

14.15: Budget Calculations

Learning Objectives

- Examine the different budget calculation methods

Before going in-depth on ways to account for and measure Marketing expenses, it should be noted that business owners often look for guidelines on how much to invest for a given campaign. To be true, there is no perfect formula for what a business should spend on marketing and promotion because this is highly subjective and dependent upon a host of variables, not the least of which are the specific strategy, existing consumer awareness and ROI requirements. That said, some outlets do publish guidelines by industry. Generally, these reflect and recommend a percentage spend of revenue be invested in marketing and promotional activities.

However, these can vary from mid single digit to low double-digit investment, depending upon industry, organizational strategy and specific financial resources. Another approach for retail organizations, if appropriate, is to fund marketing as a percent of mark-up minus monthly rent. To simply this, imagine a business that sells \$2,000,000 in goods annually.

- The product they sell costs \$2.00 for them, but sells for \$4.00.
- They sell 500,000 units/ year (\$2,000,000/ \$4.00).
- Their mark-up is \$2.00 (\$4.00 – \$2.00).
- Recommended marketing & promotion investment might be 8- 12%, dependent upon needs.
- Thus, they would consider investing \$80,000 to \$120,000 for marketing & promotion BEFORE adjusting for their rent expense (500,000 units x \$2.00 mark-up = \$1,000,000; \$1,000,000 x 8% = \$80,000; \$1,000,000 x 12% = \$120,000).
- IF their monthly rent is \$4,000, then their planned investment would be \$32,000 on the low-side to \$72,000 on the high-side (\$4,000 rent x 12 months = \$48,000; \$80,000 – \$48,000 = \$32,000 low-side; \$120,000 – \$48,000 = \$72,000 high-side investment).

Just know that these are not “hard and fast” rules for marketing investment. Instead, they inform your decisions, given your own organizational strategies, market opportunities and financial resources.

That said, it is important to understand how to describe promotional objectives and track performance, so that your firm can optimize their plan as appropriate. And, there is a specific language that speaks to advertising goals and measurement. For traditional media, important terms are:

- **Rating:** the percentage of a market that will *likely* be exposed to a single, specific ad
- **Reach:** the *likely* number of people in the market who will be exposed to the single, specific ad
- **Frequency:** the number of times the ad will be presented to the target market
- **Impressions:** the total number of times an individual is exposed to the single, specific ad. A consumer who sees the same ad four (4) times has had (four 4) impressions.
- **Response Rate:** refers to the number of people who responded to a specific marketing offer, usually expressed as a percentage (total responses/ total distribution). It is common in direct marketing like direct mail and e-mail marketing ·
- **Redemption Rate:** refers to the number of people who acted on a specific marketing offer, usually expressed as a percentage (total purchases/ total distribution). It is common in direct marketing and couponing
- **Gross Rating Point (GRP):** measures the breadth of an advertising campaign, multiplying the number of times an ad airs (spots) by the Rating
- **Cost per Point (CPP):** measures the cost efficiency of the campaign, allowing one to compare between individual ads or over time. CPP is calculated by dividing the Cost of Media by GRPs

You might notice that measures in traditional media focus upon Cost and Scale. That is, what did the media cost to produce and run, relative to the total number of people who saw it, regardless of whether they are part of the specific customer target. New media, because it is more targeted and trackable, provides for more specific measures and resulting activity.

In [Multi-Channel Retailing](#), you may have read about some common terms and measures used in new media. As a reminder, they can be unique to websites, social media and apps. Further, they speak to traffic, engagement, usage and efficiency. For web analytics, important terms are:

- Traffic
 - Hits- a request for a file from a web server

- Visits- a user's interaction with a website, measured by hits or page views
- Unique Visits
- Return Visits
- Impressions- the number of times an ad loads on a viewer's screen
- Engagement
 - Page Views
 - Click-through Rate (CTR)- the number of visitors who click on a given link / the total number of visitors who were served the link or page or advertisement
 - Duration or Time Spent on-site
 - Events- clicks, page views, downloads, video plays, etc.
- Efficiency
 - CPM- "Cost per 1,000"; frequently used in display advertising, it's the cost for 1,000 ad impressions
 - Return on Ad Spend- the number of unique people who saw an ad / the total cost of running the campaign
 - Conversion Rate- the number of visitors who complete the desired action / the total number of visitors. For example, in Lead Acquisition efforts, a marketer might measure Conversion as = Lead Cards Completed / Total Site Visitors
 - Close Rate- the number of Sales / the total number of Leads

For social networks, marketers track Followers or Friends to measure reach. They measure engagement in the context of Likes, Shares, Mentions or Retweets.

Of course, the ultimate goal of all marketing & promotion is to sell the firm's products and services. And, while measurement in both traditional and new media attempt to understand how well ads and campaigns drive action, it is very difficult (potentially impossible) to establish causality. That is, it is generally easy to see how advertising and promotion stimulate activity within the market—marketers can measure Consumer Awareness, Brand Affinity and Intent to Buy. They can also track how sales of their own products & services trend before, during and after the promotional period.

However, due to the rise of the omni-channel, consumers search and shop across channels very easily, blurring them. This means that they're exposed to a broad spectrum of marketers' advertising efforts and messages. Thus, it's impossible to understand the impact of a single ad. Think of it this way:

- How many of the firm's marketing messages did the consumer see before making their purchase?
- So, how much "credit" does each, single ad get for the sale?
- Was each ad beneficial, or did some get "tuned out" because the consumer had already decided that the product was right for them?
- Did the Facebook ad have more impact than the television spot? How did banner ads on-line fair relative to influencer posts on Instagram? Were the newspaper ads more meaningful than the in-store displays?
- What would have happened if we cut radio, but increased direct mail activity?

These questions are unanswerable. The necessity of IMC is that it considers the campaign and its channels in their entirety, knowing that attribution of sales to single marketing activity is a near impossibility. Thus, marketers should be more interested in the total impact to sales activity.

To be effective, marketers need to understand the trend of their sales, BEFORE marketing activity. This can establish baseline sales against which to measure and assess changes, once the marketing activity is in-place—incremental sales. More specifically, marketers measure the change to sales during and after the marketing activity (Total Sales – Baseline Sales = Incremental Sales). This isn't perfect, but incremental sales should reflect what the impact of the marketing activity is upon customer purchases.

With this insight (Base, Incremental and Total Sales) and the cost basis of the campaign, marketers can derive a number of useful measures:

- Cost per Sale = (Total Marketing Spend / Total Units Sold) E.g. $\$400,000 / 1,200,000 = \0.33 per Sale
- Cost per Incremental Sale = Total Marketing Spend / (Total Units Sold – Baseline Sales) E.g. $\$400,000 / (1,200,000 \text{ Total Units} - 6,000,000 \text{ Baseline}) = \0.67 . (That the Cost per Incremental Sale is greater than the Cost per Sale should make sense because customers who were interested in buying without the marketing activity also got the benefit of the marketing activity. In this sense, the marketing activity was "wasted" on them.)
- Return on Marketing Investment (ROMI) = [(Incremental Revenue x Contribution Margin) – Marketing Spend] / Marketing Spend E.g. Assume Revenue of \$4.00 per unit and a contribution margin of 25%; $[(\$2,400,000 \times 25\%) - \$400,000] / \$400,000$

= \$200,000 / \$400,000 = 50%. This means that every dollar spent in marketing and promotion returns an extra \$.50 to the firm.

Measures like the above can help firms assess the effectiveness of their promotional effectiveness during and after the marketing activity.

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