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ROMI and interface marketing-finance

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ABSTRACT

Based on the literature review and the analysis of qualitative interviews within companies, this research allows a better understanding of the specificities of the interface marketing-finance, and finally points out the fact that ROMI is a good mean, and / or an adapted tool to progress into the integration of marketing and finance. For this demonstration, the author proposes first a three-dimensional development of the literature: (1) market orientation and financial performance, (2) return on marketing investment, (3) interface marketing-finance. Next the analysis of contents underlines the rise of the "financial power" that will force the marketing departments to justify their plans and recommendations of investment with a greater rigor, thus all managers interviewed recommend a real management of the “rapprochement” of finance and marketing, and the need of dual or double formations to facilitate the integration.

Key words: ROMI, return, marketing, performance, finance, equity

INTRODUCTION

If one judges some by the speech of the managers, the companies seem increasingly worried by the need for showing the profitability of the budgets in marketing. This tendency is more important in period of turbulence and varies according to the types of marketing actions; this makes it possible to establish the priority of the investments, at least according to the cost of acquisition of a customer or the cost for retention. This corresponds to the analysis of ROMI (return on marketing investment), i.e. in binding expenditures, and/or activities dedicated to the setting in the market, to a given result (Boudreault, 2004).

The problem is that the repercussions can be observed a long time after an action and it is sometimes difficult to establish a direct relation between the investment and the output. And different levels must be observed: indeed, it is a question of determining to which point the expenditure for marketing actions contributes to the recognition of the mark, the direct attribution of the mark (for how many new customers for instance) and the memory of the message. That means that "soft" dimensions (relative to the recognition of the mark), "mild" dimensions (measurement of the interaction with the target market: request for information, presentation…) and "hard" dimensions (concrete elements such as the addition of new customers, the new sales…) must be controlled (Boudreault, 2004). That could explain the different and/or complementary points of view of authors concerning the control of quantitative/concrete data and/or qualitative/intangible data, thus the use of different criteria to check the performance. And that could explain the large literature on the difficulty in the assessment of marketing performance (Webster, Malter and Ganesan, 2005) as well as the recent development of the literature concerning the link between marketing performance and financial performance of a company.

This paper is at an exploratory stage and organized as follows: at first we offer a review of the existing literature which permits to point out the evolution of the ROMI orientation to the marketing-finance interface. Next we report the findings of an empirical study and conclude with a discussion of implications for research and business practice.

Theoritical background

The Literature review will be managed into three parts: (1) market orientation and financial performance, (2) return on marketing investment, (3) interface marketing-finance

Market orientation and financial performance

The financial and economic performance is usually evaluated by countable and financial measurements (sales, profit, costs, cash-flow, etc), by measurements of efficiency of the relationship to the customers (costs of the transaction, indices of quality...), by the creation of value or the improvement of the competitive position (Donada, Nogatchewsky, 2005). But what is the link between financial performance and market orientation?

Lambin, Chumpitaz-Caceres (2006) define the market orientation as a three-dimensional concept: culture (transversal; a philosophy of management which challenges each function in the company), analyse (transversal; a strategic reflexion: analyze of the needs of the market and choice of the strategic options), action (functional; the commercial: the means to implement the strategic options selected). The main difference between marketing and market orientation is that market orientation is directed towards the key actors of the market (customers, competitors, distributors, advisers and other stakeholders), and not only towards customers. This concept is based in an important way on the technological orientation and challenges all the functions of the company on all the hierarchical levels (and not only the marketing department). Thanks to a large review of literature and an empirical study (based on a questionnaire to 365 top executives in five European countries), Lambin and co. have observed a positive and statistically significant relation between the degree of the market orientation of a company and its commercial and financial performance. And while reinforcing its degree of market orientation, the company can attenuate the impact of turbulences of the economic and social environment on its performances. But other variables can moderate the relation between market orientation and performance, such as the satisfaction of the customers and their confidence, the relative quality of the products, the degree of innovation, the type of product...

