Introduction to the Rates of Return on Marketing Investments

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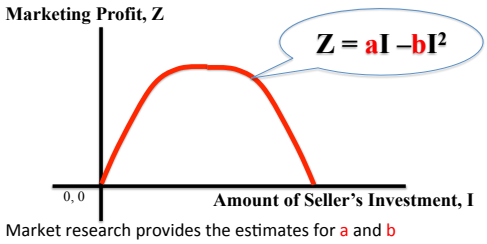
We have said that

- The marketing profit equation describes how marketing profit is a function of the **size** of the marketing investment and the **rate** at which the investment generates the profit.
- The rate of return is often called the ROMI or MROI
- MROI, Marketing Return on Investment
- ROMI, Return on Marketing Investment
- However the terms MROI and ROMI are Very Very ambiguous

The quadratic equation which describes the relationship between the financial gain, Z, and a Marketing Investment, I



Market research provides the estimates for a and b

One of the controversies/debates

- Raised Last Class was
- 2) Can the profits being returned on marketing expenses be called a legitimate 'Return on Investment, ROI, or interest rate?
- Do Marketing rates of return behave like a normal financial interest rates or normal rates of return on investment?
- Short answer is **NO**!
- Rates of return on marketing Investments behave differently from conventional financial rates of return.

Marketing rates of return

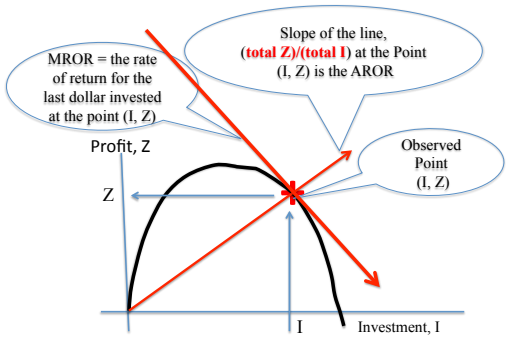
- Come in two different flavors with different values and different applications
- 1) **A**verage **R**ate at which profit is being **R**eturned on the investment
  AROR = a – bI
- 2) **M**arginal **R**ate at which profit is being **R**eturned on the Investment
  MROR = a -2bI

Financial rates of return also

- Come in two flavors but both flavors have the same constant value
  Financial profit from an investment, Z, is a direct function of the size of the investment
- Financial Profit, Z =
  (constant rate, i) x (Investment size, I)
- Average rate of return = (ROI, i) x I
  Marginal rate of return = (interest rate, i) x I
- Since they both have the same value most don't care that they are derived differently

AROR and MROR have different values

- And constructs in marketing investments
- A single observed point of performance (I, Z) with a marketing investment of size, I, and an amount of generated profit, Z,
- The Average Rate of Return can be a positive value and the Marginal Rate Of Return can have a negative value at the same point

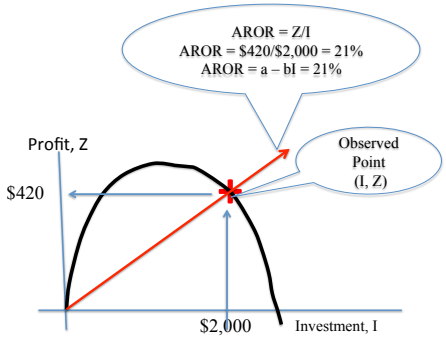


An equation is need to calculate

- The Average Rate Of **R**eturn at **any point** on the marketing profit function is written as
- AROR = **a** – **b**I
- Remember values 'a' and 'b' have been provided by market research

Example of Calculating AROR

- The value of **a** = 0.61 and **b** = 0.0002
- The firm is currently investing $2,000 in a marketing effort every week.
- What is the average rate of return on that $2,000 investment
- **Answer**
- AROR = **a** – **b**I
- AROR = 0.61 – 0.0002(2,000) = 0.61 – 0.40
- AROR = 0.21 or 21% average rate of return

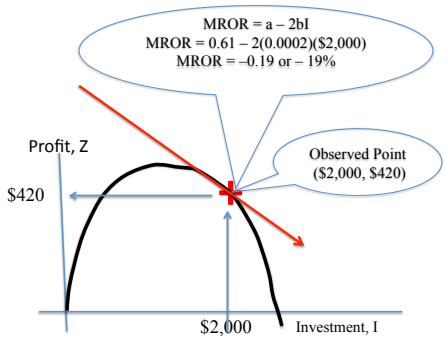


An different equation is needed to calculate

- The Marginal Rate Of **R**eturn at any point on the marketing profit function is written as
- MROR = **a** – 2**b**I
- Remember values 'a' and 'b' have been provided by market research

Example of calculating MROR

- The value of **a** = 0.61 and **b** = 0.0002
- The firm is currently investing $2,000 in a marketing effort every week.
- What is the marginal rate of return on that $2,000 investment
- **Answer**
- MROR = **a** – 2**b**I
- MROR = 0.61 – (2)0.0002(2,000) = 0.61 – 0.80
- MROR = –0.19 or a minus19% marginal rate of return (you lost 19% of the last dollar invested)



For the Midterm

- You must be able to calculate both types of returns on a marketing investment, ROMI
- AROR = **a** – **b**I
- MROR = **a** – 2**b**I
- Where market research gives you the values of the constants '**a**' and '**b**'

In the coming weeks

- We will talk about how the rates of return are derived and how they are used to analyze results and make decisions