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RANKAGENT
DIGITAL MARKETING
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USA

HOW TO CALCULATE & ESTIMATE ADVERTISING ROI

<u>FREE</u> SPREADSHEET INCLUDED

Marketing Unit Economics Overview

Before you begin marketing or advertising for your business, it's important to understand a few core concepts that are unique to your business. This will prevent us from throwing spaghetti at the wall and having to clean it up later.

We need to get clear on how much a customer is worth to you, how much it costs to get one, and everything in between.

By defining these necessary terms, the ship can be sailed in the right direction. We can better choose the right advertising channels and audience targeting settings that have the highest likelihood of success.

In addition, we will go over targets you can set for each advertising metric. Keep in mind that these targets are just that, targets. **The goal is to stay within that target range, and optimally, below.**

Let's crunch some numbers, shall we?

Understanding How Much a Customer is Worth

Calculating Lifetime Value (LTV)

- One of the ways to determine the average **Lifetime Value (LTV)** of a customer is to take your total revenue divided by the total number of customers. This is sort of back-of-napkin math and not the most accurate.
- Calculate **Lifetime Value (LTV)** by multiplying the average purchase value by purchase frequency, then divide by the average customer lifespan.
- Note: you may have different LTVs based on different categories within your business. If so, it's important to keep track of these as well.

Understanding Cost per Acquisition (CPA)

- Once you've figured out your average customer LTV, we need to know how much you would be willing to pay to acquire that customer.
- **CPA** is defined as the costs associated with sales and marketing needed to acquire one new customer.

Determining your LTV to CPA Ratio and Target CPA

- This is where unit economics really starts to influence your marketing. We need to keep a close eye on the **LTV to CPA ratio**. While the first goal is always to have a higher LTV than CPA, a **ratio of 3:1** or higher is generally considered healthy, indicating that the business has enough funds to cover operational costs, invest in growth, and generate profit. But for our sake, we'll go with 4:1 to maximize profitability.
- To set a **target CPA**, you can start by dividing your LTV by 4.

Understanding Payback Periods

- It's important to realize that almost all profit generated from marketing is earned on the backend, not the frontend. Rarely will that first click or interaction with your business produce enough revenue to pay back acquisition costs. However, through nurturing and delivering in your product or service, you can earn significant long-term returns.
- The payback period is the time it takes for a business to recoup the customer acquisition cost (CPA) through generated revenue.

Figuring Out Your Lead to Customer Conversion Rate and Target CPL

- Your **Lead to Customer Conversion Rate** represents the percentage of leads that eventually become customers. By knowing this rate, you can calculate the appropriate **CPL (Cost per Lead)** to stay within your target CPA.
- To set a **target CPL**, you can multiply your lead to customer conversion rate by your target CPA.

Setting Target Traffic Channel Costs

- Once you know your target CPL, I like to look at the percentage in which your website converts a new visitor into a lead, or your **Web Visitor to Lead Conversion Rate**. Multiply this percent by your **CPL** and you have your **Target Cost per Click (CPC)** on a traffic channel.

So, let's look at this practically from a marketing perspective.

When you have this knowledge, it puts you at a high competitive advantage, because while some businesses may glance at a marketing channel and balk at the costs per click on a given channel, you can come in and swoop that market share knowing that you could make 10 times the cost from customers coming through that channel.

Let's Look at an Example:

Say you are a general contractor.

After researching your customer history, you determine that the average LTV (Lifetime Value) of a customer is $8,000.

So, now we have our LTV and can set a target CPA (Cost per Acquisition) of approximately $2,000, or about a fourth of our LTV.

Then, knowing we would be willing to pay up to $2,000 to acquire a new customer, we can go further to determine a target CPL by multiplying the target CPA ($2,000) by your lead conversion rate (15%) to get $300 per lead.

To dial our targets even further, we can assume an average website visitor to lead conversion rate of 3%, which would give us a $9 target for our CPC.

Now, let's see how this plays out with a $2,000/month advertising budget with an estimated $9 CPC.

- **Target CPC: $9**
- **Target CPL: $300**
- **Target CPA: $2,000**
- **LTV: $8,000**

- **ROI: 300% ($8,000-$2,000)/$2,000)**

But, here's where things get interesting, at least for your wallet.

