

How to make

# MARKETING AN INVESTMENT

*(not an expense)*

---

A marketer's guide to better  
decision-making and greater ROI

**THINK.SHIFT™**

---

To keep up with the pace of change, marketers need to be more strategic than ever in their approach, but many are caught in traditional mindsets that hold them back from making different – and ultimately better – choices with their marketing spends.

**This e-book identifies some of these outdated mindsets and offers three tools to help marketers make better decisions.**

---

# Table of Contents

<b>Marketing: Expense or Investment?</b> .....	2
Are you focused on the Income Statement or the Balance Sheet? .....	2
Income Statement versus Balance Sheet Thinking .....	3
<b>How to Quantify your Marketing Investment</b> .....	4
Tool 1: Total Marketing Value .....	4
Tool 2: Marginal Utility .....	5
Tool 3: Investment Decay .....	6
Bringing It All Together .....	8
Causation versus Correlation .....	8
<b>Marketing is a Discipline of (Strategic) Choices</b> .....	9

## MARKETING: EXPENSE OR INVESTMENT?

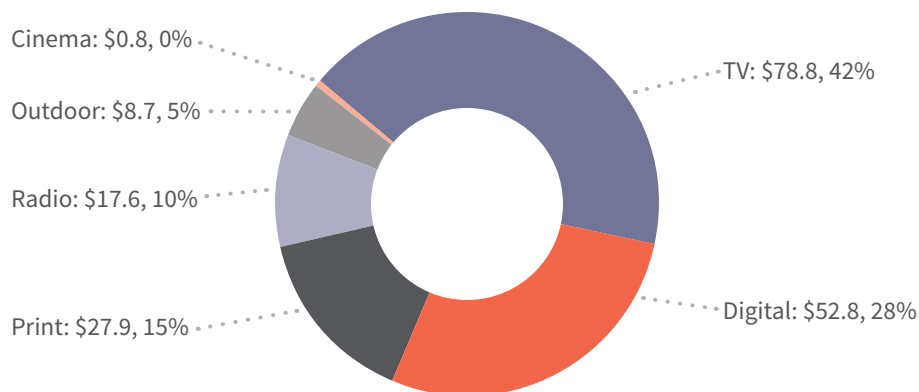
Most organizations treat marketing differently than they treat their other business functions.

What do we mean by this? We've worked with a variety of companies across many sectors and the trend has been one where **marketing (advertising, communications, promotions) is treated like an expense to the organization, not an investment.** This is not a surprising trend, as the very practices of advertising and communications – typically, purchasing outside media for finite periods of time to drive awareness and sales – have been expense driven since their inception more than a century ago.

The advent of branding and brand management changed this trend somewhat, with companies becoming aware that a brand could have equity in and of itself and therefore should be treated as an investment. But we now find ourselves in a very new reality where decisions between paid and owned media highlight the expense versus investment mindset more than ever.

For most marketers, the concept of paid versus owned media is not new. **So, why are so many marketers still investing the lion's share of their marketing dollars into paid media?**

### Share of U.S. ad spend by media type 2015 (billions)



Source: Strategy Analytics Advertising Forecast, 2015

### Are you focused on the Income Statement or the Balance Sheet?

The essential premise of paid versus owned is that the new world of marketing – mainly driven by the proliferation of digital opportunities – should be focused on investments in owned media versus large purchases of paid media.

At Think Shift, we call this **Income Statement versus Balance Sheet thinking.** While this concept might seem better suited to the world of accounting and finance around a boardroom table (indeed, our own Balaji Krishnamurthy tackled it in one of his *Food for Thought* articles), its impact on marketing is more significant than ever.

## Income Statement versus Balance Sheet Thinking

### Income Statement

*a.k.a. Paid Media or Campaign-Driven Marketing*

In the campaign-driven marketing world, communications with audiences are generally encased within a finite window using existing communications channels. There's a start date and an end date and a whole lot of expenses involved – like media, production and creative – that won't deliver much, if any, residual value after the campaign ends (i.e. once a print ad placement has run, it is essentially worth nothing).

