Teaching ROI Analysis in an Era of Social Media

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Abstract
Measuring the financial performance of communication programs is essential, and ROI (return on investment) is the most important measure of financial performance. But university programs in advertising and marketing communication often have given little attention to ROI. The result has been complaints from business executives that graduates of these programs are inadequately prepared to conduct a financial analysis of communication campaigns. The calculation of ROI for social media campaigns is more complex than might be thought and adds to the challenge facing students. This paper describes the difficulties of performing financial analysis of social media campaigns and suggests a six-step process for teaching this important topic.

The first part of this article reviews the literature documenting the problem of graduates being inadequately prepared to conduct financial analysis of communication activities, as well as the challenge faced by analysts trying to calculate the ROI of social media investments. The second part of the article presents the ROI formula and describes a six-step process for instruction in ROI analysis that will prepare students for these analyses.

Literature Review
The financial analysis of communication programs is critically important. Ganesh, Sun and Barat (2010) showed that employers see quantitative analytical skills as essential. But several recent studies cited by Chen, Greenberg, Dickson and Goodrich (2012) have found that the financial skills of students are lacking (Abernethy & Gray, 2000; Aggarwal, Vaidyanathan & Rochford, 2007; Remington, Guidry, Budden & Tanner, 2000).

The inability to determine marketing ROI has been detrimental to business organizations. Webster, Malter and Ganesan (2003) conducted in-depth interviews with CEOs and top marketing executives at 12 corporations, plus 40 other chief marketing officers (CMOs), and concluded that organizations face myriad challenges, among them an inability to quantify marketing's contributions to the firm. An Association of National Advertisers survey of their members reported that only 2 percent felt they were at a sufficient level of understanding to effectively measure ROI (Fajen, 2005). Another recent study by Finch, Nadeau and O'Reilly (2013) found that practitioners rated measuring return on investment one of the top two priorities for improvement in business education.

One solution to this deficiency is for students to learn financial analysis early in their program so that they can practice applying it in more advanced courses and thus be competent at it by the time they graduate. As Chen et al. (2012) point out, "…accounting can be successfully taught in the core introduction to marketing course" (p. 241).

Return on Investment
That widely known line from the 1996 American movie, "Jerry Maguire," summarizes the CEO's position: "Show me the money," i.e., show me the return we'll get or have gotten from investing in this proposed campaign. A definition and formula for return on investment is included in Step 5 of "A Suggested Method for Teaching ROI Analysis" later in this paper. Readers unfamiliar with ROI may wish to refer to that paragraph before continuing.

Clancy and Stone (2005) believe that "new data sources, technologies and tools have made it possible to link investments directly to market share, sales and profits," a view that may explain why CEOs expect financial analysis from advertising and marketing departments. So it's not surprising that CEOs are increasingly frustrated with these departments' inability to account for their actions in financial

terms (Fajen, 2005). ROI analysis is the key to responding to the increasing demands from CEOs to demonstrate payback quantitatively in the financial terms they understand.

But calculating ROI is not always a simple matter. Although ROI has been applied for years to traditional or conventional campaigns, and particularly to direct marketing campaigns, a number of issues nevertheless arise even there. One concern is that many undertakings are maintenance in nature more than they are investments in growing sales. For example, reminder advertising, efforts to counter a competitor's promotions and some customer service initiatives may aim to maintain sales and profits at their current levels. It is hard to show an incremental return for such programs. This problem is relevant to some social media campaigns, too.

Another criticism is that many top public corporation executives who control the purse strings focus on short-term results, even quarter-by-quarter (Webster, Malter and Ganesan, 2003). It can be difficult to show an acceptable quarterly ROI for some brand-building efforts that may require longer periods of time to produce measurable results. Faced with this pressure from the top, though, communication managers may adjust their strategies to that reality, neglecting more critical, longer-term goals that would bring higher returns. "Metrics with narrowly defined ROI tend to lead to social media campaigns that maximize short-term benefits" (Hoffman and Fodor, 2010, p. 49).

The finance and accounting literature treats ROI in more depth than advertising and marketing literature does, and the reader is referred to that body of work for a more extensive presentation of the concept than space allows here. Two standard texts in the field that include ROI coverage are Bodie, Kane and Marcus (2013) and Emery, Finnerty and Stowe (2007).

The Challenge of Social Media

Recently, social media have presented a new analytical challenge. The 2012 Digital and Social Media Survey of the Association of National Advertisers stated, "While more than 70 percent of marketers are using new media platforms, 62 percent are increasingly concerned with the inability to prove ROI across these channels" (Fogel, 2012, p.1). A poll reported that organizations dubbed the inability to measure ROI one of the most significant barriers to the adoption of social media tactics by organizations (Marketing Sherpa, 2009). "Measuring the ROI of social networking is the fastest-growing concern in marketing" (Duboff & Wilkerson, 2010, p.33).

