- KPI-Driven Business Process: Define, Calculate, Measure and Optimize
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Key Performance Indicators (KPIs) for Search Engine Marketing

Track the growth of your leads and sales with the right measurements

ANDREAS RAMOS AND ROSLYN LAYTON

About the Authors

Andreas Ramos develops analytics and marketing strategies for clients such as Stanford University's Business School, MIT, and Aveda. His book on search marketing will be published by Tsing Hua University Press in China. He wrote one of the first books on web design in 1996. Andreas has worked at SGI, SUN Microsystems, and Brio, has a master's degree from the Universität Heidelberg, Germany, and speaks four languages. Andreas lives in Palo Alto, California. Visit him at www.andreas.com.

Roslyn Layton is Agency Director at Coremetrics, a leading provider of online marketing and business optimization solutions. Roslyn and her team have helped leading companies in retail, financial services, travel, and business-to-business grow leads and sales using the Coremetrics platform including Coremetrics Search™. She is contributor to a series of books on internet marketing, including *Search Engine Marketing*, and is working with Andreas on a forthcoming book on measuring return on investment (ROI).

About Coremetrics Search™

Coremetrics Search, a key component of which is the powerful Coremetrics online marketing and analytics platform, is an application which provides a single interface to manage, improve, and report on your Pay-Per-Click programs in Google, Yahoo, MSN, and other digital channels. Rather than looking at paid search in a vacuum, Coremetrics Search integrates with contextual data from your other marketing channels to accurately measure the impact of your PPC programs. Its benefits include

- Management and reporting in one interface.
- Two-way integration and synchronization with all major search engines.
- Smart marketing attribution to accurately credit PPC in context with your other channels.
- Coremetrics Search is the first tool on the market that captures Google's quality score measure in the interface, the most important factor to manage to maximize your campaign's success.

For ecommerce, Search offers a robust online merchandising capability which allows you to manage to the keyword level the contribution margin of thousands of products individually or in aggregate. This capability can be married to your other business development tools to allow bottom-line reporting.

About Coremetrics Online Marketing Agency

The Coremetrics Online Marketing Agency grows leads and sales for Coremetrics customers using the Coremetrics platform. We are team of subject matter experts of SEO, PPC, and multichannel marketing. Our agents have at least 200 hours of training and 1000 hours of practice. We obtain superior returns on investment for our customers because we apply the capability and intelligence of the Coremetrics toolset to help customer maximize the value of every online interaction. For paid search, we obtain superior returns with our proprietary account taxonomy methodology that maximizes Google's quality score, the most important factor to manage for paid search success.

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Introduction

There is a saying that those who fail to plan, plan to fail. Without clear, focused goals, it's difficult to succeed. Setting up key performance indicators (KPIs) is essential to drive a clear and focused path to your goals. This chapter from *Search Engine Marketing* will help you set up the KPIs to meet your goals. Whether or not you have KPIs in place, this chapter gives insight on how to make your online campaigns more profitable by setting up the right measurements.

Most business people realize that online marketing can bring sizeable returns, however, not as many appreciate all the requirements needed to make a profitable program. As the director of the Coremetrics Online Marketing Agency, my team and I work with hundreds of marketing managers. Our job is to grow leads and sales for our customers using the Coremetrics platform. Our customers represent leading companies in retail, consumer products, media, travel, and finance. We work with marketing managers of these companies, and many of them struggle with KPIs. Managers are not sure what to measure and what return to expect. Additionally, they don't have ready access to key internal information.

Companies have many stakeholders, and oftentimes it becomes the marketing manager's job to consolidate the needs of many stakeholders into marketing campaigns. Those stakeholder needs may or may not match customers' desires. It is not unusual that we find campaigns dreamed up inside a company that may sound good in theory, but fail the online marketing test. Therefore, instead of intuition, we have to use evidence from our online analytics systems to drive our decisions.

Internal politics can be more powerful than analytics. Stakeholders have competing agendas. While establishing uniform KPIs allows stakeholders a common framework to discuss performance, such a framework may result in a calculation that deems a particular project unprofitable. Another challenge is that it can be hard to define profit margin on a promising, yet unproven endeavor. It is not a surprise then that setting up KPIs can create some commotion!

Nevertheless, marketing managers have an important job to do: to drive leads and sales online. You can use the information in this chapter to set up your KPIs and chart a course for your particular campaign's success. If you have a good internal accounting system, strong financial leadership, and can share your KPIs with your key internal stakeholders in a constructive way, then so much the better.

