



the basics of marketing research roi

Marketing research has been growing at a very healthy pace over the past several years: from 1988 to 2004, the industry grew at an average annual rate of 5.2%. Research spending has grown after accounting for inflation *every single year* since 1990. That kind of growth in an age of downsizing, cost cutting and corporate accountability suggests that companies must feel they get value out of marketing research.

Despite this growth, or perhaps because of it, marketers and market researchers have been increasingly faced

with the challenge to demonstrate the value of marketing and research expenditures. It is not unusual for many companies to spend over \$1 million dollars annually on research with a single research company. Sums of this magnitude stand out on a P&L and lead to senior level scrutiny and questions about the necessity of the expense. What if they cut the research budget from \$6 million to \$5 million? Will it affect their business in any way? Organizations acknowledge that they get value out of research but they are not

sure of the difference between \$6 million and \$5 million invested in research. So, organizations are increasingly challenging marketing and marketing research professionals to demonstrate the monetary value or ROI of marketing and research.

The issues involved in measuring the ROI of marketing and research are not simple. In this series of articles, I explore these issues and review some of the methods available to measure marketing research ROI.

CONSUMPTION VS. INVESTMENT

An organization can spend its resources for two basic purposes: to consume or to invest. When money is spent on consumption, it provides some perceived benefit but diminishes the capital by the amount spent. When money is spent on investing, there is an expectation that it will generate future earnings. When organizations aim to increase their efficiency, they tend to take a closer look at their non-investment expenses. Many such expenses may be considered optional and may be eliminated.

However, the distinction between investment and non-investment items is not always clear-cut. For example, if an organization spends money on research and development, will it always result in increased future earnings? When it does not, should we consider it as an expense or as an investment that did not work out? Sometimes an investment may not have an immediate effect on revenue. It may take time to realize the return on investment. An advertisement announcing the introduction of a new product may not have an immediate impact on sales. However, the advertisement can have an effect on sales if it is repeated a number of times. There may also be a time lag between the release of an advertisement and sales that ensue as a result of that advertisement. When it is not clear whether a given expenditure is an expense or an investment, it may lead to incorrect decisions such as eliminating an investment because it is seen as an expense or retaining an expense because it is seen as an investment.

In recent years, there has been an increasing tendency to concentrate on shareholder value. As a result, there is a drive towards reducing all unproductive expenditures and maximizing profitability. This has led to a serious review of all costs associated with doing business. One of the most fundamental of these questions is whether an expendi-

ture is an investment or just an expense. The more specific question is whether an item (such as marketing research) that has traditionally considered an investment, is really an investment or an expenditure that can be eliminated without it affecting the objectives of the organization.

WHY MARKETING RESEARCH IS VULNERABLE

Marketing research expenditures are particularly vulnerable because it is intrinsically difficult to show a connection between research and profitability. Yet, if an expenditure is an investment rather than an expense, we should have some way of demonstrating it, showing a linkage between research expenditure and its impact on an organization's revenue. Just as an individual would like to know the likely return on his or her investments (even when it cannot be guaranteed), so would an organization. There are two questions for the organization to address:

1. How does the organization demonstrate that marketing research is an investment and not an expenditure that can be eliminated or reduced without having any consequence to the organization?
2. How does the organization establish a quantitative linkage between research and sales or profits such that research that is too expensive (i.e., research that produces a return that is lower than the cost of research) can be eliminated?

The previous two questions are more easily asked than answered. While many expenditures such as advertising, marketing, and marketing research are traditionally considered as investments, no systematic connections have been established between these activities and their impact on revenues.

DOES PURE MARKETING RESEARCH ROI EXIST?

A case can be made to show that marketing research is an investment

rather than an expense. But there is no easy way to link marketing research to ROI. Generally speaking, marketing research in and of itself does not produce any return. Here is why.

Marketing research can produce a return only if someone acts on it.