In a same way, Queiroga and Lages's study (2007) reveals that market orientation has a positive impact on financial performance, "if the company is able to use market orientation to build customer value" (i.e., a positive image, customer benefits, customer satisfaction…); but also it shows that "market orientation by itself is not enough to improve financial performance". This is the same conclusion than Jaakkola's study (2006) that proves that market orientation must be linked with innovation orientation and "marketing capabilities" to improve financial performance. And both empirical studies suggest that not only concrete factors, but also "intangible factors" must be taken into consideration to measure performance: organizational factors, customer loyalty and retention, cultural aspects… As for Baker and James (1999) or Raju (2001), they point out the link between market orientation and the organizational performance, and between marketing orientation and the development of new products (2005). In the same way Kreis and Lutz focus on the relationship between investments in Research and Development and marketing (2007). On their side, Hooley and co-authors (2005) concentrate their research on the performance impact of the marketing resources (customer linking capability, human resource assets…).

However, although a large body of literature reveals that "market orientation is positively associated with performance" (Queiroga and al., 2007), several researchers have reported a non-significant relationship between performance and market orientation (Kirka, Jayachandran and Bearden, 2005). These contradictory results come perhaps from the difficulty in concretely measuring the performance on the one hand, and certain elements inherent with the market orientation on the other hand. In the following part, we thus propose to check through the literature if the ROMI's orientation can facilitate the quantification of the various data of the markets. And we will see in a third part of the literature review how the ROMI can serve the interface marketing-finance.

Return on marketing investment

Nowadays it is question of "return on marketing" (Rust, Lemon and Zeithaml, 2004), of "return on marketing investment" (Powell, 2002) or of "marketing ROI" (Lenskold, 2003). Indeed "marketing can be made accountable by relating its expenditure to a firm's financial return (in terms of profits, market share and shareholder's value) through generating marketing assets. Marketing assets can be considered as customer-focused measures (including customer equity and brand equity) of the value of the firm (and its offerings) that may enhance the firm's long term value" (Mac, 2007, based on Rust and al., 2004).

Regarding to Powell's point of view (2002), investment or expenditure decisions in marketing are similar to other investment decisions; they must consider "fours basic elements": "expenditure or investment, returns, risks, hurdle rates". And these four elements are in fact the elements of ROMI as the projected results must exceed a certain investment hurdle rate for a given level of risk. ROMI is a tool and a way of thinking to facilitate the conceptualization of marketing programs, the planning and the budgeting of marketing programs. It will help to communicate goals and objectives, "set priorities, gain approval, execute and manage them, monitor and measure them and, when successful, go back to the well for more money to scale them for even more success" (Powell, 2002). On his side, Lenskold (2003) suggests to use ROMI to improve profitability. For that ROMI must be measured with precision and then measures must be aligning with decisions. Thus managers must build "ROI formula" that can be adapted and implemented to match organization's operational and financial requirements. But ROMI measurements are "subject to change" because of competition, customer needs, new marketing channels… So ROMI measurement must be "(1) flexible, (2) dynamic, and (3) focused on each incremental investment". In that way marketing ROI can be used to run projections and guide marketing strategy development.

Lenskold (2003) proposes the following formula of ROMI "in its most basic format":

$$\text{ROMI} = \frac{\text{Gross margin} - \text{Marketing investment}}{\text{Marketing investment}}$$

(gross margin = revenue – cost of goods – incremental expenses)

But what about this formula, when Rust, Lemon and Zeithaml (2004) propose to include into the evaluation of ROMI "such criteria as return on quality, return on advertising, return on loyalty programs, and even return on corporate citizenship, given a particular shift in customer perceptions" ? Notably this formula is not easy to apply in a long term way, because of the cumulative effects of some elements (effects of the advertisement for instance) (Lenskold, 2003).