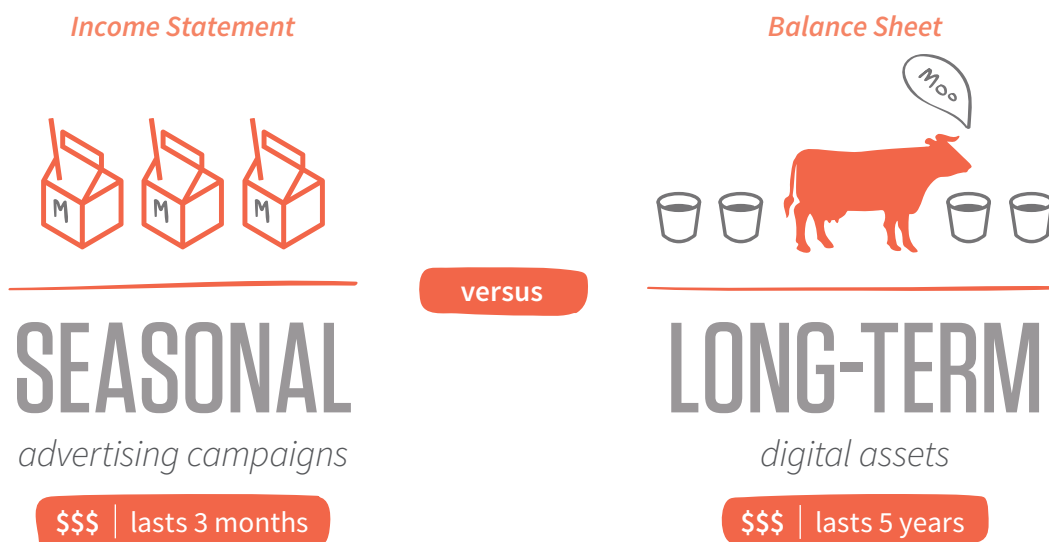
In this model, you're basically balancing revenues (i.e. sales) with expenses (i.e. outside costs) on an income statement in the hopes that the former will outweigh the latter.

### Balance Sheet

*a.k.a. Owned Media or Solution-Driven Marketing*

In taking a balance sheet approach, marketers seek the best solution possible by looking outside of existing channels and instead at what can be created to provide and build value for their audiences and themselves over time. The focus then shifts from finite promotions to ongoing platforms, from short-term campaigns to long-term assets.

For example, instead of developing a campaign to build awareness of a product or service that can help solve an audience need (i.e. faster bank teller service), balance-sheet-minded marketers would create a tool the audience can use themselves to solve the same need (i.e. mobile banking apps).



So why have so few marketers converted their thinking to the balance sheet? If you were to quickly scan some of the millions of articles written on the topic, you'd find the answer. While almost every article speaks to the "what" and "why" of the subject (i.e. what owned media means and why it is preferred), few if any address the "how" and "when" (i.e. how to budget for and when to financially shift from one to the other). Ultimately, despite the proliferation of content on the topic, there is little to no quantification provided to support the approach.

What we put forward here is exactly that: **A means to help quantify the benefit of owned versus paid media, including tools to determine when you should switch from one to the other and how to best financially allocate your budget to both.**

# HOW TO QUANTIFY YOUR MARKETING INVESTMENT

The first step is defining the value of your **total marketing efforts** (what we call TMV). For many years and for most organizations TMV was synonymous with terms like Annual Marketing Budget or Total Marketing Spend. However, the use of terminology such as “budget” or “spend” inherently keeps us in a cost/expense or “money out” mindset, one that is mainly focused on the income statement. By considering marketing *value* instead, we are able to look at not only the budget or spend but also your marketing investments (i.e. balance sheet items) that can and should provide value year-over-year.

Tool 1:  $TMV = \text{Annual Marketing Spend} + \text{Balance Sheet Asset Value}$

## Example: TMV in Action

Assume you are the VP of marketing for a medium-sized company that generally budgets \$500,000 per year for marketing efforts. As the head of your department, you are responsible for the allocation of these funds, and you’ve heard rumblings that sometime in the next couple of years your budget may decrease due to head office cuts.

### Scenario 1:

Assuming that budget cuts may arise, you determine that the best strategy is to invest all \$500,000 into promotions and campaigns intended to drive sales growth. You do this for two years before your budget is cut to \$400,000, at which point you try to do as much as you can by running similar yet smaller promotions and campaigns. At the end of each year, you have fully expended your dollars and have achieved a TMV equal to your annual budget, as your promotional and campaign efforts provide little to no residual value from one year to the next. While you were able to drive decent sales in years one and two, the diminished funds in years three and four also saw diminished sales returns.

