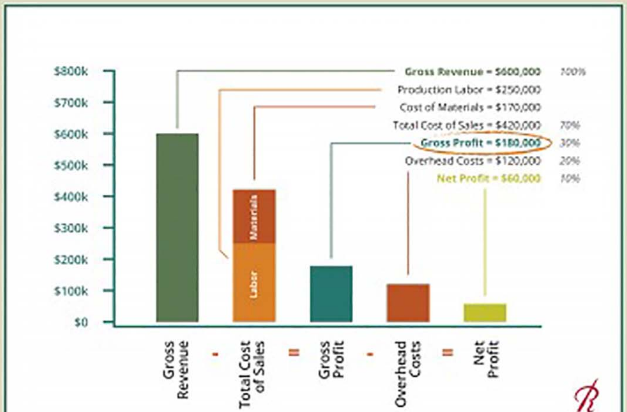

Figure 2

Defining Our Terms

(The graphic below is a screenshot from an ROI calculator produced by Rosewood Marketing. You may obtain a copy of the Excel-based ROI calculator from the Anabaptist Financial website, by calling 800-653-9817 ext 214, or by faxing 866-230-6253.)

Marketing Return on Investment (ROI)

Your Company Name Here

Enter your numbers in the cells with this background color | Cells with this background color are calculated for you.

Developed by: Rosewood Marketing 717-866-5000

Projection A

Impressions	500	
Conversion Rate %	1.00%	
# of New Customers	**5**	
Average $ Sale	$ 1,200	
# of Sales	4	
Gross Profit %	30%	
Profit Per Customer	**1,440**	
Total Gross Revenue	24,000	
Total Gross Profit Amount	7,200	
Marketing Investment	**1,500**	
Return on Investment	**5,700**	**380%**

Projection B

Impressions	375	
Conversion Rate %	0.75%	
# of New Customers	**3**	
Average $ Sale	$ 900	
# of Sales	3	
Gross Profit %	23%	
Profit Per Customer	**608**	
Total Gross Revenue	7,594	
Total Gross Profit Amount	1,709	
Marketing Investment	**1,875**	
Return on Investment	**(166)**	**-9%**

Projection C

Impressions	625	
Conversion Rate %	1.25%	
# of New Customers	**8**	
Average $ Sale	$ 1,500	
# of Sales	5	
Gross Profit %	38%	
Profit Per Customer	**2,813**	
Total Gross Revenue	58,594	
Total Gross Profit Amount	21,973	
Marketing Investment	**1,125**	
Return on Investment	**20,848**	**1853%**

Impressions: The number of impressions is the number of prospective buyers reached by a particular marketing campaign. For example, you might send a direct-mail campaign to 500 addresses, or you might advertise in a speciality newsletter with 500 subscribers, or you might exhibit at an event with 500 attendees. In your calculations, you may choose to not use the total number of names that are potential customers. For instance, you may be a exhibiting at an event with 2,000 attendees, but if you already know that only 500 of those are potential buyers, you would use 500 instead of 2,000.

Conversion Rate: The conversion rate is the percentage of prospects who convert to customers. For our example, we will use a 1% conversion rate.

Number of New Customers: The number of impressions times the conversion rate equals the number of new customers acquired through your marketing campaign (500 x .01 = 5 new customers).

Average Dollar Sale: Average $ Sale equals gross revenue (total sales) divided by the number of purchases. Here is an easy way to calculate this for a year:

1. Find the first and last invoice numbers for the year. Subtract the first invoice number from the last invoice number. This is the number of transactions for the year.
2. Divide gross revenue by the number of transactions. This is your average dollar sale.

Example:
Last invoice number: 2155
First invoice number: 1655
Number of transactions: 500

Gross revenue: $600,000.00
Number of transactions: 500
$600,000 divided by 500 = $1,200.00

Average dollar sale = $1,200.00

Number of Sales: The number of sales is how many times the average customer makes a purchase. In some businesses, customers may only purchase once in a lifetime. In other businesses, customers return several times a week. The number of sales is calculated for a specific time period, such as a month, a year, several years, or the expected purchasing lifetime of a customer. Be sure to use the same time period for both average dollar sale and number of sales.

Based on the example above, let's calculate the number of sales for a year. First, find how many customers purchased from you in the year. If you have a business from which customers only purchase once in a lifetime, you could use the number of invoices (500). But most businesses have return customers within a year. For the example we will use 125 customers.

Divide 500 invoices by 125 customers to average four sales per customer. While some bought seven or eight times, others bought only one or two times, so the average is four invoices per customer.

Gross Profit Percent: It is important at this point to understand the difference between gross profit and net profit. (Figure 2)