One can perhaps find the answer in the focusing on the customer, more specifically on "customer equity" (i.e. the total of the discounted lifetime values of all the firm's customers) (Rust and al., 2000). And the customer equity depends on three key drivers: value equity (customer's objective evaluation of the firm's offerings, such as price or quality), brand equity (the customer's subjective view of the firm and its offerings, for instance brand awareness) and retention equity (the customer's view of the strength of the relationship between the customer and the firm, such as loyalty). Rust and al. define ROMI namely as:

$$\frac{\text{change in incremental customer equity (long-term discounted profit net of expenditure)}}{\text{Discounted expenditure}}$$

Indeed customers must be evaluated because "not all customers are equally valuable to the firm and, as such, resources expended on each can produce different returns"; customers differ in profitability. Reinartz, Thomas, and Kumar, (2005) conclude from their study that optimal profitability coincides with optimal return on investment. On his side, Ambler has analysed the same data than Reinartz and al. and conclude that maximum ROI is reached with lower expenditure than maximum profitability. At all events, for a better balancing between resources and customer profitability (Reinartz and al., 2005), a higher cooperation between marketing and finance would be helpful, as developed in the following part.

Interface marketing-finance

As Mac (2007) concedes, if return on marketing investment has become one of the most important research areas to develop, there is a potential problem with this area of study, because of the difficulty of establishing « cause-and-effect relationship between the input(s) and output(s) in marketing ». Indeed most marketing actions are not easily quantifiable in financial terms. That is why the interface between marketing and finance is particularly relevant: it can even be considered as "instrumental to the firm's profitability" (de Ruyter, Wetzels, 2000). In fact relationship and cooperation between both disciplines may help "to *properly quantify*" marketing's return on investment and contribution to shareholder value (Weissbrich, Miller and Krohmer, 2007). In this way this is a real stake (Batteau, Changeur, 2006).

According to Weissbrich and al.'s review of literature, with regard to the "specific performance implications of the marketing-finance interface", there are only a few conceptual studies or empirical studies. Weissbrich, Miller and Krohmer have structured these existing studies into three categories: studies on (1) the characteristics of the marketing-finance interface (this category focuses for instance on: exchange and communication, budgeting, pricing, marketing performance measurement, reporting, problem solving, cultural differences…); (2) the antecedents of the marketing-finance interface (focus on a mutual relationship attitude between marketing and finance: resource dependence, procedural fairness and interfunctional rivalty) ; and (3) the performance implications of the marketing-finance interface, examined at various levels (at the relationship level, at the decision level and at the business performance). Above mentioned authors underline the lack of an "integrative framework" in the current literature (existing studies focus on isolated issues), and propose a more comprehensive perspective.

Also based on the analysis of the literature review and of qualitative interviews with marketing and finance managers, Weissbrich and al. propose to conceptualize the marketing-finance interface as "a five-layer phenomenon" (see appendix 1): information sharing (notably intelligence and knowledge sharing), structural linkage (formal channels, interaction…), power distribution (between the two disciplines), orientation of individual functions (goals, time horizons…), knowledge of individual functions (expertises of the units). The constructs which characterize these five layers have performance implications on a relationship level (refers to the quality on the relationship between marketing and finance, such as mutual understanding) and on a decision level (refers to several dimensions of decisions in marketing and in finance). Finally these performance implications "influence positively the business performance".

To conclude on this part, all the authors agree on the need for a more intense cooperation of marketing and finance, even an integration marketing-finance. And regarding to the elements developed at the beginning of the review of literature, the ROMI seems here to be one of the means of integrating marketing and finance, one of the possible tools to facilitate the interface. And to reach this integration, at least to improve the interface marketing-finance, firms must *manage* the marketing-finance interface, using an opportunity "for higher relationship quality, decision excellence, and business performance" (Weissbrich and al., 2007).

Empirical study

Thus we propose now to look further into these first results thanks to the analysis of interviews carried out within the framework of a complementary research that we cannot detailed as our partner asks for the confidentiality on this study. But this qualitative research permits to better understand the specificities of the interface marketing-finance, to check within firms if this interface is real, accepted and managed. In so far we also got the point of view of managers concerning the return of marketing investment.