Marketing research can produce valuable information that can be used to take action. It is the action that is taken as a result of marketing research that produces the return, not marketing research itself. For example, suppose you spend \$30,000 on a research project which shows that promoting the product among those with income over \$100,000 will increase your revenue by \$1,000,000. What is the return on your research investment? The answer is "nothing," unless somebody takes action to promote the product to the selected group. Even if someone were to take relevant marketing action, it might involve additional expenses. Promoting the product to the selected group may involve an added advertising expenditure of \$950,000. So our total investment to generate \$1,000,000 in revenue is not just \$30,000 (the cost of research), but \$980,000 (the cost of research plus the additional expenditure to implement the research recommendation).

So, without knowing whether any action was taken, and without knowing the cost of the action taken, it is not possible to calculate the return on research investment. The above example shows some of the pitfalls of calculating marketing research ROI in a vacuum. Initially, compared to the research cost of \$30,000, the revenue of \$1,000,000 looked very attractive. However, when we take the true costs into account, a total return of \$1,000,000 on an investment of \$980,000 appears unattractive and risky.

The same marketing research may lead to different actions. Suppose your research shows that your product is

weaker in the West than in other parts of the country. You may decide to strengthen the demand for your product in the West or decide to promote your product more heavily in those regions where you are already strong. Depending on the action taken, the investment required and the return generated will be different. So, the return cannot solely be attributed to the marketing research, without taking into account the actual course of action taken. Given the same piece of research, different decision makers may take different actions. So, the same research can lead to different ROI depending on how it is interpreted by the decision maker.

In some instances, the ROI is not worth calculating. Often the value of information provided by research is obvious. Suppose a firm suspects that its declining sales may be due to quality problems. A research project designed to assess this could cost \$50,000. Is it meaningful to calculate the ROI on this expenditure? Suppose the research showed that the declining sales are not due to quality problems. How do we calculate ROI when all that research showed is that no action needs to be taken in terms of quality?

Marketing research may be used as input to many decisions. Consider a Usage and Attitude study. The information collected here is not used to take a single decision, but is used as input to several decisions, taken at different points in time. One person in the organization may use it to understand how people feel about the price of the product and use it as input in determining a proposed price increase; six months later another person in the same organization may use the data to understand the product's competitive strengths and create line extensions; a third person may use the study to understand the de-

mographic profile of the users so a suitable advertising strategy may be created. It would be fairly unproductive to calculate ROI on this project since it is continually used for different purposes to make more informed decisions at different times.

WHAT THEN IS MARKETING RESEARCH ROI?

Since pure marketing research ROI may not exist for reasons discussed above, what do we mean by marketing research ROI? In reality, marketing research ROI refers to *research driven marketing ROI (including research driven advertising ROI)*. When researchers refer to marketing research ROI, they use it as shorthand to mean ROI of marketing research driven measures.

For example, if research shows that a one point increase in overall customer satisfaction rating results in \$1,000,000 in sales, then what we measure is the investment we need to make to increase customer satisfaction by one point and the sales generated as a result of it. If research shows that increasing product awareness by 5 percentage points will result in a sales increase of \$2,500,000, then we calculate the advertising investment needed to increase awareness by 5 percentage points and relate this to the sales increase.

The above examples show that what we measure is not, strictly speaking, ROI on marketing research itself but ROI on marketing research generated measures. Management does not demand that marketing research demonstrate ROI on research itself, only that what is measured by research can be used to generate ROI in a measurable way. In our example, if customer satisfaction can be shown to be related to revenue in a measurable way, and if customer satisfaction cannot be measured

without marketing research, then marketing research is an integral tool for generating ROI.

A PRELIMINARY DEFINITION OF MARKETING RESEARCH ROI

When we want to calculate ROI on marketing research, we need to define what we consider "marketing research investment" and what we consider "return" on this investment. While these terms may sound obvious, in practice there are many things to consider. We will return to these considerations later. For the time being we will consider ROI to be:

$$\frac{(\text{Revenue generated by research} - \text{The cost research}) \times 100}{\text{The cost of research}}$$

For example if \$50,000 was spent on research and it generated revenue of

\$300,000 then

$$\frac{(300,000 - 50,000) \times 100}{50,000}$$

= 500%

We will revise and modify this basic definition later on.

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