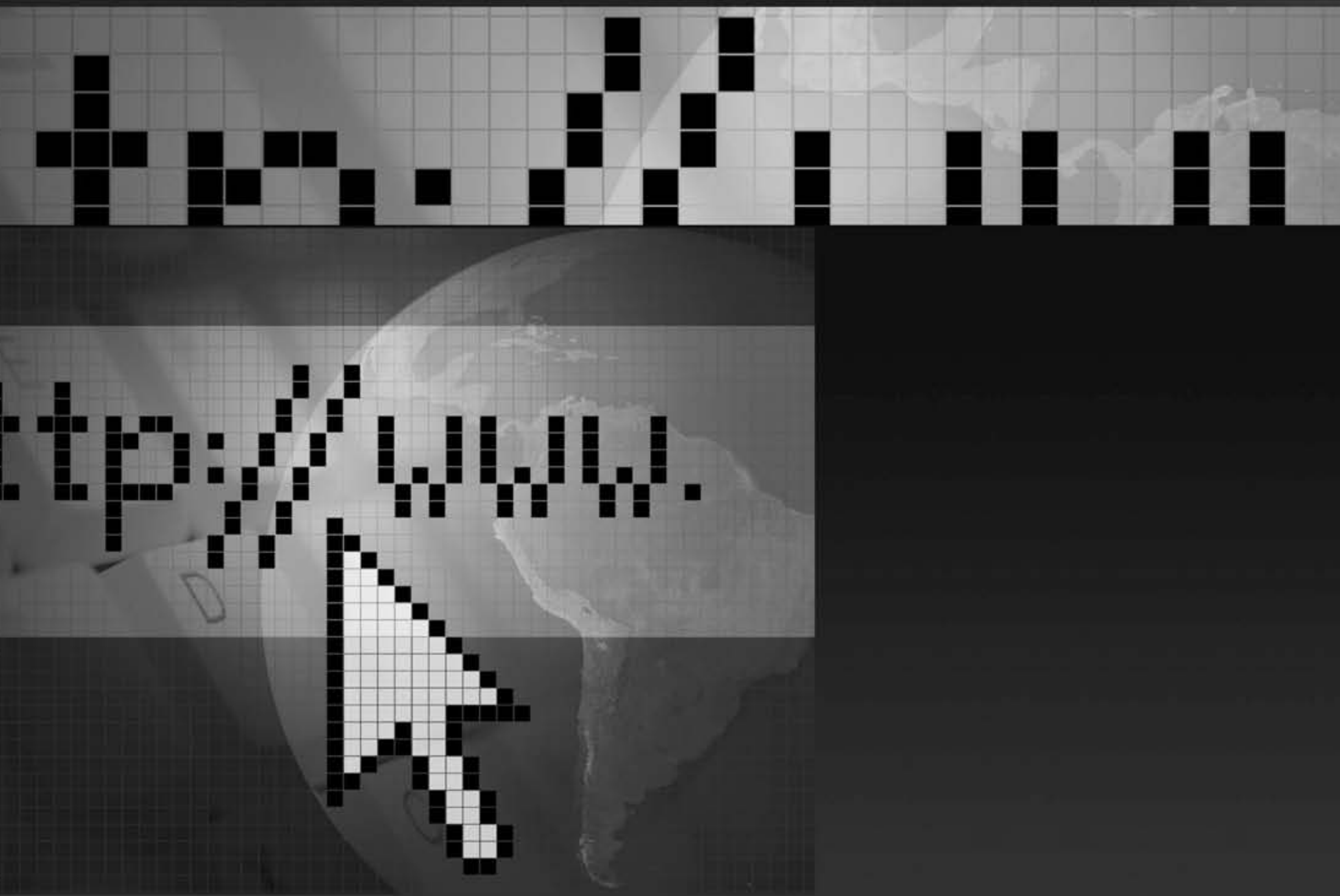
The particular KPI strategy you use depends on your industry. For example, a company that sells 10,000 products online might use a return on ad spend (ROAS) model, while another that uses its website to collect leads for an offline sale with an 18-month cycle, would use a cost-per-lead model. The following discussion is best for companies who use their website for lead generation where the sale happens offline. We will discuss KPIs for ecommerce in a forthcoming book.

At the Coremetrics Agency, we understand you as an individual and a company—we use KPIs to help you maximize your return on investment. We also know that you need to succeed within your organizational context. So we work with you to develop the methods and reporting to communicate your success and win the support of your stakeholders.

We invite you to be in touch.

—Roslyn Layton
Director, Coremetrics Online Marketing Agency

KPIs



Key performance indicators (KPIs) are the metrics that guide and measure your progress toward your business goals. KPIs support both the strategy and tactics for your business decisions. By knowing your KPIs, you'll know how to manage your marketing campaigns for maximum profitability.

The most important KPIs for your business are average order value (AOV), customer lifetime value (CLV), contribution margin (CM), cost-per-action (CPA), cost-per-lead (CPL), and close rate (CR). These numbers quantify your goals and provide guidelines for your marketing efforts.

Business is also a social activity. For your projects to be successful, you need cooperation and collaboration with your team. To win support for your project, you need to be able to show the value of marketing in a simple and powerful way. Communicating information is just as important as gathering and analyzing data. By clearly stating the KPIs, you can tell the story you need to grow your business as well as your career.