Scenario 1	Year 1	Year 2	Year 3	Year 4
Balance Sheet				
Income Statement	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$	\$\$\$\$
TMV	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$	\$\$\$\$

### Scenario 2:

Understanding that budget cuts may arise, you strategically decide to allocate \$100,000 of each year’s annual budget toward balance sheet assets. This includes items like your website, an e-commerce app and a digital tool that helps your customers compare products. Once completed, these assets require only a little maintenance but maintain strong customer value in subsequent years. While your TMV at the end of year one is the same as your annual budget, this changes in year two.

In year two, you gain the carry-over value of the website you built the previous year, providing a TMV of \$600,000. In year three, when the budget cuts take place, you are still able to achieve the same \$600,000 TMV with only \$100,000 less going to income statement items. By year four, your TMV has actually increased again to \$700,000 even though you are operating at a smaller annual budget.

Scenario 2	Year 1	Year 2	Year 3	Year 4
Balance Sheet	\$	\$\$	\$\$\$	\$\$\$\$
Income Statement	\$\$\$\$	\$\$\$\$	\$\$\$	\$\$\$
TMV	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

As this example shows, **wisely allocating marketing dollars toward both balance sheet and income statement items can greatly increase your overall TMV.**

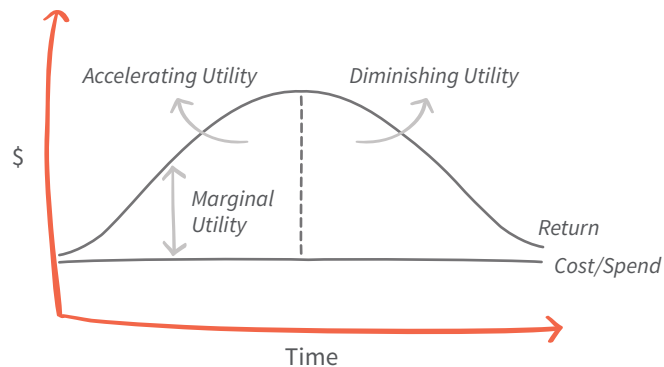
For this simplified example, we randomly allocated funds to each bucket, but in reality these figures should be intentionally calculated. This is where our next two tools, Marginal Utility and Investment Decay, come in.

## Tool 2: Marginal Utility

Marginal utility is the additional value gained by investing one more dollar toward a specific business goal. Every additional dollar generates additional benefits.

- **Accelerating marginal utility** is when each additional dollar generates an increasing amount of additional value. However, there comes a point where the additional dollar of investment generates additional value but not at an increasing rate.

- **Diminishing marginal utility** is when an additional dollar of investment will generate positive but less additional value than the last dollar generated. When an investment reaches a level of diminishing marginal utility, you should be more skeptical of additional investment toward that goal.



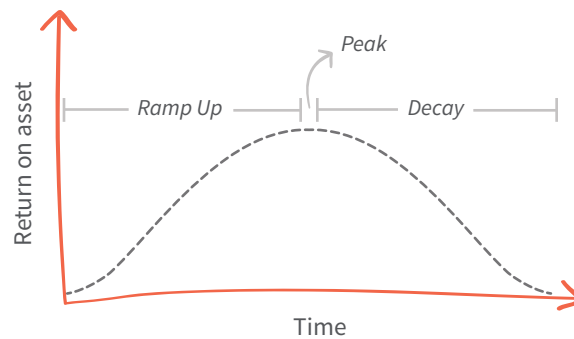
**Example:** Imagine you are at one of your favourite restaurants and have just been served a slice of their famous cheesecake. You have been anticipating this moment and the first bite does not disappoint. While you know that the calories and fat count of that bite are high (the cost), the joy you get from that first bite is substantially higher (the return). Now think about your second bite, your third bite and all the way to your last bite. While the calories and fat count for each bite haven't changed (i.e. the costs are the same), the amount of joy you get from each (the returns) most likely diminishes with each bite. In this example, the marginal utility is the difference between the cost (the calories and fat count) and the return (the joy you experience) and, as the return is the highest after the first bite, you essentially enter into a state of diminishing utility immediately thereafter.