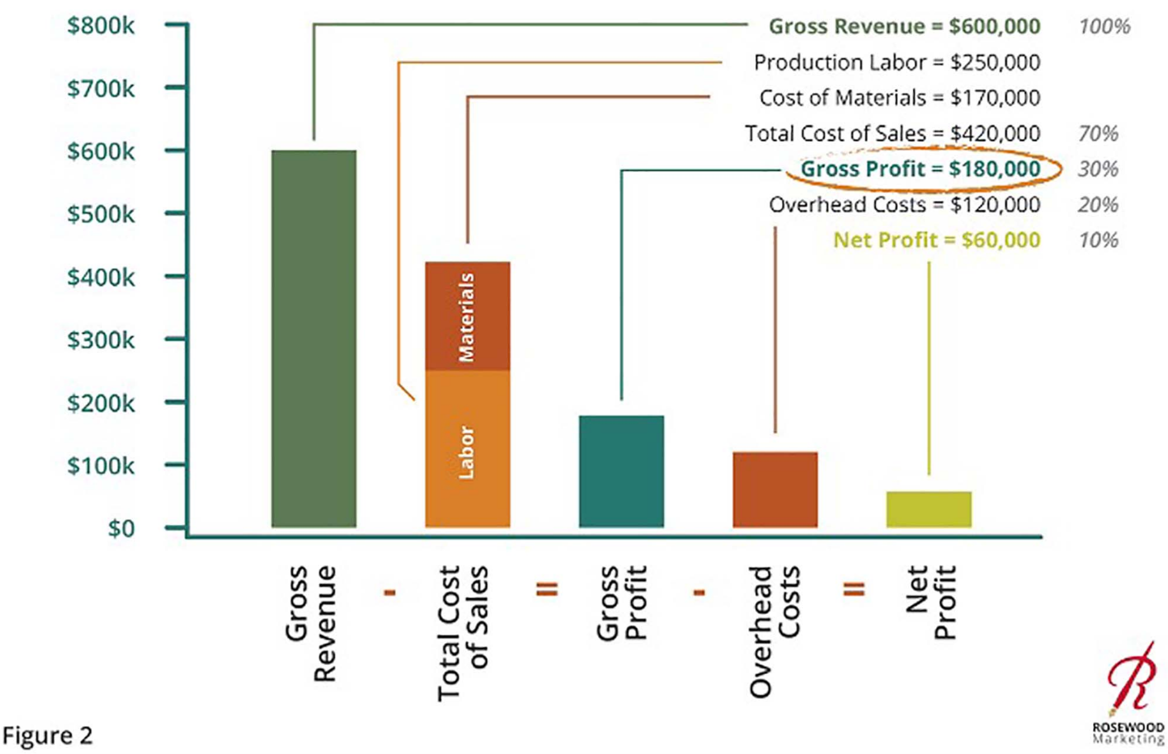

Figure 2

Gross profit equals the gross revenue minus the cost of the materials and production labor for those sales. It does not consider overhead costs such as rent, utilities, overhead labor, or janitorial supplies. Marketing return on investment (ROI) is calculated using gross profit. "Why?" you may ask.

Let's say our example business is making a profit each month. On the last day of the month at five minutes before closing time, a customer comes in. At this point all the overhead costs are covered (paid) with the gross profit from previous sales and there is already a profit for the month. This last-minute customer buys $1,200.00 of product with a 30% gross profit. What happens to the net profit for the month? You are right, it increases. By how much? Thirty percent of $1,200.00, which equals $360.00. How much would you be willing to pay to bring that last-minute customer in? Do you see how gross profit is important to know when calculating your marketing ROI?

In this example, we are not using marketing dollars to make the business profitable, but rather to make it more profitable. What if your business is operating at a loss? The calculation is the same because every sale decreases the loss by the amount of gross profit.

Profit Per Customer: Average dollar sale times the number of sales times gross profit equals the profit per customer.

Total Gross Revenue: Total gross revenue yielded by your marketing campaign equals the average dollar sale times the number of new customers times the number of sales. In our example, gross revenue looks like this: $1,200.00 x 5 x 4 = $24,000.00.

Total Gross Profit Amount: The total gross profit is the gross profit from all the sales to your new customers ($24,000 x 30% = $7,200.00).

Marketing Investment: The marketing investment is the amount of money you expended in the marketing campaign. Be sure to figure all the costs, including the cost of labor for trade shows and other things that take your employees' time. If you offer a discount incentive or free product you must also calculate that in. The cost of our example campaign is $1,500.00.

Return on Investment (ROI): Return on investment equals the total gross profit minus the marketing investment ($7,200.00 - $1,500.00 = $5,700.00). The percent of return is calculated by dividing the return on investment by the marketing investment ($5,700.00 ÷ $1,500.00 = 3.8 or 380%).

Making Projection Decisions

Take a look at the chart showing the comparisons A, B, and C. The numbers in column B are adjusted 25% for the worse. The numbers in column C are adjusted 25% for the better. Notice how small changes in the same direction on all the numbers make an exponential difference on the bottom line. It is very easy to make the projection say what you want it to say--but what you want it to say is not a good guide. Be very careful to make realistic projections.

You may think that a 380% return is fabulous. That is much more than the bank will pay; but the bank doesn't work as hard as you do. You also have an element of risk in every campaign, even if you have done it successfully before. When considering a new marketing campaign that you have no experience in, you should only invest in campaigns in which you expect a 300% return or more. If that is unrealistic, look for better opportunities.

What if you projected a 380% return but the actual was only 150%? Should you run that campaign again? It depends. If this is your first campaign in a new business, you have made a great step forward. You have identified a campaign that works! Repeat the campaign again. On the other hand, if you are in a mature business, and you have used twelve other campaigns which worked better, you may want to discard it; but not too quickly. Why did it not work as well as you projected? Could you make some changes to improve its effectiveness?

Testing and Measuring

If you want to calculate ROI, you need to track which sales were generated by the campaign. This is simple but not easy. In many cases, all you need to do is ask your customers, “How did you hear about us?” or “What brings you in today?” Near the phone or at your counter, keep a sheet of paper on which you can put a mark beside the correct campaign each time you receive an answer. Even if only half of your customers know the answer, you will know much more than if you had never asked. Creating the habit of asking will take time and effort for you and/or your salespeople, but it is well worth it.

Testing and measuring gives you the opportunity to calculate ROI. Unless you test, measure, and calculate ROI, you will have no way of knowing whether your marketing is getting better or worse, or whether it is effective at all. Sometimes we think we know what is working without going to all the hard work of tracking and calculating returns. And sometimes that may be true. But other times gut feelings will lead us astray.

Schedule a time right now when you can spend a minimum of one hour exploring how you can implement testing and measuring to calculate ROI on your next advertising campaign.