There is often a conflict between the finance and marketing departments. The two camps don't speak each other's language. Marketing sees the accountants as bean counters who don't understand that it takes money to make money, and finance thinks marketing is a black hole with no connection to the bottom line. With a set of simple metrics, both sides can understand each other. You don't need more than third-grade math to calculate these numbers.

A KPI-Driven Business Process

KPIs inform and guide the business process. They give you a rational method, based on objective data and results, for making business decisions. You first set your goals and then you establish how to measure the progress toward those goals. Thus, you will be able to answer the questions *What is working?* and *What needs to be changed?* The following process will help you make the most of KPIs:

1. Define your tactical goals. This comes down to a simple goal: *You want to get more* ________. This may be leads, sales, subscriptions, downloads, views of a video, and so on.
2. Establish the target KPIs. By knowing the KPIs, you'll know how much you can spend and still make a profit.
3. Launch your marketing campaigns in SEO, PPC, radio, TV, print, and so on. Use the target KPIs to set the budgets.
4. Measure the actual KPIs. Collect the results and see the actual KPIs for each campaign.

5. Optimize your marketing channels. Improve the successful campaigns and reduce or close the unsuccessful campaigns.
6. Communicate the results to your team, including coworkers and upper management.

Let's look at each of these in greater detail.

Define Your Goals

The tactical goals for your project generally come down to a simple goal: *You want more* ________. This may be leads for services, product sales, newsletter subscriptions, PDF downloads, views of a video, and so on.

Calculate Your KPIs

You need to establish the maximum amount you can pay to acquire a customer and still be profitable. We'll describe this in general terms, explain each of the KPIs along with their formulas, give you a worksheet with the formulas, and then demonstrate this with an example. First, an overview of the KPIs:

- Find the average order value (AOV). Divide the total revenue for the period by the number of orders to get the average value for an order. Some customers may buy a single item; other customers buy several items at different prices. Use these to find the average value of an order.
- Find the customer lifetime value (CLV). Multiply the AOV by the average customer's number of annual purchases and length of customer lifetime (usually, several years) to get the CLV. This is how much the customer is worth to you in revenue.
- The question is then how much you're willing to spend to acquire that customer (in other words, how much you invest to get a certain amount of revenue). In many companies, your finance team tells you that you must achieve a certain return in order to get the funding for your project. For example, for every dollar you spend, you should get four dollars in revenue.
- Find your close rate (CR), which is the number of leads you need to get customers. If you need 100 leads to get 20 customers, that is a 20% CR.
- Multiply the CPA by the CR to get the target CPL. This tells you how much you can spend to get a lead.

Let's look at each of these KPIs in detail.

Average Order Value

Average order value (AOV) is the average value (in dollars, Euros, and so on) of your orders. This is the total value of an order, not the price of each item in the order.

This assumes the items in a sale are generally in the same price range. It can produce misleading numbers if the order basket has items that differ by several orders of magnitude. If a sale includes a $500,000 house and a bird bath, the average value isn't $250,000. If your orders include items with a wide range in price, you may need to develop KPIs for different amounts of sales.

To find the AOV, divide your revenues by the number of orders. Pick a time frame (such as last month, last 60 days, last quarter) that is representative, and look in your records for the amount of revenue and the number of orders.

> $______ Total Revenue / ______ Number of Orders = $______ Average Order Value (AOV)

We use revenues, not profits, to calculate AOV. In very simple cases (such as Koi-Planet), we can calculate costs and profits, but for mid-size companies with dozens of products and revenue lines in the tens or hundreds of millions of dollars, it can be a daunting task to determine profit and costs. Profit margins constantly shift as the company develops better processes, switches to other suppliers, launches new sales campaigns, and so on. Furthermore, accounting rules and regulatory issues can make it difficult to state profitability, so we use revenues, not profits.

Customer Lifetime Value

Customer lifetime value (CLV), which is also called *lifetime customer value (LCV)* or simply *lifetime value (LTV),* is the value of the revenue from the average customer over the lifetime of that customer. This means how much revenue you will earn from a customer over the years that the customer buys from you.

To find the CLV, multiply the AOV by the average number of orders by customers and the average lifetime of a customer.

> $______ Average Order Value × ______ Number of Orders by a Customer per Year × ______ Number of Years for Customer = $______ Customer Lifetime Value (CLV)

CLV is a relatively new concept in marketing. Customer-centric marketing considers the customer as a person with needs and behaviors. The company can then provide ongoing products and services to the customer, which produces additional revenues. This leads the company into cross-selling (if the customer buys a digital camera, offer them a camera bag or a tripod), up-selling (offer advanced cameras), extended warranties, maintenance contracts, and so on. Software companies often use a lock-in strategy. They make it difficult for customers to switch to other tools. The company also plans for the product version to become obsolete, so the customer is forced to buy upgrades. This generates additional revenues from a customer.