While it can be challenging to measure the direct financial impact of customers obtained from social campaigns, those customers also may have substantial influence on others through their posts, comments, likes, retweets, etc. Measuring social word-of-mouth and incorporating it into projections of future sales is important but very challenging. It is difficult to show that a 'like' or a product review by Mrs. Smith in Idaho caused Mrs. Jones in England to buy from the firm. Nevertheless, these influences are relatively more important for social media campaigns because the social nature of the media means that customers should have a greater impact on purchases by others through retweeting, reposts, etc., than customers obtained through more conventional means.

Lack of data with which to make projections is another challenge. The organization may house gigabytes of data, but that doesn't mean the data are particularly helpful for the analysis of social media communications. Projections of the lifetimes and future purchasing behavior of customers obtained from social media are problematic when made with historical data of customers obtained from, for example, direct mail and email campaigns. "A lengthy history of longitudinal data is needed" (Rust, Lemon & Zeithaml, 2004, p. 109). It may take several years to build up a useful database of information about customers obtained from each of the various social media channels.

Perhaps in defense of their inability to show a quantitative ROI, some managers heavily involved in social media take the position that ROI is not relevant. As Fisher (2009) observed, "it seems like every week brings another post attempting to reinvent the acronym or the meaning — ROI really means return on influence or return on engagement. There is another group of online Zen masters who would have you believe social media ROI is old-school thinking and not in tune with social media Zeitgeist" (p. 189). Fisher quotes one individual as saying, "Perhaps we shouldn't measure social media ROI in the first place … Social media isn't about sales. It isn't about market share. It isn't about profit margins" (p. 193).

Typical of this pushback against ROI is an executive's statement quoted by Kirkpatrick (2011): "There is more than just ROI, and the real value of marketing may require a different metric, or a different scorecard, than just the financial one" (para. 10). But it's unlikely that CFOs will entertain such arguments and settle for nonfinancial measures, useful as they may be for analysis lower down in the organization. To illustrate, a count of the number of the organization's apps downloaded to mobile phones is unlikely to satisfy hard-nosed execu-

tives focused on the bottom line. For a fuller exposition of the arguments against the use of ROI to measure the results of social media, see Fisher (2009).

The viewpoint that ROI is not relevant to social media is understandable, albeit futile. The objective of many social media activities is not to produce sales but rather to strengthen customer relationships, improve customer service or affect indirect drivers of profitability such as brand awareness. Social media marketers are naturally oriented to metrics that show how well such objectives are achieved.

Social media are just that — social. A caveat heard by perhaps every person engaged in social media is that social media are seldom the place to sell product. The phenomenon is analogous to a cocktail party. An insurance salesperson can engage in conversation with a group at the party and respond, when asked, that he or she is in insurance and offer a business card. But for the salesperson to go further and try to sell a policy on the spot will only chase away the others, yielding no sales. Calculating ROI for attendance at cocktail parties would be considered absurd, yet that is analogous to what some communicators say they are asked to do to justify their social media budgets.

Despite the analytical problems and the resistance of some social media managers, the demands of top executives for return on investment projections or results are not going to go away. So, managers need to take two steps if they are to satisfy their C-suite executives. The first step is to select each campaign objective's relevant driver or drivers of sales or profits. Here, we define drivers as the immediate goals of campaigns that will, in turn, lead to return on the investments in those campaigns. For example, a campaign may increase awareness (the driver) of a product, e.g., a new model of automobile. Even after the campaign has ended, the higher awareness may lead to higher sales of that model for some period of time.

Changes in drivers can be evaluated by using whichever metrics apply; the applicable metrics will depend on the objective. The Internet Advertising Bureau (2009) has prepared a comprehensive list of many social media metrics. It includes 22 metrics for general use, including return visits and time spent, plus 14 different actions that might be taken by visitors. It also lists 12 metrics specifically for blogs, including unique monthly visits and mean time between posts, and nine for widgets and apps, including total installations and number of active users.

The second and more challenging step is to relate these metrics to sales or profit measures quantitatively (Hoffman and Fodor, 2010). For example, how much of an increase in sales will result from a one percent increase in awareness? If those quantitative relationships can be established, ROI can be calculated. However, Verna (2011) observed, "Online channels provide feedback that offline media cannot, but marketers are still grappling with how to make the input work toward the bottom line" (p. 12). Even for traditional mass advertising, "No one has yet codified the chain of marketing events that could serve to measure ROI. Each event, like brand sales … has a different set of metrics. So the ROI problem is difficult to solve" (Fajen, 2005, p. 24).