### Tool 3: Investment Decay

Investment decay is the return over time on total performance generated by each dollar invested in a specific business function. This economic concept suggests that for every investment there will be a point in time at which each dollar will generate its maximum return followed thereafter by decreasing returns to total performance.

While the curves for investment decay will differ by organization and investment type, a typical curve would include:

- A **ramp up** period where the investment has yet to achieve its maximum return
- A **peak** period where the investment is achieving its maximum return
- A **decay** period where the return on investment decreases



**Example:** Imagine you have just purchased a new home. It's a brand new place in a popular neighbourhood where demand and prices are steadily increasing. Over the next 10 years, rising demand in the area causes the value of your house to increase 30% at which point the market plateaus. Over the next three years, you notice that roof and fence replacements are common amongst houses in the area and that these houses, when sold, are selling at no more than the market price at year 10. In year 15, you decide to sell and ultimately settle for a price below market. In this example, your ramp up period would have been years one through 10 with a peak shortly thereafter. As the neighbours who invested in replacing their roofs and fences in years 10 to 13 did not realize any additional value for those costs, the point of decay would have started somewhere within that period of time. By the time you sold your house in year 15, you would have been in a state of investment decay for over two years.

While these two concepts may seem very similar, it is important to remember that marginal utility represents the spread between ongoing costs (not investments) and the value they generate as a means of determining when the value for each additional dollar spent starts to diminish. Investment decay, on the other hand, is based on only the initial investment (not an ongoing cost) and the point at which its value starts to decay. Therefore, marginal utility is a measure for expenses on the income statement whereas investment decay is a measure for assets on the balance sheet.

Let's see how marginal utility and investment decay could come into play, using a situation many companies may face.



## Example: To Hire or Not to Hire?

Your organization's executive team has just completed its five-year strategic plan, which calls for sales increases of 20 to 25 percent per year. To help achieve these sales targets, an additional \$200K will be invested back into the sales function of the business. As the VP of sales, you must determine how and where to invest the funds.

While your initial reaction is to hire two additional sales reps (at roughly \$100K apiece) to focus on two new territories, you first run a trend analysis on *marginal utility* over the last five years.

Fiscal Year	Investment Budget	Investment Area	Sales Growth (Year to Year)
2011	\$100,000	Added 1 Rep	12%
2012	\$100,000	Added 1 Rep	13%
2013	\$50,000	CRM Improvements	5%
2014	\$0	N/A	7%
2015	\$0	N/A	8%

What you find is that adding an additional sales rep has generally generated 12 to 13 percent sales growth, due mainly to new sales generated in a previously untapped region. Using this math, you determine that adding two new reps for two new regions should indeed achieve the 20 to 25 percent increase you need this year. However, you also notice that the rate of increase in sales is not maintained from one year to the next, meaning you would essentially need to add two new reps each year for the next five years.

While feasible, you are not guaranteed a \$200K investment each year, and ultimately this decision would leave you with a larger team to manage and all of the additional costs associated with it (professional development, salary increases, managerial constraints, etc.). Thankfully, you also noticed that by investing in your CRM technology, you were able to achieve an increase (albeit less substantial in the first year) that has grown over time.

In this same line of thinking, you decide to run an analysis on *investment decay* for three additional pieces of technology. You find that (based on market research and industry trends) adding e-commerce plus one new sales rep should provide you with the desired sales growth – not only in year one but for every year thereafter.

Options	Investment	Sales Growth (Year 1)	Sales Growth (Year 2)	Sales Growth (Year 3)	Sales Growth (Year 4)	Sales Growth (Year 5)
CRM Upgrade	\$50K	4%	8%	10%	10%	7%
E-Commerce Website	\$150K	8%	15%	22%	24%	22%
E-Commerce App	\$100K	7%	14%	20%	22%	20%

## Bringing It All Together

Now let's see how marginal utility and investment decay can be applied to our TMV example from page 4. Remember, in scenario 1, you put the entire year's budget towards income statement efforts, resulting in a declining TMV proportionate to your decreasing budget. In scenario 2, you put \$100,000 of each year's budget towards balance sheet assets, allowing TMV to grow despite budget cuts. In scenario 3, we'll use marginal utility and investment decay analysis to inform overall budget allocation.