Coremetrics recommends its clients think of marketing as a service. Because the Web enables customers to shop anonymously and makes it easy for them to find another vendor, the buyer has more control over the transaction. However, you as the seller can differentiate yourself with better service, ensuring that the customer will stay with you. Consider the customer's point of view so you can offer additional appropriate products and services. With web analytics tools (such as Coremetrics) and CRM tools (such as Salesforce and Sugar CRM), companies are able to manage customers on an ongoing basis.

Contribution Margin

The next step is to apply the requirement for the project's contribution margin. A marketing project can use a *contribution margin* value, such as 25%. You invest in marketing in order to get sales and profits. Your CFO may set a revenue threshold you have to meet in order to justify the investment.

We use CM for our KPI calculations. Some companies may use internal rate of return (IRR), or a combination of other metrics to determine profitability. In general, these numbers tell the marketing department how much they are expected to produce in revenues from their marketing investment.

The CM is generally around 25%. This means the revenue will be four times the investment. In other words, if you invest $1 in marketing, you should expect $4 in revenues. The CM can vary according to the type of company. If the company is 50 years old and established in their market, they can spend less and get more results. Their CM can be 10%. If the company is new and wants to grow aggressively, they will spend more to acquire customers. The CM can be 50%, 75% or higher.

We don't use ROI (return on investment). ROI is *profits divided by costs multiplied by 100*. To use ROI, you need to know the cost, but it is very difficult to determine costs in a mid-size or large business because it becomes a matter of definitions. Do you include fixed costs (such as the cost of the building, salaries, and interest)? Do you include variable costs (such as materials and outside services)? How do you allocate these costs across several hundred products, which may range in price from low to high? Costs may also vary according to the size of an order because of volume discounts. The company's accounting method (cash vs. accrual) also affects your calculations. To add more complexity, costs are constantly shifting. You find better materials, you find a cheaper supplier, your supplier runs out of a material and temporarily substitutes another, you upgrade the production machines, and so on. We have not even opened the discussion of corporate finance, merger and acquisitions, the effect of taxes and regulation, and so on. You can appreciate the difficulty of calculating costs in a global enterprise such as Toyota, SAP, or the Tata Group.

This is why we use revenues instead of profits or costs to calculate the CPL and cost-per-action. You only need to know the CLV and the CM. You focus on getting leads and converting them into sales. These are the numbers that guide you to making profitable business decisions. We've found this works for our clients, even those with hundreds of millions of dollars in revenue.

Cost-per-Action

The next step is to calculate the cost-per-action (CPA). An *action* is the successful completion of a goal. You first define the goal (more leads, more sales, more registrations, views of a video, and so on) and then count the completions of that goal.

To find the CPA, multiply the CLV by the CM.

$_____ CLV × 25% CM = $_____ Cost-per-Action (CPA)

We assume the CM is 25%. Your CM may be different.

For many salespeople, CPA is cost-per-acquisition, which generally means they acquire a customer. If your goal is to get visitors to download a PDF document or watch a video, that isn't really an acquisition. That's a desired action (the visitor did what you wanted), so it's better to use the general term cost-per-action. It basically means the same thing.

Close Rate

The close rate (CR) is the ratio of how many leads turn into customers. If you get 40 conversions from 100 leads, that is a 40% CR.

To find the CR, divide the number of customers by the number of loads.

_____ Customers / Leads = _____ × 100 = _____ % Close Rate (CR)

Close rates can vary by industry and company. They can range from 2% to 50% or higher.

Cost-per-Lead

Finally, we calculate the cost-per-lead (CPL). This is how much a lead may cost. A *lead* is a prospect or a contact that you then convert into a customer. If a CPA costs $10 and you need ten leads to get one conversion, then those leads cost $1 each.

To find the CPL, multiply the CPA by the close rate (CR)

$_____ CPA × _____% Close Rate = $_____ CPL

Assumptions

Our KPI model has several assumptions and limitations. We assume a discount rate of zero, meaning that revenues earned in the future are worth the same as they are today. Most marketing projects have a short time horizon, so the discount rate generally doesn't matter.

You may need to adjust the KPIs several times over the course of a campaign. When you begin to optimize the campaign, the numbers will affect each other. You improve the CR, which increases the CPL, which produces more leads.

An advanced formula for CLV and AOV may distinguish between high-value and low-value customers and products. Work with your accounting team to develop appropriate models.

The KPIs will differ, depending on the type of site. There are four basic types of websites:

- **Lead generation websites** These sites get leads, registrations, or contact requests. Many of these sites produce leads that are closed by other teams, so the KPIs consider the CPL, not the cost-per-action.
- **Sales sites** These sites sell products or services. Our KPI model is best suited for sites that sell products, such as Koi-Planet.
- **Support sites** These sites offer support, FAQs, and information for products or services. Companies use them to reduce the cost of telephone support. If a support site does its job well, fewer visitors will contact the company (they got the solution at the website). For these sites, KPIs may consider the volume usage of the internal search tool, the reduction in support calls, and similar.
- **Informational websites** These sites offer content, such as information, videos, music, and so on. For example, there is Facebook, Education.com, and MySpace. These sites use advertising to generate revenue. They use other KPIs such as eRPM (revenue per million page views), eCPM (cost per million page views), time-on-site, and so on.