Teaching ROI Analysis

An introduction to ROI analysis should occur in a first advertising or marketing course. Students should then be given the opportunity in their more advanced courses to apply what they have learned, such as in case studies. Unfortunately, ROI often is taught poorly in introductory courses. As pointed out by Chen et al. (2012), many instructors were never taught financial analysis and therefore have an inadequate understanding of it, and so have little confidence in their ability to teach it to their students.

These instructors are not likely to get a good education on the topic by reading the academic literature. An extensive survey by Gleaves et al. (2008) concluded that "the marketing literature shows confusion and contradiction in its understanding" of customer profitability (p. 825). Some instructors probably rely on the textbook they are using in their courses for their own education on the subject. But Gleaves et al. analyzed 22 core marketing textbooks published since 2000 (core marketing being defined as texts that covered the whole field and not focused on a particular area), and found that only seven to 12 of these texts, depending on definitions of terms, included profitability analysis. Though advertising or communication texts were not studied, a survey of their contents may produce similar results.

In addition to inadequately trained instructors and the shortcomings of textbooks, there is another objection that can be raised to devoting greater time and effort in teaching ROI: there is little or no class time available in the already crowded curricula. But financial analysis is arguably more important than some other topics now taught in introductory courses, and it should be possible for the subject to receive increased attention.

A Suggested Method for Teaching ROI Analysis

Instructors who recognize the need and wish to

devote more attention to ROI analysis can use the six-step process suggested in the remainder of this paper. This procedure should move the student from a total absence of knowledge of the topic to an adequate, basic understanding. In the first two steps, the instructor reviews or provides the accounting knowledge that is a prerequisite for understanding ROI analysis. The next two steps present the idea of customer lifetimes and explain why contributions expected over the customers' lifetimes must be discounted. In step five, the calculation of the rate of return from the campaign investment is explained. The final step describes the challenge of measuring returns from social media investments. An example of these steps is presented in the tables. The example is quite simple so that students may concentrate on the concepts and procedure without getting bogged down in accounting details. The discussion below has been kept correspondingly simple. Instructors can, of course, introduce additional sophistication (such as payback period and internal rate of return) if they wish, and supplement each step with additional numerical exercises.

Step One: Relevant Accounting Concepts

The first step is to review two basic accounting concepts: the income statement and direct costs versus overhead. Table 1 shows a simplified income statement of a hypothetical campaign, also known as a P&L (Profit and Loss) statement, which will be used in this and subsequent steps. Direct costs are those costs incurred as a direct result of gaining the sales shown on the first line. The largest direct cost is usually the cost of the products shipped, called Cost of Goods Sold. Income statements traditionally show this cost first and subtract it from sales to arrive at Gross Margin.

The campaign cost shown on the statement is the funds that will be or were spent to conduct the campaign, i.e., the funds that would not be spent if the decision were made not to launch the campaign. Campaign cost is the investment that will be used in step five to calculate ROI, although to the accountants in the firm, the campaign costs are not an investment but simply another direct cost.

"Other direct costs" are costs incurred as a result of the campaign, even though they are usually not part of the communication department's budget. An example is the cost to ship orders to customers. These costs are analogous to bank fees or penalties that would be levied on an investment account one might have at a bank, fees that would not be incurred if the investment were not made.

Several simplifications are made in this example. The term "sales" is used rather than "revenue," and "profit" is used rather than "income." There is no discussion of cash flow versus accounting statement numbers. Also, accounting statements usually show two categories of "fixed" or "indirect" expense: overhead and General and Administrative expense (G&A). The latter is a category of overhead the contents of which, for example, the CEO's salary, need not concern the students. So, to keep the example simple, Table 1 shows only one category, overhead. Overhead is usually allocated to campaigns as a percentage of their sales. In other words, each campaign might have to absorb overhead of, say, five percent of sales so that the organization's total overhead is paid for by year-end. Also, Table 1 does not show taxes deducted from profits because they, too, are not the responsibility of the communication department and not part of the ROI calculation.

