



Pricing Tool Guide

Promotional ROI – A Basic ROI Calculator Example

A promotion ROI calculator, like the basic version in the Toolkit, is a tactical planning tool, as opposed to the other tools that are more strategic in purpose. It provides the means to calculate the return to a supplier selling through an intermediary on an investment of incremental trade funds that secures a promotional event.

Trade promotion ROI calculations are usually summarized by the basic formula:

$$ROI = \text{Incremental Profit} / \text{Incremental Trade}$$

The numerator, Incremental Profit, is the non-promoted contribution times the promoted volumes less the incremental trade. The denominator, Incremental Trade, is just the incremental trade committed in order to secure the promotion. A simple calculator for this formula looks like the version below and found in the Toolkit. It requires inputs (red) for estimates of non-promoted volume and earnings if the promotion did not take place. It then accepts the promoted sales for the same time period and the incremental trade invested to secure the promotion. In this case and extra discount of \$.05 per unit and a \$25K fixed investment (for an ad, for example) secures an incremental contribution of \$42.5K and an ROI of 83%.

Basic Promotion Planner -- One SKU, One Promotion

Scenario One Input				Output	
Non-Promo Information		Promotion Information		Promotion	
Code Name	XYZ	Promotion Type	TPR	TPR For XYZ	
Non-Promoted Volume	400,000	Promotional Volume	525,000	Incremental Volume	125,000
Unit*		Unit	131	Unit	
Non-Promoted Trade Investment on		Promotion Trade Investment		Promotion Trade Investment	
Base Variable Per Unit	\$ 0.10	Incremental Variable Per Unit	\$ 0.05	Total Difference	63,750
Base Total	40,000	Fixed Per Promotion	25,000	Of which pure incremental is	51,250
		Total Per Promotion	103,750		
Non-Promoted Variable Contribution		Variable Contribution		Incremental Variable Contribution	
Per Unit	\$0.75	at Non-Promo Price	0.75	Total	93,750
Total	300,000	Per Unit (at non-promo price)		Less incremental Trade	42,500
		Total	393,750	ROI	82.9%

Tips and Watch-outs:

While seemingly straightforward, there are a number of complications when conducting this analysis for eve this simple calculation.

- **Non-Promoted Volume:** The non-promoted volume is itself a forecast that may never be verifiable if the promotion actually takes place. Furthermore, the non-promoted volume for a particular period, for instance, during a holiday, may be very different from the non-promoted sales rate on a more normal week. How the non-promoted baselines should be determined will be the subject of another Guide. For now, just know that any definition will be challenged by some. The important thing is to set a common standard that can be used to compare promotion options within or across customers.



Pricing Tool Guide

- **Base vs. Incremental Trade Per Unit:** Base variable trade rates per unit exist if a subsidy per unit has been committed for every product sold whether on promotion or not. This might be provided, for instance, to subsidize an everyday price point on the shelf. It is often, but not necessarily, built into the invoiced cost. This is important to know because the impact of this base rate flexed against the incremental promotional volume should **not** be counted in the denominator of the promotion ROI formula. As a rate, it has already been committed to the non-promoted price of the product and is reflected in the contribution margin in the first column of the calculator. Only the incremental rate and incremental fixed trade investments should count in the ROI formula denominator. This is how this calculator does it. This calculation may be controversial if trade budgets are treated as absolute amounts rather than percentages. After all, there is a total amount of incremental trade dollars committed to secure the promotion and the base rate times the incremental volume adds to it. This controversy should be addressed through policy clarifications as to how funds are committed to customers vs. how it is earned for budgeting purposes by the sales force. The truth is that if the problem being solved for is how much more of a discount is required to secure incremental volume, then the impact of the base rate is not incremental.
- **Non-promoted Variable Contribution:** If the purpose of using the calculator is to decide between near-term promotion alternatives, then the contribution should be profit made from non-promoted sales. This is calculated as the list price less any discounts applied to non-promoted sales minus the variable cost of that product. Thus the contribution margin already reflects the base trade rate deal, which is another reason to exclude it from the incremental trade calculation. It is also important that the variable contribution is tailored for non-promoted sales only. It should **not** be an average variable contribution for the SKU based upon a P&L level allocation that may include promotional funding. The costs should also not include fixed manufacturing or other costs that do not flex with volume. Including either of these will reduce the ROI and make potentially profitable promotions appear unprofitable.
- **Promoted Volumes:** Promoted volumes are also an estimate. In this calculator, it is inputted as an absolute amount. The relationship between promoted and non-promoted sales is captured as an index, which compared to history for reasonableness. The caution here is that this estimate is easily manipulated to justify promotions beforehand. So, consistent rules about how promoted volumes should be calculated and how indexes will be judged for reasonableness are important. This simple calculator also does not account for cannibalized sales of other codes in the portfolio, forward loading by retailers that builds inventory at a lower price that is then sold at a non-promoted rate afterwards, or pantry loading by consumer that might depress non-promoted takeaway afterwards. Excluding these negative offsets might make this simple example yield a high-side estimate as to whether or not a promotion is profitable. A more complex ROI calculator, also in the ToolKit, illustrates how some of these other factors can be accounted for.



Pricing Tool Guide

As a final caution, evaluating a single promotion on a single code in isolation is not a wise idea. This simple calculator is easily adapted to quickly estimate different promotions with different volume assumptions. Comparing scenarios provides additional insights to guide the final decision. One should also remember the more strategic considerations for promotion, including: the long-term effect on brand price elasticity, the cross-customer reactions to others promotions, the index relationships vs. competitors. Avoiding violating strategic guidelines may be a reason not to choose the most profitable promotion in the short-term. Nonetheless, having a calculator like this is a good starting point to highlight principle and issues meriting deeper analysis.