Targeting profitability within Google Ads

.Adchieve

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In the past, when you started advertising on Google you would set a bid price and then await in anticipation of what would happen. If you wanted more visitors, you would increase the bid price for a click. The price per click was known for short as CPC, and it was this CPC that you targeted. The next thing you wanted to know was your return on all of this advertising spending and you started measuring conversions. This enabled you to calculate the average cost of one conversion and your “Cost Per Action”, or CPA for short.

A target ROAS is often used

Nowadays, many companies have gone a step further and use a target ROAS instead of a target CPA. In that case you don’t just look at the number of conversions, but also at the value of those conversions. ROAS stands for Return On Ad Spend.

Calculating the ROAS is fairly simple.
Let’s assume the following:

- You spend €50 on ads
- The turnover resulting from your ad is €1,000

In that case your ROAS is 1,000 / 50 * 100% = 2,000

As an alternative to the ROAS, sometimes the value / cost ratio is used. It is calculated by dividing the value by the cost. In the example above, the result would be 1,000 / 50 = 20.
In other words: your turnover is 20 times higher than your cost.

Google likes to push its own ROAS bidding algorithm

Whoever manages a Google campaign, is often instructed to achieve the highest possible turnover given a target ROAS. Google has capitalized on this fact by offering the possibility to work towards achieving a target ROAS in an automated way. With Google you can specify a target ROAS for each campaign if you have built up a minimum amount of data within that campaign.

A specific advertising option that Google offers these days is the socalled Smart Shopping campaign. It involves you setting a target ROAS. Google then gets to work for you by advertising not only within the Google search engine, but also within Google's Display and YouTube network. It's super easy, you hardly have to do anything yourself and Google manages the campaigns. Google also doesn't bother you with all kinds of details. For example, within a Smart Shopping campaign you won't get to see what keywords people have used to find you.

Do you entrust your money to Google?

Obviously there are some very smart people working at Google who can create great bidding algorithms, based on the information available to Google. On the other hand, however, Google is also the party that makes money from those very same ads. It's like giving your wallet to a car dealer and telling him to find you a nice, reliable second-hand car.

In the case of Smart Shopping campaigns, you hardly have any insight into what is happening. If you make a sale to someone who wound up on your website by searching for your own brand name, for instance, Google will allocate that sale to itself. And why wouldn't Google generate large numbers of clicks via the Display and YouTube network in order to build up a higher cookie share and claim more sales, without this actually amounting to extra sales?

Is ROAS really the holy grail?

Regardless of whether or not Google is impartial, though, you can ask yourself if Google has all of the information that is important to set your bids. There are many markets with specific characteristics and business models.

For instance, Google doesn't take the following factors into account when setting the bids.

- What if your product is almost sold out and you could easily sell the last few units without Google?
- What if the vacation accommodation that you offer is almost fully booked for the summer months?
- What if a few extra sales will entitle you to a big kickback from your suppliers?
- What if you make most of your turnover in physical stores and this turnover is not easily measurable or attributable to your Google campaigns?

The question therefore is whether ROAS is the right model to target. ROAS is not the same as profit. ROAS only tells you something about how much revenue you make in relation to your cost. In practice, however, products have different profit margins, some articles are returned frequently and others much less often. It's also possible that a customer isn't all that profitable in the short term, but could generate a lot of income in the long term.
The example below shows that a higher ROAS doesn't necessarily equate to higher profitability.

ROAS profitability

Good ROAS, negative net margin

	Conversion value	Ad Cost	ROAS	Gross Margin	Net Margin
Ad group A	€ 500,-	€ 25,-	20	€ 20,-	- € 5,-
Ad group B	€ 500,-	€ 50,-	10	€ 150,-	€ 100,-