The 20 companies concerned appear all among the leaders of their sector (for instance Danone, Renault, Henkel…) have consequent budgets of marketing, and have for the majority of them consequent marketing teams. People interviewed are President / Chairman, General Director, Marketing Director and Director of Communication.

In the majority of companies, the marketing departments must present calculations of return on investment to justify their recommendations and requirements; The analysis of contents show clearly that the marketers have and will have more and more to prove the profitability of the carried out actions and to justify the investments that they propose, if they want to keep their "influence" within the company.

Notably the question is not only to know how to calculate the budget and how to split this budget into the different actions, but also which simulation of expenses is adequate. Thus some specific tools with ROMI orientation are developed within companies and are still *specific* to the company. For example when the company decides to create a program of fidelity, it is essential to determine beforehand the return on investment and the economic point. It is imperative to study the mechanisms to be set up to optimize profitability in the short and medium term and to integrate indicators of performance. For that it is necessary to use a rigorous economic model that must be elaborated from realistic assumptions. And these realistic assumptions as the indicators of performance will depend on the companies, their sectors, skills, strategies, types of products, own resources… Standard models or formula are not appropriate.

In this way, people interviewed use seldom the tools proposed by authors. And when they use a tool, a model or apply a formula, people interviewed consider that ROMI formula is interesting and "close to reality" only if some factors can be easily isolated. But manager must make choice between multiple data. So they would prefer a more holistic approach, a global and integrated approach (some of them quote the Integrated Marketing Communication used by advertisers, as example), which could combined qualitative and quantitative approaches. But they concede that even if global formula or tools bring to raise questions, they are too complex and difficult of interpretation. Some doubt of the capacity of the company to use them.

The fact is that people interviewed would prefer to use multi-levers (multi-data) models which are closer to the reality but the analysis of a simple regression (even of multiple regression) are easier for interpretation. So they usually apply simple models of estimation (such as models of simulation of mass).

However some of the people interviewed gave us some names of the ROMI tools they apply (or at least “have tried to apply”); for instance: the joint solution “ROI evaluation” of MMA and Copernicus to help marketers for the evaluation of the impact of their investments, or the “Microsoft Office Excel 2003 templates” (DemandROMI) for marketing channel managers to calculate the return on investment of their own department. But, in a general way, even for the questioned people who use formulas with ROMI orientation, the budget planning process is strongly based on the *last experiment and the practice of the persons in charge* as for their mark and to the actions dedicated to these marks, and of course on the last actions undertaken by competitors. The return on investment is finally often made a posteriori… And according to some of the people interviewed, ROMI is insufficient for a good budget planning, notably because programs often have many “moving parts”, which makes it difficult to have a complete view of performance. Indeed the appropriate evaluation measurement criteria should be added into the program design (at the very beginning), so that “all components can be tracked”.

Moreover one underlines in certain companies, a presence and a stronger influence of the management auditors, and that not only in the phases of planning/development of the budgets, but also in the periodical meetings of marketing department (when the short-term marketing actions are already taken). We are well far from a simple dialogue between finance and marketing.

This suits with the nearly general report of the increasingly large influence of the persons in charge of financial issues and the financial considerations in the decision-making processes. This is the element dominating for the large majority of the interviewed people. Some of them evoke even an evolution of *cultural context* within companies.

Finally as the rise of the "financial power" will force the marketing departments to justify their plans and recommendations of investment with a greater rigor, all of them recommend a real management of the “rapprochement” of finance and marketing, but they admit not knowing concretely how to implement this management of the interface and how to think about possible dual or double *formations*.

To conclude on this part we propose to schematize the remarks of the questioned people and to compare with the literature (see hereunder). The diagram will synthesise the following elements. To better conceptualize the marketing programmes and plan budgets, both authors and manager concede that ROMI is a good tool. But people interviewed regret the complexity of ROMI and prefer to develop own specific tools. They declare as well that ROMI is not sufficient; indeed experience and experimentations, practices and analysis of the actions of competitors are as important to take the good decision. Thus, in spite of the fear of a too great implication of financial, the marketers feel and know that the bringing together with finance is inescapable and necessary/ "they will not have the choice" for a more intensive cooperation with finance, which is nevertheless more and more present for marketing decisions. This interface marketing-finance must be managed by companies and the people concerned should be prepared and formed with this necessary integration. And finally ROMI can be a good mean to facilitate exchanges, links, cooperation, interface between marketing and finance.