Let's say you are able to get the CPC under your target down to $4.

- **Estimated CPC: $4**
- **Target CPL: $300**
- **Target CPA: $2,000**
- **LTV: $8,000**
- **ROI: 800% ($8,000-$888.9)/$888.9)**

The ROI nearly triples and CPA drops way down.

That's the power of knowing your data and optimization. You can play with these calculations in my **free spreadsheet**.

3 Ways to Lower Your Acquisition Costs

Decrease Your Cost per Click (CPC)

- One of the ways to do this is by decreasing your CPC. While ad platforms will have varied baselines based on industry and target audience, better targeting, copywriting, and design can be rewarded with lower traffic costs and more impressions.

Increase Your LTV

- Create new products and services to upsell customers to increase their value.
- Increase product prices.

Increase Your Lead Conversion Rate

- Nurture leads in order to convert at a higher number.
- Improve your sales and follow-up process.

- Ensure you have the right product-market fit and are hitting the bullseye of what the market really wants, not what's just convenient for you.
- Take a look at your pricing strategy to determine if there is a better structure that would convert at a higher rate.
- Develop a better user experience on your website.
- Provide more value up front through engaging content.

Thanks for sticking with me until the end!

At the end of the day, regardless of what industry you are in, we are all in the math business—the business of making a profit.

To help you visualize all of this into a simple tool, **just click here** to be automatically directed to a Google Sheet that summarizes everything for you like the example below. Just be sure to **make a copy**.

Profitability Targets	Value	Instructions
(LTV) Average Customer Lifetime Value	$8,000.00	<— Enter Here
Lead to Customer Conversion Rate	15.00%	<— Enter Here
Web Visitor to Lead Conversion Rate	3.00%	<— Enter Here
Target Cost per Acquisition (CPA)	$2,000.00	Formula [Don't Touch]
Target Cost per Lead (CPL)	$300.00	Formula [Don't Touch]
Target Cost per Click (CPC)	$9.0000	Formula [Don't Touch]

Ad Simulator	Value	Instructions
Ad Budget	$2,000.00	<— Enter Here
CPC Estimate	$9.00	<— Enter Here
Estimated Number of Visitors	222	Formula [Don't Touch]
Estimated Number of Leads	6.7	Formula [Don't Touch]
Estimated Number of Customers	1.0	Formula [Don't Touch]
Estimated CPA	$2,000.00	Formula [Don't Touch]
Estimated LTV	$8,000.00	Formula [Don't Touch]
Estimated ROI	300.00%	Formula [Don't Touch]

A Few Notes on Startups and New Businesses

It can be difficult when just starting out to come up with these numbers without any previous data. In this case, I would advise you to research industry averages.

I also don't want to give the impression that marketing will and always should make a profit in the short term.

For a new business, it's quite common and sometimes necessary to require significant upfront investment in order to get the pieces of your brand together.

You're going to need a logo, you're going to need a message, a website, and so on...

As stated earlier, marketing return is almost always made on the backend as you nurture relationships with your customers and establish your brand presence in the market.

So, take a deep breath, embrace the process, and remember that you're laying the groundwork for a thriving and profitable venture.

Appendix: Summary of Key Terms

Term or Concept	Definition
Lifetime Value (LTV)	The average revenue generated by a customer over their entire relationship with your business.
Cost per Acquisition (CPA)	The average cost associated with sales and marketing efforts needed to acquire one new customer.
LTV to CPA Ratio	A measure of the value generated from customers relative to the cost of acquiring them. A ratio of 3:1 or higher is generally considered healthy.
Payback Period	The time it takes for a business to recoup the customer acquisition cost (CPA) through generated revenue.

Lead to Customer Conversion Rate	The percentage of leads that eventually become customers.
Cost per Lead (CPL)	The average cost associated with acquiring a single lead.
Return on Investment (ROI)	The percentage of return on the money invested in marketing efforts, calculated as (LTV-CPA/CPA) x 100.
Cost per Click (CPC)	The average cost associated with each click on your advertisement, which can vary based on ad platforms, industry, and target audience.
Website to Lead Conversion Rate	The percentage of web visitors that eventually become leads.
User Experience (UX)	The overall experience a user has while interacting with your website or product, including factors such as ease of use, navigation, design, and content.