

# Calculating Return on Investment (ROI) with CRM Software

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One of the most commonly asked questions by organizations both before and after implementing a CRM solution is, 'How do I know how much money CRM is saving me?' The ROI on any large business undertaking is an extremely important measurable. But just how do you go about calculating the ROI on something that can be seemingly transparent



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## 1.0 Introduction

One of the most commonly asked questions by organizations both before and after implementing a CRM solution is, 'How do I know how much money CRM is saving me?' The ROI on any large business undertaking is an extremely important measurable. But just how do you go about calculating the ROI on something that can be seemingly transparent at times?

A Return on Investment in purely financial terms has a very specific definition. It is simply a comparison of what was invested, against what was gained on the investment. This is the same "return" concept used in stock markets, such as a stock portfolio having return of 15%. To apply it to a CRM implementation has a few variables which cause a bit of uncertainty to the casual observer. Most of online web based CRM software / web-based SFA's revenue potential comes from a theory which is easy to rationalize but hard to prove. By increasing the value of your customers, you are in essence generating more business (and thus revenues) for your company. Customer retention is a critical part of the CRM solution, and it is sometimes difficult to tell just how the CRM project has helped your company in this matter. There are many steps to generating a fairly accurate portrayal of the ROI for your online web based CRM software / web-based SFA implementation.

### 1.1 First Step in Uncovering ROI

The first step and most critical is, define what metrics you need measured to weigh in on your ROI calculations. Make sure everyone within the company agrees on that definition, because you will likely find that opinions differ from finance, to marketing, to sales departments. However, some companies are unfamiliar with a direct customer contact business model in general. These companies may have a harder time accurately measuring an ROI.

As an example, there are cost reductions created by CRM implementation that are extremely easy to measure (talk time, call back percentage, time taken to solve cases, etc) and can be used to offset the cost of the CRM solution. But if the theory of CRM (improving customer retention and loyalty will increase customer value) is accurate, then the ROI for a CRM solution should also measure the likelihood of increased customer value in the future. To not factor this measurable into the ROI calculations would miss a potentially large offset to your CRM solution costs.

## 2.0 Generating Profitability with CRM

CRM can generate increased profitability for your business in two key ways:

1. Reducing costs, usually in a call center or distribution system. The measurement of this ROI is usually quite straightforward so long as you understand your current operating costs in detail.
2. Increasing customer value (Lifetime Value) through analytical CRM. ROI calculations in this category are usually a bit more complex, especially if your company doesn't have a prolonged history of tracking and applying customer data to generate increased revenues.

## 3.0 Understanding RFM

To be able to accurately measure the ROI on your CRM solution, you will need to understand the RFM model (Decency, Frequency, and Monetary value.) RFM is a behaviour-based model, meaning it is used to make predictions for the future based on the behaviour that a customer typically uses. The RFM model states three conditions:

1. The more recently someone has engaged in a particular behaviour, the more likely they are to repeat the same behaviour, especially if prompted
2. The more frequently someone has engaged in behaviour, the more likely they are to repeat the same behaviour, especially if prompted.
3. The more monetary value someone has created by purchasing, the more likely they are to continue to purchase, especially if prompted.

RFM has a precipitate: The more likely a person is to do something, the higher their response rate will be if you prompt them to do it. Customers who have engaged in a typical behaviour, such as purchasing or visiting, more recently, more frequently, or created higher monetary values are far more likely to respond to subtle prompting such as marketing efforts, compared to other customers who are less recent, less frequent, and create less monetary value.

If this is true, of course, the objective of any business should be to raise the RFM value of each individual customer. This is a critical step in assessing the ROI of your online web based CRM software / web-based SFA implementation.

### 3.1 Classic RFM Implementation

Classic RFM implementation will assign customers an RFM score, measuring their decency, frequency, and monetary value against all other customers. This score can be used to isolate and directly target your more profitable customers against ones who may actually be costing more to retain than they are putting back into your company. Customers with a higher RFM score will be far more likely to respond to promotions, and the inverse is true for a customer with a lower RFM score.

## 3.2 Web Based CRM & RFM Calculations

This being said, your online web based CRM software / web-based SFA solution will also introduce more revenue via marketing campaigns. This is another important part of RFM calculations - by measuring the recency of customer transactions and comparing it to the recency of marketing transactions, you will be able to quickly identify what marketing campaigns were successful with what customers, and which marketing campaigns failed with which customers. But most importantly, with enough data it should give you a good definition of why they worked or didn't work.