### Example: TMV in Action (*continued from page 4*)

#### Scenario 3:

Before allocating any of the funds in your \$500,000 marketing budget, you run a three-year analysis on your prior spends to determine whether your paid media campaigns are still generating accelerating marginal utility.

Based on this analysis, you discover the following:

Fiscal Year	Budget	Sales Growth (Year to Year)	Growth in Leads (Year to Year)	Growth of Site Traffic (Year to Year)
2013	\$200,000	10%	15%	20%
2014	\$250,000	12%	20%	25%
2015	\$400,000	13%	22%	25%

As the numbers indicate, your marginal utility continued to increase year-over-year (with the exception of site traffic in 2015). However, you notice that the rate of growth diminished significantly from 2013-14 to 2014-15. For every additional \$1K you invested from 2013 to 2014, you saw accelerating marginal utility with an average return of .04% on sales growth, .1% on leads generated and .1% on traffic. Whereas for every additional \$1K you invested from 2014 to 2015, you saw diminishing marginal utility with an average return of .006% on sales growth, .013% on leads generated and 0% on traffic.

This tells you that your peak for accelerating marginal utility generated through paid media campaigns lies somewhere between \$250K and \$400K. Running a monthly analysis, you've determined a plateau around \$280K. As such, with a marketing budget of \$500K, you now know that spending any more than \$280K on paid media (income statement) would be a poor use of funds, so you decide to invest the remaining \$220K in owned efforts (balance sheet).

With this insight, you now seek to determine which owned media investments will both return the greatest accelerating marginal utility and protect against the steepest investment decay.

## Causation versus Correlation

In marketing, it's difficult to determine the true return on your promotional efforts. This is namely due to the fact that promotions do not happen in a vacuum – there are many other things happening within your organization during a period of promotions (sales training, channel partnerships, pricing programs, etc.). As such, to say that the promotions “caused” an increase is hard to prove.

Rest assured, it is not critical to be able to measure true ROI in order to apply the concept of marginal utility. Why? Because what we are looking for are trends over time that can be “correlated” back to marketing efforts. If you measure marginal utility over time, you do not need to know that a promotion specifically caused an increase in sales, you just need to know that they are correlated.

By adding in other factors (more directly tied to promotions and marketing, like leads and traffic), you can also create a more specific and meaningful metric for marginal utility. For example, you may wish to track a marginal utility metric that is a weighted average of sales, leads and traffic, with the latter two more heavily weighted. Ultimately, this will still allow you to determine whether every additional dollar spent is having an affect on the other side.

## STRATEGIC MARKETING IS A DISCIPLINE OF CHOICES.

Whether discussing marginal utility, investment decay, income statement versus balance sheet, or paid versus owned media, it is imperative that we, as strategic marketers, give greater consideration to the allocation of the funds we steward.

Unfortunately, the trend has been to the contrary. In many organizations where marketing is viewed as an expense, those committed to stewarding the resources are given the task to either manage or reduce spend by finding areas to cut. More often than not, this involves junior to mid-level individuals assigned to marketing without formal training in marketing theory. The result is a less-than-strategic approach, where the decision maker looks at what has been done in the past and tries to find areas to reduce the budget.

This reality is the polar opposite of what your organization should be doing. The marketing decisions you make should be strategically determined by those with the capacity to conduct strategic analysis, and the answer should be specific to your company's needs.

In an industry where the only constant is change, we as marketers must not only recognize change but leverage opportunities for the companies, brands and resources we manage. And these changes aren't small. We're talking about a complete overhaul in the way we create and deliver value. It can seem daunting, but for those who dare to change, the rewards are greater than ever.

## CONTACT US

## THINK.SHIFT™

A-120 Donald Street  
Winnipeg, MB R3C 4G2

1201 SW 12th Avenue, Suite 400  
Portland, OR 97205

---

### **David Lazarenko**

*President*

davidl@thinkshiftinc.com  
(204) 989.4323 (ext 217)

### **Anthony Gindin**

*Client Development Lead*

anthonyg@thinkshiftinc.com  
(204) 989.4323 (ext 218)