What is ROI?

ROI stands for Return on Investment. ROI is calculated to understand if financial investments are paying out. While ROI seems simple (and it is) accurately calculating it is challenging, as we often don't know specifically the full return that our marketing efforts generate.

$$\frac{\text{Return} - \text{Investment}}{\text{Investment}}$$

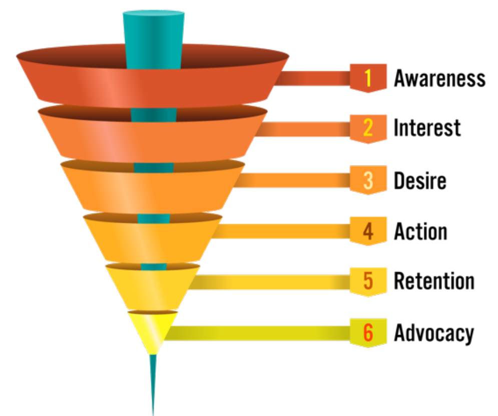
Prior to embarking in ROI efforts, it is important to think about WHY you are calculating ROI. There are 2 main reasons:

1) Is this a profitable investment?
   - Focus on known data + reasonable assumptions to validate
   - Goal isn't to generate an accurate ROI number, but one that is directionally correct
   - May be other methods to achieve this

2) How does this compare to other uses of my funds?
   - Focus on consistency of methodology and assumptions across marketing efforts being measured
   - Very difficult to achieve

Calculating ROI: Return

Determining the return from marketing investments can be a challenge. Most marketing (traditional and digital) doesn't create an immediate action, and we know that many marketing efforts generate a benefit that is realized over time.



Often times marketing efforts aimed at "top of funnel" like awareness or interest are difficult to attribute specific sales to. Consider 3 things in determining your return:

- Directly attributable sales
- Indirect sales
- Additional benefits

For example, if you consider the value of a coupon, you have the direct benefit of sales from those who redeem the coupon (less those who would have purchased it anyways) + the media benefit from those who see the coupon and eventually buy, even without redeeming.

Also note, that in order to accurately calculate return you want to focus on the lifetime value of a new customer, not a single purchase. The "return" in ROI should be your profit for a lifetime customer, not sales.

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Calculating ROI: Investment

When calculating the investment many businesses make the mistake of only incorporating initial costs to execute. In the ROI calculation you should include:

- Setup costs
- Indirect costs
- Media/promotion costs
- Run/maintenance/going costs
- Time/energy/internal people

Alternatives to ROI to Justify Investment

Calculating ROI can be very challenging, and it is important to keep in mind the *reason* for calculating ROI – to understand if we are making wise investments.

There are other ways to calculate this:

- **Backwards Math** – What do we need for this to be ROI positive? Does that seem reasonable?
  - If we spend $100K/year on social media, we need to gain or retain 10 new customers/year.

- **Back of Envelope Math** – What do we expect this to do? Does that generate positive ROI?
  - We assume that our "refer a friend" campaign will generate 5,000 new customers based on previous performance.

- **Translate KPIs to Sales** – Use reasonable assumptions to translate your KPIs to sales.
  - If we reach 100 people, let's assume we converted 1 of them. If we get 50 website visitors, we assume 1 becomes a lead.

Things to Consider

Profit Not Sales: Remember, when using any ROI or other approaches to calculate your return, look at the **lifetime profit** of a new customer – not sales and not a single purchase (unless you don't typically have repeat purchases).

Avoid the Trap: Try to avoid the measurement trap where you spend lots of time trying to get an accurate calculation for something that is based on many assumptions. Think about what you need to make a decision and invest an appropriate amount of time.

Consider KPIs as an Alternative: Sometimes ROI is challenging (or impossible) to measure. For this reason, we often use KPIs to judge the value of our marketing investments. See the KPI Quick-Start for more details.

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