You can use our model to develop a KPI model that is suited to your industry, products, and website.

KPI Worksheet

Here is the KPI formula as a worksheet:

KPI	Explanation	Worksheet
Customer Lifetime Value (CLV)	The total revenue value of the customer.	$______ Avg. Order Value (AOV) × ______ Number of Orders by an Average Customer per Year × ______ Number of Years for an Average Customer = $______ CLV
Cost-per-Action (CPA)	How much are you willing to pay to get a customer? Use the contribution margin (CM) (let's assume CM at 25%).	$_____ CLV × 25% CM = $_____ CPA
Close Rate (CR)	How many leads turn into customers?	____ Customers / ____ Leads = ____ x 100 = _____% Close Rate
Cost-per-Lead (CPL)	How many leads must you buy to get one customer?	$_____ CPA × _____% Close Rate = $_____ CPL

Work with your finance team to build a worksheet that matches your projects. You can download our worksheet from the book's website at Insider-SEM.com.

An Example: Selling Bags of Koi Food

Let's try out the KPI worksheet with an example. Let's assume Koi-Planet is selling bags of koi feed.

KPI Concept	Formula	Results
Average Order Value (AOV)	$42,000 revenue per month / 420 sales = $100 AOV	$100 AOV
Avg. # of Orders per Year	4 orders per year per customer	4 orders
Avg. # of Years for a Customer	3 years	3 years
Customer Lifetime Value (CLV)	$100 AOV × 4 orders × 3 years = $1200 CLV	$1200 CLV
25% PRR	$1200 CLV × 25% CM = $300 CPA	$300 CPA
Close Rate (CR)	20 sales / 100 leads = 20% Close Rate (CR)	20% CR
Cost-per-Lead (CPL)	$300 CPA × .20 CR = $60 CPL	$60 CPL

In this example, Koi-Planet can spend up to $60 for each lead and be profitable. The close rate (CR) is fairly low at 20%; if we improve that, the CPL will increase, which allows us to spend more on leads and be profitable.

Estimated KPIs or Actual KPIs?

The point of these calculations is to estimate the upper limits of your marketing expenditures that allow your project to remain profitable. If you know how much you can spend and stay profitable, then you can spend up to the limit. This sets a ceiling for your marketing spend.

Many books and articles about KPIs calculate these numbers the other way around: They start with how much you actually spent, look at how many leads you got, and then state that your leads had a cost of $10. That's a factual statement that doesn't give you any guidelines. What does it mean if you find that the CPL was $10? Was it profitable? Did you lose money? Could you spend $15 and still be profitable? Without including the CM (or a similar number), the revenue value, and the CR, a factual CPL isn't useful.

Our KPI model combines several formulas into one larger formula to give you a way to calculate how much you can spend in marketing to produce the revenue you want. It also tells you how much you can spend per lead or action and remain profitable.

Why This Works

Books are available with hundreds of KPIs, but you only need a few to get control over your project:

- The CLV tells you how much a customer is worth in revenue. This is based on the AOV and the number of orders a customer makes during their life cycle.
- Multiply the CLV by the CM to get the cost-per-action (CPA). The CLV is the value of the customer. The CM tells you how much revenue you must produce to be profitable. By multiplying these, you'll know how much you can spend to get that revenue value. If you want $100,000 in revenues and the CM is 25%, you can spend up to $25,000 for marketing. For every dollar you spend, you get four dollars back.
- Multiply the CPA by the CR to get the target CPL. The CR measures your ability to convert leads into sales. If you know half of your leads turn into sales, you need two leads to get a sale. If you can afford $10 for a CPA, you can spend up to $5 to get each lead. The CPL tells you how much you can spend to buy a lead.

All you have to find out is your CLV, your CM, and your CR. With these, you can calculate the CPA and CPL, which tell you how to be profitable.

You have a great deal of control over the close rate. If your conversion is done on a web page, you can use multivariate tools to improve the close rate. If your conversions are done by a sales team on telephones or in person, use training and bonuses to motivate the sales team to improve the close rate.

The success of this formula depends on reliable data. Most companies have several years of sales data from the business intelligence (BI) tools and can quickly calculate these numbers. If you're starting a new project (or a new company), you can estimate/guess these numbers and then adjust them as you collect data. We will show you how to do this later in the chapter.

This formula works for both online projects (lead generation, e-commerce sales, registrations for social networking sites, and information distribution sites) and offline marketing projects.

Use CPLs to Manage Your Campaigns

The target CPL is the maximum amount you can spend for a lead. If you keep the actual CPL at or less than the target CPL, your campaign will be profitable.

In other words, the CPL is how much you can pay to buy a prospective customer. If you know your target CPL, you can buy the number of sales that you need for your business. This is why CPL is your most important KPI.

