



# Measuring ROI in CRM

Customer Relationship Management  
White paper  
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An estimated \$6.8 billion will be spent this year on customer relationship management, or CRM, by retail financial services institutions, an amount that is expected to grow at nearly 14 percent a year for the next several years. While there seems to be no evidence of a significant slowdown in CRM spending, many financial services institutions are beginning to question what they are achieving with the investments they are making.

The difficulty in measuring progress stems from an unclear understanding of where the institution started and what the measure for customer management performance was before these investments were made. Lacking this baseline, many firms adopt simple measures of performance that are often based on program or departmental activities, such as call duration, cross-sell ratios, or campaign response rates. The baseline of comparison is often anecdotal. While these are not inappropriate measures, they fail to acknowledge the interdependency of CRM strategies and the alignment of business processes across the enterprise that must take place for an organization to truly center its strategies around customers.

ROI analysis is used to determine if an investment has produced the desired impact. Return on investments includes cost savings as well as revenue growth, but the process of developing an ROI analysis produces other benefits as well by requiring that the institution consider other investment variables such as intangibles and assumptions, risk, and timing.

- **Intangibles and assumptions.** Intangibles are often benefits about which management is unable or unwilling to make assumptions. Simple assumptions can convert intangibles into economic returns and cause important and revealing dialogue.
- **Risk.** Risk is inherent in the benefits, in the assumptions used to solidify intangibles, and in the CRM project itself. Discount rates are often used to mitigate risk in the ROI analysis.
- **Timing.** Timing establishes milestones for spending, for benefits, and, hence, for return on investment, but more importantly it establishes expectations for management.

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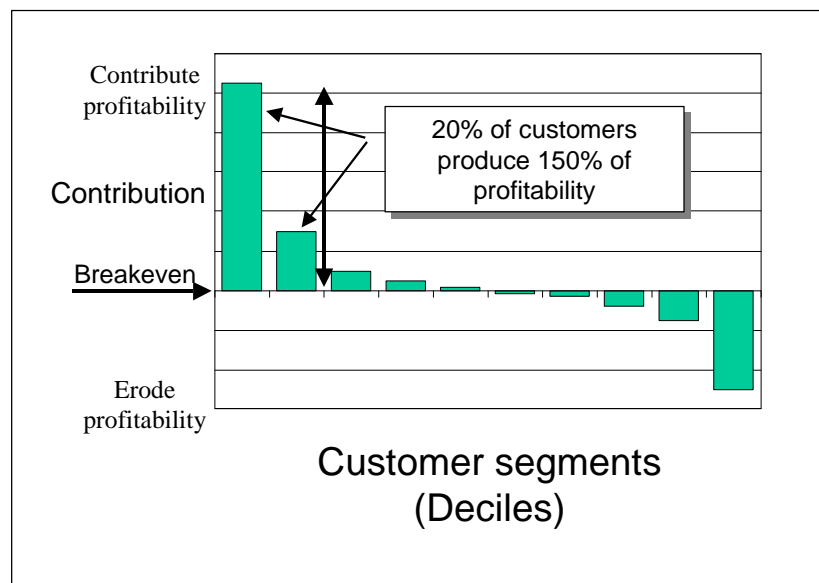
The business of business is to generate shareholder value from customers. Many would say this is also the definition of CRM. Traditional business education teaches us that shareholder value is derived from products and services. Financial services firms, therefore, have targeted their CRM programs on enhancing products and on reducing costs in customer service.

This may be because cost benefits are often based on experience, have clear origins, and a proven “cause and effect” and so can be reasonably precise. But revenue benefits are often based on unsubstantiated anecdote, with little or no experience and often imprecise origins.

At Meridien Research, we believe customers drive shareholder value. Customers determine both revenue and cost by their choices, by their behaviors, and by how those behaviors consume resources. What we may not have considered before is that shareholder value is determined almost entirely by the types of customers a company attracts. We believe this provides new impetus for getting CRM right.

When you accept that customer behavior, not a product or service, determines a company’s shareholder value, it quickly becomes apparent that the objective of a CRM strategy is to influence that behavior. And because customers are not equally profitable, shareholder value is determined almost entirely by the types of customers a company attracts. Too few of a firm’s customers exhibit the behaviors that contribute to long-term value. Not all customers are created equally, nor will each customer provide an equal return for the same investment (Figure A shows the unequal distribution of customer profitability).

**Figure A: Customer Contribution to Profitability**



Source: Meridien Research

CRM thus becomes an investment in targeting the right type of customer, getting those customers to adopt a specific set of beliefs and consequent behaviors, and retaining those customers throughout the lifetime of their profitability. Without the ability to measure shifts in these behaviors over time, a firm cannot determine the efficacy of its strategy, decision-making, or supporting investments.

To measure the return on CRM investments, then, we need a set of tools that can address the following six tasks:

1. Identify targeted behaviors.
2. Measure the impact of shifting those behaviors.
3. Size the investments accordingly.
4. Categorize and segment customer behaviors for analysis and treatment.
5. Track customer performance against goals.
6. Adopt a common language...
  - ...for comparing alternative investments.
  - ...for setting priorities.
  - ...for measuring progress.
  - ...for connecting “cause and effect.”
  - ...for testing assumptions.

We believe activity-based costing (ABC) provides the best foundation for calculating customer profitability for CRM. Activity-based costing calculates resource usage based on transaction type. A specific transaction consumes a determined, fixed amount of resource and so can be used to distinguish between different patterns of usage from one customer to another. As such, ABC can identify shifts in behaviors by watching patterns in the resources consumed. Shifting customers to more profitable behaviors is a goal for most CRM programs. For more information on activity-based costing, consult Customer Knowledge report “Putting ABC into Customer Profitability,” Volume 4, Report 1, September 27, 2000.

