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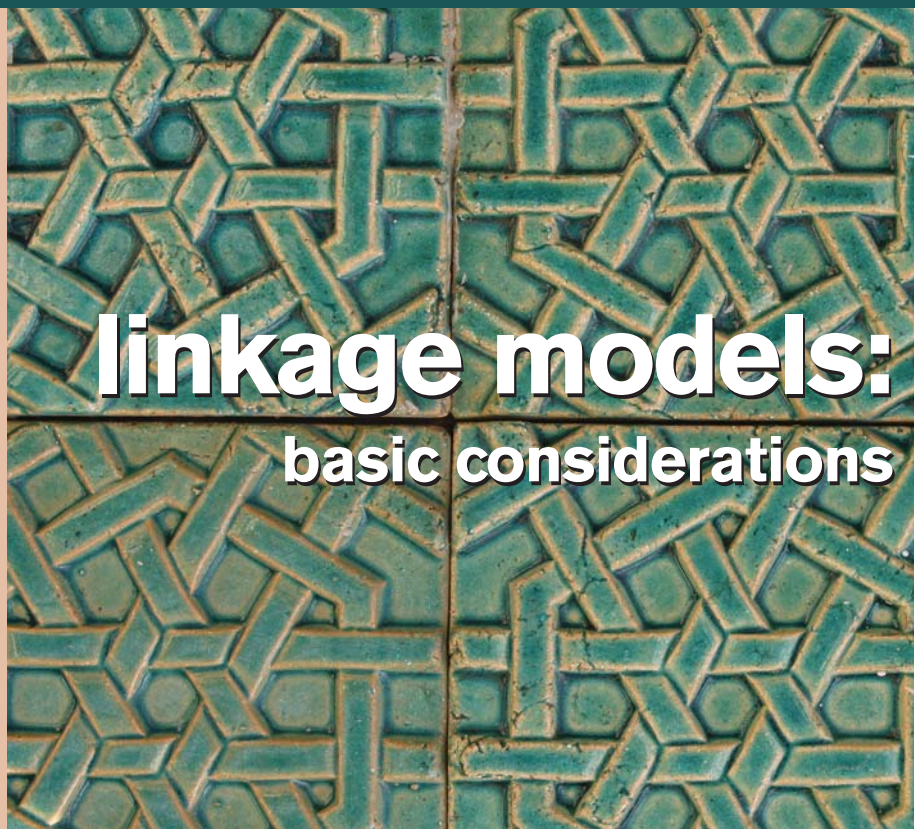
linkage models of roi

Linkage models generally incorporate elements from the other models discussed so far. They offer a more sophisticated way of relating marketing research measures to revenue. What distinguishes measurement models from other models is the heavy reliance of linkage models on hard data. Linkage models can be demanding both in terms of input measures and the specific financial outcomes to which the income measures are linked. Linkage models attempt to quantify the connection between marketing/research expenditure and the profitability of a corporation. Any objective as ambitious as this involves complexity beyond just saying "by doing research for x dollars, we gained $x+y$ dollars in revenue."



linkage models: basic considerations

Let's begin with a simple relationship:

Product/Service → Customer Satisfaction → Customer Loyalty → Increased Profits

The product or service, along with marketing communications, leads to customer satisfaction. Customer satisfaction, in turn, reinforces customer loyalty. This results in increased business to the company and hence greater profitability. But when one actually wants to measure these aspects, a number of issues arise.

- What aspect of product or service are we referring to here? Do all aspects of product or service affect the consumer? If not, which attributes do, and by how much?
- What is the relationship between customer satisfaction and customer loyalty? If satisfaction does not reflect loyalty, why measure it at all?
- How do we measure increased profitability? Are we talking about more customers or greater usage by existing customers? Are we talking about long-term profits or short-term profits? If we are talking about long-term profits, how long, and how do we measure them?

PROBLEMS AND ISSUES

The many effects of marketing efforts on consumers can now be summarized. Marketing/research ROI depends on how a consumer responds to a firm's efforts. Consumer response is affected by four types of influences: time-based, content-based, response-based, and competition-based (see figure).

Time-based influences refer to the fact that marketing/research efforts may have an immediate effect on sales (e.g., direct mail advertising, current event advertising), a delayed effect on sales (e.g., image-building advertising that is expected to increase sales at some future time), or a combination of both (e.g., ongoing advertising for an established product that generates sales now and increases the probability of buying in the future). Are there carryover effects?

Content-based influences refer to the way in which the message is presented to consumers. For example, if in general $1 million spent on advertising results in $5 million in sales, can it be increased to $6 million by simply making the ads more effective? If a perfume sells at $50, can we increase the price to $70 by changing the distribution channel (e.g., by making it available only through select high-end boutique shops)?

Response-type influences refer to the nature of consumer responses. For example, do marketing/research efforts have a linear effect? If $1 million results in an ROI of $5 million, will spending $2 million result in an ROI of $10 million? Does consumer response reach a plateau after a certain level? Is there a threshold level below which marketing/research expenditure results in zero increment in ROI? Does response to marketing efforts change over time? For instance, is there advertising wearout?