Assuming these scores have an economic value, the higher the RFM score, the more profitable the customer is. Following this line of reasoning, one can draw close ties between RFM scores and LTV. (Lifetime Value) LTV is the expected net profit a customer will generate for your business, for the duration of his/her lifetime as a customer of your company.

High RFM scores represent future business potential, because these customers have the highest probability of continuing to do business with you, and carry a high LTV. Inversely, a low RFM scoring customer represents falling business opportunity, and a low LTV. This indicates that something should be done to increase these customer's RFM scores.

Another variable which will measure into your online web based CRM software / web-based SFA solution will be doing just that - finding ways to increase your customers RFM scores, thus increasing the average customer's LTV. This will be made available by primarily compiling analytical data from your marketing efforts.

## 4.0 Evaluating Your Customer Base

The easiest way to evaluate your entire customer base is through usage of Hurdle Rate Analysis. In this case, "hurdles" are selected for Recency, Frequency, and Monetary value of customers, and the entire customer base is evaluated against them as a group.

A hurdle rate is simply the percentage of your customers who have met or surpassed a certain rate of recency, frequency, or monetary value. Because of the link between RFM and LTV, it can be concluded that:

- If the percentage of customers over each hurdle is growing over time, then the business is healthy and thriving. Customers are generally satisfied with their service and are more likely to engage in profitable transactions in the future.
- If the opposite is true, and the percentage of customers over each hurdle is falling over time, then the business is losing its high-profit customers, who are defecting elsewhere. Customers are responding negatively overall to the service they are receiving.

A business should expect a successful CRM implementation, due to the very principal behind the system promoting customer satisfaction and productivity. A successful implementation would result in rising hurdle rates, whereas an unsuccessful one will see falling hurdle rates. Finally, an implementation with no effect would produce neutral hurdle rates.

One of the most important things to remember about hurdle rates is that they are averages. While hurdle rate averages do generally indicate that business is either rising or declining in value, it does not tell the entire story. Sometimes, it is necessary to examine customers in segmented groups, or high-profile customers on a one-by-one case study basis, to find out how your online web based CRM software / web-based SFA solution has impacted their accounts specifically.

For those not familiar with the RFM model, the sequence of the words is intentional. Recency is by far the strongest value in terms of predictive importance, followed by Frequency and then Monetary value. Lacking the ability to track one or more of the measurable's, one should start with Recency, and then add the others as time or resources become available for use.

## **5.0 Ensuring Accurate Results**

A business with a lot of 'pollution' in its customer base should try to eliminate these from the database before compiling any meaningful analysis. For example, if there are a lot of one-time buyers, you should exclude these customers from your hurdle rate calculations. These customers tend to dilute the process by lowering the margin at which a "good" profitable customer resides at. This is also true if you have the inverse problem, in that a very small portion of your customer base creates far more transactions than the "average" customer would. A typical business with this issue would be one that generally deals in low-volume business-to-Consumer transactions, but does maintain a few high-volume business-to-business accounts.

If you are looking for a very definitive value for your ROI on a CRM solution, you will need to fully understand customer segmentation prior to implementing the CRM project. This knowledge will serve as a "control" or a standard with which to measure your future results against; the capability to definitively measure profit gains versus implementation costs. A simple way to accomplish this is to look at customer profitability overall both before and after the CRM implementation.

In some cases, of course, this will not be possible, due to the lack of customer data in an analytical state in a repository. In these cases the comparable ROI calculations may not be as completely precise, but the results that are generated should give a good indication of what your online web based CRM software / web-based SFA solution is actually generating in increased revenues, customer retention, etc.

## 6.0 Summary

The bottom line; is that a good on demand hosted CRM software implementation will always equal a high ROI. A CRM solution that works for your company will be easily customizable to scale with your company's future needs, and will provide a medium with which to fully understand your customer base with a 360 degree view of each and every one of them. Once this solution is implemented, the ROI calculations will almost always yield a positive value, sometimes in a matter of weeks after taking effect. As an example, when Ubisoft implemented their on demand hosted CRM software solution, they found a net ROI of 200% over 0.64 years. To most companies, on demand hosted CRM software is quickly becoming a much more lucrative investment than the bonds market.

As the old adage goes, 20% of your customers contribute 80% of your revenue, and with a proper CRM solution, there is no easier way to find and retain those customers.

## **7.0 Contact Us**

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## **8.0 More Information**

For more information regarding our products and services please visit our site at:

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