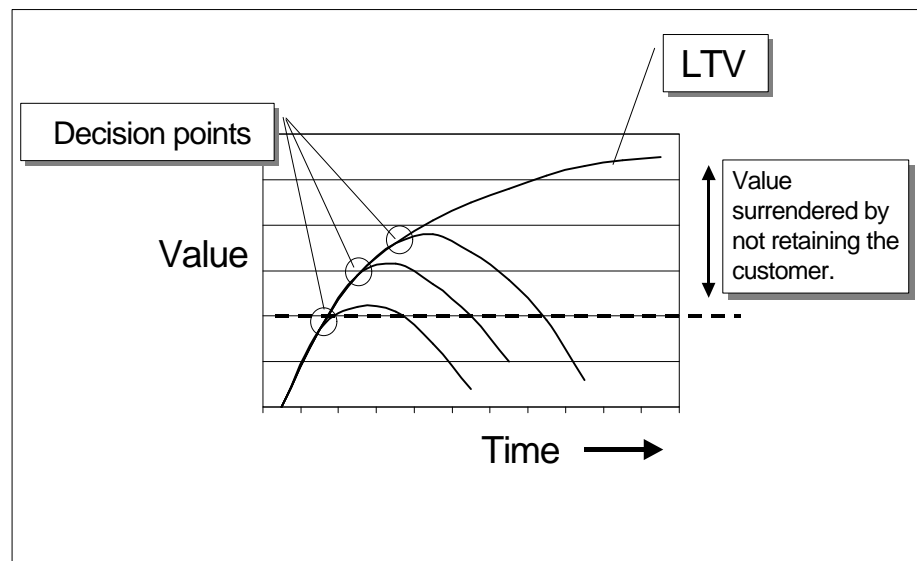
Human psychology is slow to accept change, and it may take considerable effort to get customers to behave differently. A more effective CRM measure would take this into account and consider a customer’s value over time.

Customer lifetime value (LTV) provides the needed tool and builds on ABC by extending the net profit of a customer into the future for as long as the customer is expected to remain with the firm (we introduced this topic in our November 1998 Customer Knowledge report “Event and Life Cycle Management”). Shareholder value is thus the sum of the lifetime values of all a firm’s customers, and this value can shift because of

the firm's CRM programs. Also known as "customer equity," it provides a basis for measuring the return on investment for CRM.

If the lifetime value of a customer can be projected, the firm can quickly determine the maximum amount to invest to develop the relationship. LTV analysis can also indicate windows of opportunity inherent in the life cycle of each customer in which the financial services firm can anticipate customer needs (life insurance at age 34, for example). It can further indicate the most likely path that a customer will follow while doing business with the firm—the strategic value of the customer. And it can indicate those points in time in which the customer is faced with the decision to remain with the company or go elsewhere—every four years for an auto loan, but once a year for car insurance, for example (see Figure B). Once the path is mapped out, the actual value of the customer can be compared to the strategic value at any point, and decisions can be made as to why the planned and actual vary. ABC can quickly expose the source of the differences.

**Figure B: Retention and Customer Lifetime Value**



Source: Meridien Research

Once the tools are in place and agreements reached on goals and objectives, financial services institutions can begin to answer the questions needed to determine ROI.

- How far can the baseline be lifted?
- How much investment is warranted to accomplish the goal?
- How much "goal" is required to support a proposed investment?
- How well did the firm perform against its goal?
- What investments should be made first? What ones second?

Some might argue that there is nothing new here. We at Meridien Research would agree, but this answer falls short of answering the question as to why more firms have not employed these basic tools. **We believe the reasons are several, but for many, it was urgency and a process that made it easier to buy CRM than to plan for it. Many are still waiting for software to produce the benefits.**

Many managers of financial services institutions are still endeavoring to understand what CRM is truly about, let alone what constitutes customer profitability and how to measure it at any given point in time. We believe that CRM is about shaping customer behaviors, and not simply about enhanced customer service and cost saving. Once a firm understands its customer base (who they are and how they behave), it can begin to segment its customers into groupings that reflect profitability. Using ABC and LTV, it can quantify shifts in behavior through patterns of resource usage and extrapolate this over time. This then forms a basis from which to target customers, develop custom programs and content, and measure the contribution of its CRM efforts—the “cause and effect” that is so important for the ongoing tuning of a CRM program.

Any examination of ROI results in observations and tactics for how to manage and improve it. While ROI is important, it is the process and dialogue associated with developing it that provides the important business benefits.

A framework for measuring return on CRM investments and steps for getting started are included in Meridien Research’s Customer Knowledge and Customer Interaction report “Measuring ROI: Yardsticks for Managing Successful CRM Strategies,” Volume 4, Report 4, March 27, 2001. An online “Lifetime Value calculator” is also available for use in association with the report. The calculator can be used to observe the influence of several variables on customer LTV and net present value, and to help familiarize the user with LTV calculations and drivers.

### **About Meridien Research**

Meridien Research of Newton, MA, provides analytical research services to users and providers of financial industry technology. The firm targets three technology areas of strategic importance to financial services firms: e-Financial Services, Trading & Risk Management, and Customer Relationship Management. Each practice delivers twelve reports a year, detailing new issues and challenges. Visit [www.meridien-research.com](http://www.meridien-research.com) for more information.