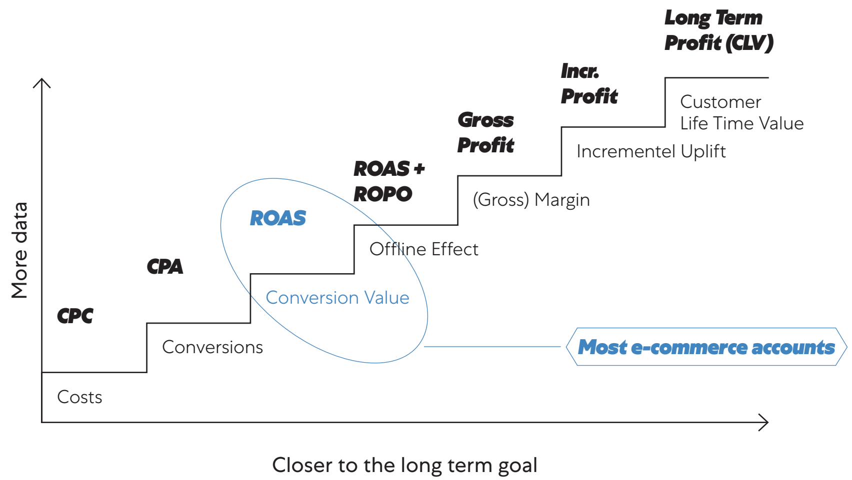
Less good ROAS, better net margin

The next step: using your own order data

Why not take the next step and target margins? Or why not also consider the ROPO effect (Research Online Purchase Offline) and directly target your campaigns based on the Customer Lifetime Value (CLV) of customers?

The following graph shows the development in the targeting of ad campaigns. Hereby you should keep in mind that the more advanced your targeting model is, the greater the amount of data needed to arrive at the right insights and bids.

Key Performance Indicators



An important source of information that advertisers have and Google doesn't, is the order data of their customers. That order data tells you who ordered what, for which amount, which products were returned, the brand of the products ordered and, for example, the payment method that a customer used.

The order data therefore contains a lot of information that makes it possible to calculate the margin per order. For example, based on the type of product or brand of the product you can determine what the purchase costs were, you can allocate shipping costs and payment costs, and when a product is returned you can exclude the related turnover from your actual turnover.

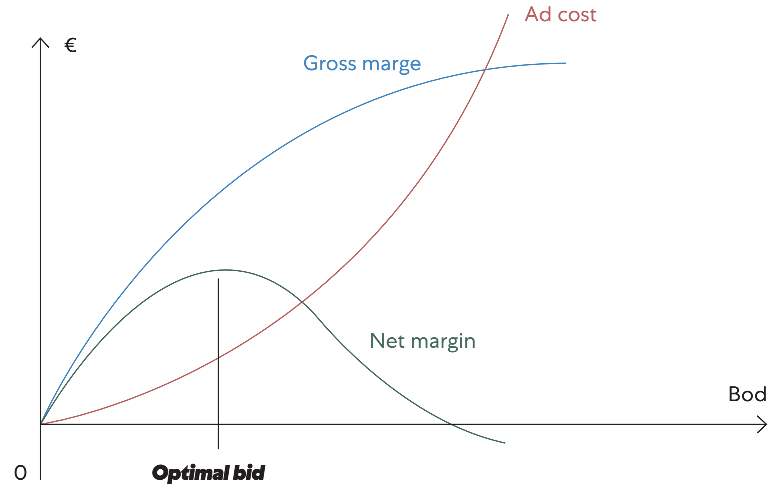
When you have allocated all costs, you can calculate the (gross) margin per order. You can then link the orders to the ads within your Google campaign.

This enables you to see exactly how much revenue the ad campaign has generated and how much it has cost (net margin). It also should be noted that you sometimes may sell a different product than the one that you advertised. That's something that also becomes clear using this method.

Maximizing margins through bids

If the net margins per ad group are clear, you can start aiming at maximizing that net margin. This is a similar process to determining bids when targeting a ROAS. Also in this case you'll try to take into account as many factors as possible that affect your final margin. And here too, data is combined across campaigns if necessary.

Over time, you can map the relationship between your gross margin (without advertising costs) and the height of your bid and the Google Ads costs that it entails. Then it's actually quite simple: you choose the point on the graph where you achieve the highest total margin, and this corresponds with a bid that you can set within Google.



If you want to go one step further, you can even consider looking not just at the current margin, but also at the Customer Lifetime Value of ads.

Connecting brilliant minds for next level data solutions

How does Adchieve help you to take the next step?

Adchieve is a data driven online marketing automation company. Our mission is to make online advertising efficient and successful.

With our software we automate the campaigns of our clients. In addition, we apply data science to ensure greater relevance and optimum results. Using a team of data scientists, developers and consultants, Adchieve creates tailor-made algorithms and campaigns for each unique business case. Currently, hundreds of companies are using ADchieve's tools and knowledge.

Adchieve works closely with various online marketing companies. In particular, we maintain close contact with Google. We are a Google Premier Partner and rank among the top Google API partners in the world.

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