Step Two: The Concept of Contribution

Contribution to overhead and profit should be used as the best measure of results of campaigns, rather than profit. "Because the assignment of many fixed costs is arbitrary, we often use the net present value of a customer's contribution stream rather than profits" (Rust,

Table 1:
A Simple Hypothetical Campaign Income Statement

Sales	$1,000,000
Cost of goods sold	450,000
Gross Margin	550,000
Campaign cost	300,000
All other direct costs incurred as a result of the campaign	50,000
Contribution to OH & profit	200,000
Allocated overhead	250,000
Profit before taxes	(50,000)

Lemon & Zeithaml, 2004, p. 110). Contribution to overhead and profit is defined as the amount left from sales after the paying of all direct costs that will help the organization pay for its overhead and increase profits (Peavier, n.d.). Net present value is explained in step four.

Contribution to overhead and profit is measured as sales from the campaign minus all direct costs — costs of goods sold, campaign cost, bad debt expense, shipping and fulfillment costs, etc. — generated by the campaign. These are costs the company would not have incurred if the campaign were not implemented. For simplicity in Table 1, the direct costs incurred by the firm are shown as the campaign cost and "all other direct costs." Deducting these costs arrives at the contribution of the campaign. Evaluating the profitability at the contribution level avoids inclusion of accountants' arbitrary overhead costs allocation to the campaign, costs over which communication departments usually have no control and for which they have no responsibility.

Table 1 shows that this hypothetical campaign lost money at the net profit line but that the contribution for which the communication managers should be held accountable was positive. The campaign contributed $200,000 toward the company's overhead and profit. If this example was a proposed campaign and someone decided not to run it, the overhead burden on sales from other campaigns would increase by that amount.

Step Three: Customer Lifetimes and Lifetime Value of a Customer

The instructor should now introduce the concepts of customer lifetime and the lifetime value of a customer. Customer lifetime is defined as the number of periods — usually years — the customer will continue to purchase from the firm. Lifetime value is defined as the sum of all contribution dollars obtained from the customer over the customer's lifetime. In this step, instructors can explain that a historical database of customer activity can be used to calculate the average lifetime value of existing and former customers similar to those targeted in the proposed campaign.

Table 2 expands Table 1 to include sales and costs over an assumed three-year average customer lifetime. In the 'real world,' some part of the campaign costs, e.g. media charges, might stretch over more than one year, but for simplicity, they are assumed in this example to be fully incurred in the first year.

Step Four: Net Present Value of Future Contributions

Now, we introduce the concept of the time value of money — specifically, the present value of sums of money to be obtained in the future. "Future sums" means the stream of future contributions to overhead and profit shown on the bottom line in Table 2. The standard formula for present value, or *PV*, of a sum due in the future is:

$$PV = \frac{FV}{(1+i)^n}$$

where *FV* is the amount of money to be received in the future, *n* is the number of compounding periods between the present date and the date when the money is received (usually in years) and *i* is the interest rate for one period (Ross, Westerfield & Jordan, 2010; Brigham & Ehrhardt, 2010).

The parameter *i*, which stands for interest rate and is also called the discount rate, is the rate of return or the interest the organization could earn on an investment in the financial markets with a similar degree of risk. The finance department usually provides the value of *i* to be used. The interest rate is expressed as a decimal in the formula.

Table 3 shows the stream of future contributions from Table 2 discounted to their net present value using an assumed 10 percent interest rate. The instructor can explain that the contribution in each year including the first is discounted in this simple example as if it all

Table 2:
The Hypothetical Campaign Showing Projections of Contribution over Customer Lifetimes

	Year 1	Year 2	Year 3
Sales	1,000,000	600,000	200,000
Cost of good sold	450,000	270,000	90,000
Gross Margin	550,000	330,000	110,000
Campaign cost	300,000	0	0
All other direct costs incurred as a result of the campaign	50,000	30,000	10,000
Contribution to OH & profit	200,000	300,000	100,000

were received at the end of each year. A more sophisticated calculation might assume that sales and thus contributions flow in all during the year or, on average, halfway through the year.

Regarding the number of years to be used in the calculation, students should be able to see that the need to project contributions more than several years into the future is not great if a reasonably large i is used in the formula, as the discounted value of cash received far in the future is considerably reduced and might reasonably be ignored as too small to affect the decision to invest in the campaign. Post-campaign analysis of actual results would refer to sales records to determine the actual period of time over which sales were obtained.

Step Five: Return on Investment

Now, the instructor can introduce the ROI formula. The formula is widely available in financial texts (Ross, Westerfield & Jordan, 2010; Brigham & Ehrhardt, 2010):

$$ROI = \frac{\text{investment gain} - \text{investment cost}}{\text{investment cost}}$$

Applying the formula to a proposed campaign (Farris, Bendle, Pfeifer & Reibstein, 2010):

$$ROI = \frac{\text{contribution to overhead and profit}}{\text{campaign cost}}$$

Table 3 shows the calculated ROI for the example. The illustrative campaign is projected to return approximately one and two-thirds times its cost over three years.