Guide of marketing strategy development
Conceptualization of marketing programmes, planning, budgeting
Communication of marketing goals and objectives
Improve profitability

ROMI
Expediture, returns, risks, hurdle rates

Tool
Way of thinking

Formula
but flexible, dynamic, focused
adapted to match organizations
customer equity

concrete factors + intangible factors

REVIEW OF LITTERATURE

ROMI
Mostly internal formula, specific tools

Nead to be more holistic, global
But: too complex (capacity to use?)

ROMI is insufficient
→ add : last experiment, practice, analysis of competitors actions

Qualitative and quantitative data

ANALYSIS OF INTERVIEWS

Management ⇕ **Formation (double)**

INTERFACE MARKETING – FINANCE
ROMI = a mean, a tool for integrating

Conclusion and discussion

Thus, regarding to this exploratory and qualitative analysis, it appears that the trades of marketing as the trades of finance are probably in phase of change. Therefore there is a large range of perspectives of research on this matter and a great expectation of managers for advice and consulting. As far as we point out an important field of reflexion as for the evolution of the students in these disciplines, even if this research presents an important lack: the opinion of the professionals and the authors of finance. There is another limit with this study: the questioned companies are very large companies.

In this stage we firstly suggest that the Weissbrich and al.'s model (see appendix 1) could add the question of the integrated formation ("dual or double") of the people concerned by this interface. If above mentioned authors speak about "knowledge of individual functions", it should be interesting to think about a knowledge management of the two disciplines for the same people, for a better mutual understanding. This is of course not enough to improve the management of the interface, so this should also concern the people in charge of the management of the human resources and the general management.

Secondly we intend to improve this research thanks to further interviews of finance people and thanks to the managing of a quantitative study on ROMI and on the Interface marketing-finance. Indeed the results of our exploratory research gives not enough practical examples of the implementation of ROMI (one of the reasons is the confidentiality required by companies) and insufficiently information for a better understanding of the measurement of ROMI and the influence of market orientation on financial performance.

Nevertheless the results of the interviews, compared to the literature have helped to conclude that ROMI can be used, on the one hand, as a long-term tool to measure the economic benefits created by marketing investments (it is known for instance that some large companies as Hewlett-Packard or Procter & Gamble are using ROMI in this way;

and see Powel, 2002). And on the other hand, for many organizations, ROMI is considered as a short-term tool that gives ability to prioritize marketing investments on a "scientific basis" (according to some of the professionals interviewed) to determine marketing effectiveness and to look for the more productive activity (in particular when it is question of communication's actions). But the problem is that this tool is often considered as too sophisticated and that, as most of the people interview point out, it cannot be to use without reference to the last experiment.

Thirdly we point out that ROMI is not only a good tool for any marketing professional looking to improve their ability to produce real results in revenue growth, it is also a good mean to improve the interface marketing-finance and it should be an appropriate tool to manage this interface and to facilitate the mutual understanding for a better profitability of the company. It would be interesting to go further in this point notably while working with specialists in value-based marketing, such as Doyle (2000) who considers that value-based marketing "redefines" marketing as the "central contributor to shareholder value and presents a clear framework for evaluating the success of marketing strategies".

We finally suggest involving into a review of the financial literature compared to the marketing literature on these questions, and involving into a quantitative research on the matter of (1) the tools with ROMI orientation, (2) the interface marketing-finance and the means to facilitate this interface (as ROMI for instance) *and* (3) the (double or dual) formation of people concerned. Middle and Small Companies should be questioned as well.

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APPENDIX 1: **Integrative Framework of the Marketing-Finance Interface and Its Performance Implications**

(Weissbrich, Miller, Krohmer, 2007)