A high target CPL doesn't mean you must spend that much. It means you can spend up to that limit and still be profitable. It also doesn't mean you should spend as little as possible for a lead. Many marketers see advertising as a cost, not an investment, and they try to limit their costs. They generally underspend. If the KPI model shows they can spend $15 for a lead but they spend only $2 per lead, they will get few leads. If they are willing to pay up to $15 per lead, they will buy many more leads. As long as you are within your target CPL, you will be profitable. Spend up to the target CPL for the channel and buy as many leads as your sales team can handle.

If your competitors haven't calculated their CPLs, they will get nervous when CPLs go as high as $5. They refuse to pay $5, which means they lose the opportunity to buy customers. If your calculations are based on reliable data and you know $15 CPLs are profitable, you can spend $15 to buy more leads than your competitors.

Don't look at marketing as a cost. The goal of marketing isn't to reduce your costs. Your goal is to acquire customers to maximize your revenues.

CPL lets you manage your campaigns. You can use multiple channels such as Google, Yahoo!, and Microsoft PPC, along with Facebook, radio, TV, print, bulk e-mail, SEO, link building, direct mail, billboards, catalogs, coupons, and so on. The close rate will be different for each channel.
This depends on many factors: the quality of your ads, the quality of your competitors, your unique selling point (USP), your sales team's close rate,

and so on. Try the channels that are appropriate to your target audience. Measure the resulting KPIs and see where you can make profits. Track the KPIs in each campaign and compare the campaigns in terms of revenues against each other. If you keep the actual CPLs lower than your target CPL, the channel is profitable for you. This means you can increase the ad spend to get more leads and more sales. Turn up the volume!

You can assign the campaign to a staffer and give them the target CPL as their guideline. They can then manage the campaign, adjust bids and fees, and try out keywords and ads so long as they keep the average CPL at or under your target CPL. You can also give the target CPL to a marketing company or PPC agency and tell them to produce as many leads as possible within that CPL.

In some cases, CPL and CPA are the same. At an e-commerce website with a shopping cart, if the visitor buys, they become a customer. There isn't an intermediate stage of leads in the cycle.

In PPC (pay-per-click), you set bids by the keyword. But don't worry about the bids or costs for each keyword. Look at the average CPL for the entire ad group. As long as the ad group delivers leads within the target CPL, the ad group is profitable. This means it can be okay in an ad group if the CPL for some of the keywords is higher than the target CPL, as long as the average CPL for the ad group is within your target CPL. This allows you to use a kind of *portfolio management* for your pay-per-click campaigns. Some keywords may be high, but they are making conversions, and the more conversions you get, the sooner you reach the breakeven point.

We often meet people who say, "We've been doing great in SEO for the last three years, so we're not paying for PPC!" They think they're really clever. They are managing marketing as a cost, not an investment. When we sketch out this financial model and they realize how much they've lost in potential sales for the last three years, they move fast to set up campaigns in every channel.

Go After Your Competitors' Customers

You can also use these KPIs for competitive marketing. Once you've established your KPIs and you have a working model (optimized campaigns, actual KPIs, and so on), you can afford aggressive bidding campaigns to target your competitors' customers. You're helping their customers to get better products—namely, yours!

Set Your Baseline

When you start your project, set your baseline. Knowing your baseline, you'll be able to see if you are making progress. Use a time period for your project, such as sales the last month, the previous quarter, or the preceding year. The time period should be large enough that you have at least 1000 orders. If you have no data at all, start at zero.

How Much Data Do You Need?

You should use around 1000 data points as your basic set. Why 1000? Statisticians have shown that 1067 events are sufficient to draw conclusions with a 3% margin of error.

For example, if you have 1067 leads and you got 181 sales, that's a 17% conversion rate. You can expect the future conversion rate to be 17%, with a ±3% margin of error, which is 14% to 20% (3% below 17%, and 3% above 17%).

Of course, the more data you have, the better you can project the future. If you use fewer events, the margin of error will be greater. You can use more events to make predictions, but it improves the margin of error only slightly. With 2401 events, the margin of error is 2%. With 10,000 events, the margin of error drops to 1%.

We find that 1000 events with a 3% margin of error is sufficient to make decisions with a good level of confidence. For more, see "margin of error" in Wikipedia.

You should have about 1000 impressions or clicks before you can decide whether to delete a keyword or ad. This is for the same reason. You need 1000 events to make reliable conclusions. Adjust the time span (yesterday, seven days, one month, and so on) until you get 1000 events so you can make decisions.

What about Impressions and Clicks?

As you can see, many of the numbers commonly used in PPC and analytics don't matter. Although it may be nice to know that traffic is up on your site, you should focus on conversions, sales, and profits. The following are not KPIs:

- Traffic increased by 24%.
- Clicks dropped by 10%.
- Page views are up by 7%.

Don't confuse KPIs with activity on your website. Those numbers come from the traditional IT's concern with data tracking. They have little to do with your business.

What about KPIs for Media Companies?