Now that students understand the calculation of ROI, the instructor can show that ROI has several uses. One is to establish a "hurdle rate" for all investments, which is an ROI percentage below which no investment will be approved. The other is to evaluate specific proposed campaigns that exceed the hurdle rate, against each other and all other investment opportunities available to the organization. With limited investment funds, opportunities projecting higher ROI's will ordinarily be chosen over those with lower ROI projections. Also, ROI is used to show executives after a campaign runs that it was (or wasn't) financially successful.

Step Six: Recognizing the Complexities of Social Media ROI

The instructor now can discuss in qualitative terms the difficulties students may face in the "real world" when they try to apply what they have learned. Some have been described earlier in this paper: the maintenance nature of some campaigns, the pressure for short-term results, the difficulty of measuring social word-of-mouth sales and insufficient historical data on which to base projections. Students should understand that ROI analysis starts with a sales figure. For analysis of completed campaigns, sales should be available from accounting records or performance reports. But an estimate of sales for a proposed campaign is another matter altogether. The problem of converting estimates of changes in selected drivers to estimated sales has been discussed earlier in this paper. Most social media campaigns are usually intended to achieve a goal other than sales. Instead, they produce an improvement in a driver of customer equity, e.g., greater loyalty to the brand. Adding to the complexity is the fact that a social media campaign may affect several drivers, not just one. The challenge for management is not only to select the proper drivers, display them on dashboards and evaluate how the drivers have been positively affected by the campaign, but also to show quantitatively what the ROI of that positive effect is.

Students should understand that the way a change in each driver is converted to sales is specific to that driver. For example, awareness of a new product resulting from a social media effort must be converted, quantitatively, to an effect on future sales. Perhaps existing customers will purchase the new product and be satisfied, leading to an increase in average customer lifetimes during which they also purchase other products. Or, some social media campaigns may have little effect on sales but will reduce costs, e.g., an instructional video placed on

Table 3:
The Hypothetical Campaign Showing Contributions Discounted to Present Value and ROI

	Year 1	Year 2	Year 3
Contribution to OH & profit (from Table 2)	200,000	300,000	100,000
Discount factor, $(1+i)^n$ where $i = 0.10$	1.1	1.21	1.33
Discounted contribution	181,818	247,933	75,188
Cumulative net present value	181,818	429,751	504,939
Return on investment of $300,000			168%

YouTube demonstrating how to assemble or use a product may result in fewer returns.

The analytical task, while challenging, is not totally bleak. Students should see that estimating the investment required for a campaign, the denominator of the ROI ratio, should not be particularly challenging because doing so is part of the normal process of creating the marketing or advertising department's annual budget, particularly if the 'bottom-up' or 'objective-and-task' estimating method is used. Unlike television or other traditional media, the media costs of most sites that might be used in a social media campaign are relatively low or even zero. Most of the cost of a social media campaign is the labor to design and implement the campaign, which usually involves personnel within the communication department whose costs are known.

Social media managers are not competing only with other departments for budget dollars, just as the sales promotion team proposing a rebate program is not just competing with the brand manager who is asking for money for market research. In fact, they are competing with all other investment possibilities open to the firm at that time. Top executives could decide to invest the limited funds available into a proposed social media campaign or decide instead to put the money into a stock buy-back program, new factory machinery or any other opportunity that projects a higher ROI.

Instructors who wish to cover the topic in greater detail, such as in advanced courses, may wish to consult a text on ROI by Lenskold (2003). Advanced topics that might be covered in advanced courses include the concept of customer equity as the total of discounted lifetime values summed over all of the firm's current and potential customers. Campaigns can then be evaluated more from a strategic view, as producing a return on investment that is the increase in the firm's customer equity achieved from the expenditures (Rust, Lemon & Zeithaml, 2004).

Future Directions and Conclusion

There is little in the academic literature on the relationships between drivers of social media campaigns and sales. Because an ROI analysis of proposed campaigns begins with sales estimates, these relationships should be an important area for future research.

Gleaves et al. (2008) expressed their concern about "survey evidence that companies are more interested in consumer profitability . . . than the researchers and teachers of either discipline. This could mean that graduates and postgraduates are ill-equipped to address the needs of the organizations that recruited them" (p.840). Social media have created a need for increased emphasis on teaching return on investment to our students. Focusing on this instruction can help graduates to argue successfully for adequate budgets that optimize their employers' investments, not just in social media, but in all communication efforts.

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