Competition-based influences acknowledge the fact that marketing/research influences do not operate in a vacuum. The ROI on marketing efforts when there is no competitive activity is

likely to be very different than the same marketing efforts mounted in a highly competitive environment.

These are just examples of issues we face and questions we need to answer when we start measuring marketing/research ROI. To answer such questions, we may need an extensive data base, which may or may not be easily available. Even more importantly, calculating linkage involves hidden assumptions that may not be apparent. (We will touch upon some of these issues as we explore linkage models.) What is of relevance here is that we are faced with too many variables as well as too many unknowns. We need to limit the unknowns and, along with this, limit the number of variables.

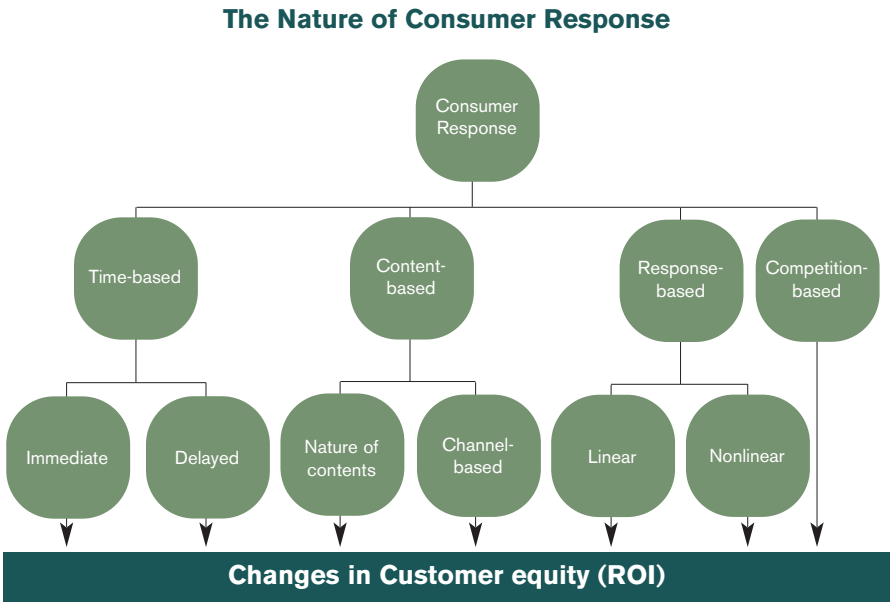


Figure: THE NATURE OF CONSUMER RESPONSE

DEALING WITH THE UNKNOWNS: LIMITING THE SCOPE

Unknowns can be tackled in two ways. We can limit the scope of what we want to know and assume that the unknowns are linked in a certain way. For example, when we measure customer satisfaction and assume that it would lead to loyalty and therefore to increased profitability, we measure a narrow aspect and assume the rest. Unfortunately, in the realm of ROI this approach hasn't worked very well: customer satisfaction by itself is no longer assumed to lead to profitability, and advertising exposure by itself is no longer assumed to result in increased sales.

DEALING WITH THE UNKNOWNS: CREATING A FRAMEWORK

The second approach is to create a framework within which ROI can be measured. A framework links the entire path, from marketing/research inputs all the way to profitability. It is not that no assumptions are involved in frameworks. In fact, there are many. However, this approach is more advantageous because, if within a given framework marketing/research inputs do not lead to increased ROI, then we would know that the framework is inadequate and create a different framework. Another advantage is that it is possible to create different ROI frameworks for different purposes.

CUSTOMER LIFETIME VALUE (CLV)

One such framework assesses the impact of marketing/research efforts on customer lifetime value (CLV). CLV is the net present value of a customer's profit stream. Thus, if a customer continues to be with the firm for five years and in each year generates a profit of $100, then the total profit generated by the customer is $500. However, in reality the total profit is less than this because we need to take into account other factors, such as risk and inflation. By adjusting the figure for other factors, we arrive at the CLV in today's dollars. We will return to this concept later.

CUSTOMER EQUITY AND THE VALUE OF THE FIRM

Obviously, different customers will have different CLVs, both in terms of longevity and profitability. By aggregating the CLVs of all customers of a firm, we arrive at the customer equity of the firm. Within this framework, ROI is measured in terms of increase in customer equity. Customer equity measured in dollar terms is the ROI we are trying to increase. If a given marketing/research expenditure does not result in a measurable increase in customer equity, then it is an expense that does not contribute to the ROI. The larger the increase in customer equity as a result of marketing efforts, the greater the ROI of a given marketing/research effort.

Why is customer equity important? Since a firm depends on customers for its revenue and profits, the CLV of all its customers represents the current value of the firm. If two firms have similar revenues and profits, the firm with higher customer loyalty will be worth more because of its higher customer equity. Therefore, if we view customer equity as a proxy for value of the firm, then it is logical to consider it to be a good ROI measure. As a result, many large companies use increase in customer equity as the criterion for assessing the ROI of marketing/research effort.

In the next few articles we will build on these concepts.

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