Up to now, we've looked at KPIs for companies that generate revenue through transactions, such as selling products or services. Let's briefly look at media companies. These generate revenue primarily through advertising. For media companies, the KPIs have different factors. The goal isn't an event or transaction. Instead, a media company may generate value through three primary methods: advertising impressions, clicks on advertisements, and actions taken by their customers for CPA advertisements. Using this as a baseline, we can calculate each of the KPIs as follows:

- **AOV** If an average customer looks at ten ads per session, and one out of every ten customers clicks on a CPC advertisement, and one out of every 100 customers registers for a product demonstration offered by a CPA advertisement, the AOV is the sum of the value generated by each of those actions by an average customer. If we assume each ad impression is worth \$.01, a click on a CPC ad generates \$.30, and the registration for the product demonstration is worth \$5.00, then the AOV would equal (\$.01 × 10) + (\$.30 × 1/10) + (\$5.00 × 1/100), or \$.18.
- **CLV** The CLV is the AOV multiplied by the number of times the average customer returns to a company's website without that customer having to be repurchased. If that customer returns four times without having to be prompted by another marketing campaign, then the CLV in our example is 4 × \$.18, or \$.72.
- **CPA** In the same way that a transaction-based company uses CM to calculate this metric, a media company must also calculate their target return to determine their target CPA. For media companies, the variable cost of delivering additional ad impressions tends to be very low. This allows the company greater flexibility to spend up to as much as the CLV to drive new visitors to the site and still generate incremental value for the business. This is because the contribution margin (CM) is positive up to the point where the cost of driving the last visitor equals the CLV. (See Wikipedia for more details on contribution margin.)
- **CR** The conversion rate of a media company can be segmented based on the different advertising models or based on the channel the company is using to market to prospective customers. For example, a company may use a display advertising campaign as part of its portfolio approach to driving traffic, where the average impressions conversion from advertisement to visitors is 0.1%.

For those campaigns, the conversion rate would be equal to the click-through rate on the advertisements, which is 0.1%. In the case of PPC campaigns, the calculation is different. The action the company is looking for in calculating its CPA may be to drive more visitors to its site. For a PPC advertising model, every click becomes a visitor, so the conversion rate is 100%. These differences in channels are important for media companies.

- **CPL** A media company may define a lead and a visit as the same, in which case the CPA and CPL are identical. If the company is using display advertising, its CR is the percentage of advertising impressions that converts to a visitor. In this case, the ad impression is the lead, so CPA and CPL are calculated with the CR.

How to Set a PPC Budget for a New Product

What if you're launching a new campaign and you don't have any data for your KPIs? How do you set your budget?

Google AdWords suggest the bids and a daily budget, but these are just their guesses. They have no idea of your average order value (AOV), close rate (CR), or your business model. Ignore their numbers.

To set the initial advertising budget for PPC, you'll need to calculate your CPL, as follows:

1. Estimate the amount of revenue you expect to make in one month. Use the minimum amount of revenue that you'll need to stay in business.
2. Guess at your close rate. For every 100 leads, how many will you convert into customers? Ten percent is fairly conservative. After a few months in business, you'll get better at selling.
3. Use your close rate to estimate how many leads you'll need to be able to make the minimum number of sales.
4. Calculate your target CPL. Talk with a few people with experience, make best guesses, and be conservative.
5. Multiply the number of leads by the target CPL. That's how much you'll have to spend per month to buy the leads you need.

For example, you want to sell 100 koi per month. You have a 50% close rate, so you'll need 200 leads to sell 100 koi. If the target CPL is $10 and you need 200 leads, you'll need to spend $2000 per month in marketing.

Watch your campaigns every workday. Yes, take weekends off. You need a break from all these numbers. Besides, you'll find from analytics that there are few buyers on weekends anyway. Try different ads and delete the ones that don't work. Keep your ad group's average CPL within your target CPL. It takes about four to six weeks to optimize a PPC campaign, so the numbers will fluctuate. The CPC will drop, so the number of clicks will increase. This means you'll get more leads. You'll get better at selling koi, so your close rate will improve. When your PPC account has reached optimal levels, you can recalculate your numbers. You'll know the actual CPC, conversion rates, and cost-per-conversion.

Work with your team to improve the close rate. Aim for a 30%–50% close rate. If you have a 50% close rate, see if you can get 75%. The more leads you close, the more results you get with the same advertising budget, so you can afford more for a CPL, which lets you buy yet more leads.

When you find it costs, for example, $12.53 to sell one koi, then in effect you know how much it costs "to buy a sale." You can then budget to buy the sales you want. If your sales team can only handle 20 leads per day, then budget what it takes to get 20 leads. There's no point in buying leads you can't handle.

How to Set a Budget for an Existing Product

If you have an existing product and you have data for the last six months (including number of monthly sales, AOV, CR, and CM), you can calculate your CPL as follows:

1. Set the target for monthly sales.
2. Use the KPI worksheet to calculate your target CPL.
3. Multiply the number of target sales by the target CPL. That's how much you'll have to spend to buy the leads you need. This is your campaign's monthly budget.

Again, watch your results for the first few months. Because this is an existing product in an ongoing campaign, we're assuming you have optimized your campaign. Nevertheless, you can try to improve your close rate.

The Breakeven Point

Another important concept is the breakeven point (BEP). This is the number of sales you need to cover your costs. In some situations, it has additional benefits for your business.

Let's say we set up a small workshop to produce koi food. We hire four people to mix vegetables locally grown by organic farmers joyfully singing their traditional harvest songs. We add up the costs, which include monthly rent on the building, salaries, cost of vegetables, macrobiotic mango juice for the workers, and so on. Let's assume the total costs are $4000 per month. If a bag of koi food sells for $50, then we need to sell 80 bags to make $4000 to cover our costs.

This means we don't make any profit at all on the first 80 bags. We might think we have a 40% profit margin, but that's a mistake. The first 80 bags have zero profit. They merely cover the costs. So $4000 is our monthly breakeven point.

A very curious thing happens with the 81st bag. The cost for the 81st bag is only the cost of a bit of vegetables and the shipping bag. The 81st bag's profit margin may be 95%. All of your additional bags after the breakeven point are practically pure profit.

This means once you've covered your costs, you should use every possible channel to sell. The more you sell, the quicker you reach the breakeven point and the sooner you go into the high-profits zone. If Koi-Planet is shipping 1000 bags of koi food per month at $50 per bag, with a 95% profit margin on 920 bags, it's making good money (take out your calculator and calculate those numbers). With such high profits, Koi-Planet can aggressively target the market. It can bring in a Danish gourmet chef to make deluxe koi food, open up a production plant in China, and set up distribution in the European Union.

We've sketched out a simple model of the breakeven point. There are additional details, including the marketing costs, CM, and so on. Again, talk with your finance team and develop a model that fits your company. This model works for companies with a high startup cost and a low cost-per-item. It also works for software companies, where the first few thousand sales cover the costs, and thereafter, it's basically free to create additional copies.

One of our clients sells a name-brand product that is used in Europe and the U.S. Many of you use it. It's great stuff. When we first met with their VP of Sales, we asked for the CPL. "Well, we haven't quite figured that out." We asked about their close rate. "We don't really know that either." So we paused for a moment and asked them about their sales strategy. "Oh, we just sell as much as we can!" Hey, that works. They had discovered the breakeven-point trick. By maximizing their sales, they reached the breakeven point, covered their costs, and had very high profit margins, which allowed them to grow explosively.

The Social Context of KPIs: Communicate Your Results

KPIs aren't just numbers. They help your career. At the director and C-officer level, KPIs are used to keep score. Your salary, bonus, and advancement will depend on KPIs. If you can define the KPIs, manage them successfully, and show that you reach your goals, you will do well.

You can consider several questions, such as how much improvement in the KPIs do I need to demonstrate success? How much revenue is produced by this KPI? What is the loss in potential revenue by not reaching a KPI? Can I get additional compensation based on my improvements in the KPIs?

A key question is to determine who controls a KPI. Who has the ability to make changes in strategies and tactics to improve the KPI? This can include the person who manages the channel, the webmaster, the graphics person, the sales team, and so on. By understanding and setting KPIs, you can give your team the direction they need to reach their goals, bonuses, and promotions.

When making presentations, keep your audience in mind. Are they owners, investors, directors, fellow managers, or your team? What do the KPIs mean to them? Which KPI matters?

These KPIs allow you to *measure marketing that makes money*. Marketing is no longer a mysterious hole in which we throw money and hope for the best. With AOV, CLV, CM, CR, CPA, and CPL, the finance and marketing teams will be on the same page.

KPI and Analytics in Your Marketing Strategy

This combination of financial strategies and software tools is changing the way to do marketing:

- With KPIs, we can calculate the proper amount of marketing spend to produce maximum profitability.
- With analytics tools, tracking URLs, and unique domain names, we can track campaigns in multiple channels, such as PPC (Google, Yahoo!, and Microsoft), radio, TV, and print, plus other channels such as bulk e-mail, SEO, link building, direct mail, billboards, catalogs, coupons, and so on. With the automated rules in Coremetrics, you can carry out thousands of campaigns in all of these channels.
- Through Google's global advertisement distribution platform, we can place advertising in multiple channels such as PPC, radio, TV, and print.

This lets you carry out multichannel marketing. You can use KPIs and analytics to compare the marketing channels against each other and find which ones produce the best results.

Conclusion

As you can see, analytics, SEO, and PPC aren't technical issues. They are at the heart of your business. By first establishing business goals and then defining the KPIs, you have the numbers that help you determine the limits for your campaigns and bids. You can set budgets and manage bids to get sales that produce the best profits. Just as you can optimize a website, you can optimize your sales. That's what this is all about: more leads and more sales.

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