It takes money to make money.

Know your numbers!

by Mark Smith, CEO, inConcert Web Solutions, Inc.

Over the last forty plus years I've owned and managed a media company, a printing company, and now a web development and marketing agency. I have discussed sales and marketing strategies and goals with countless business owners. In the course of these discussions some of those business owners have wanted to talk about their return-on-investment (ROI) for the money they were spending on our services.

I learned quickly (although not quickly enough) that one of the most important things these owners needed to know was that only THEY could accurately determine their ROI -- I could only provide half of that equation. I could tell them how many touches, views, or leads we were providing, but I couldn't tell them how much money they were making. One of our main goals now at inConcert is to ensure that our clients have the systems in place to confidently answer any ROI questions about their sales and marketing investment.

What exactly is ROI and what's the best way to figure it out?

Typically, ROI is the ratio of a profit or loss made in a fiscal year expressed in terms of an investment and shown as a percentage of increase or decrease in the value of the investment during the year in question.

The basic formula for ROI is:

Net Profit / Total Investment x 100 = ROI%

$$\frac{\text{Net Profit}}{\text{Total Investments}} \times 100 = \text{ROI\%}$$

For this exercise, our main objective is to determine the amount of gross revenue generated by your sales and marketing expenses, so we'll call this sales return on investment (SROI). It is up to you to determine your profit margins on your actual sales to determine the actual goal numbers required to be profitable. If you know your profit margin or net profit numbers, you can easily substitute these numbers with your gross sales numbers to get a true ROI number.

Our modified formula for SROI is

Gross Sales / Total Investment x 100 = SROI%.

$$\frac{\text{Gross Sales}}{\text{Total Investments}} \times 100 = \text{SROI\%}$$

In almost every case, the business owners I've spoken with were not able to put a number on two critical metrics needed to determine ROI: customer acquisition cost and lifetime value of customer. Most of the time they just guessed or had a "feel" for what those numbers were. Knowing these numbers is critical for helping a company make decisions on what to spend for marketing and where to spend it. You cannot determine your ROI without these numbers!

I have learned that it is crucial to gather metrics that reveal:

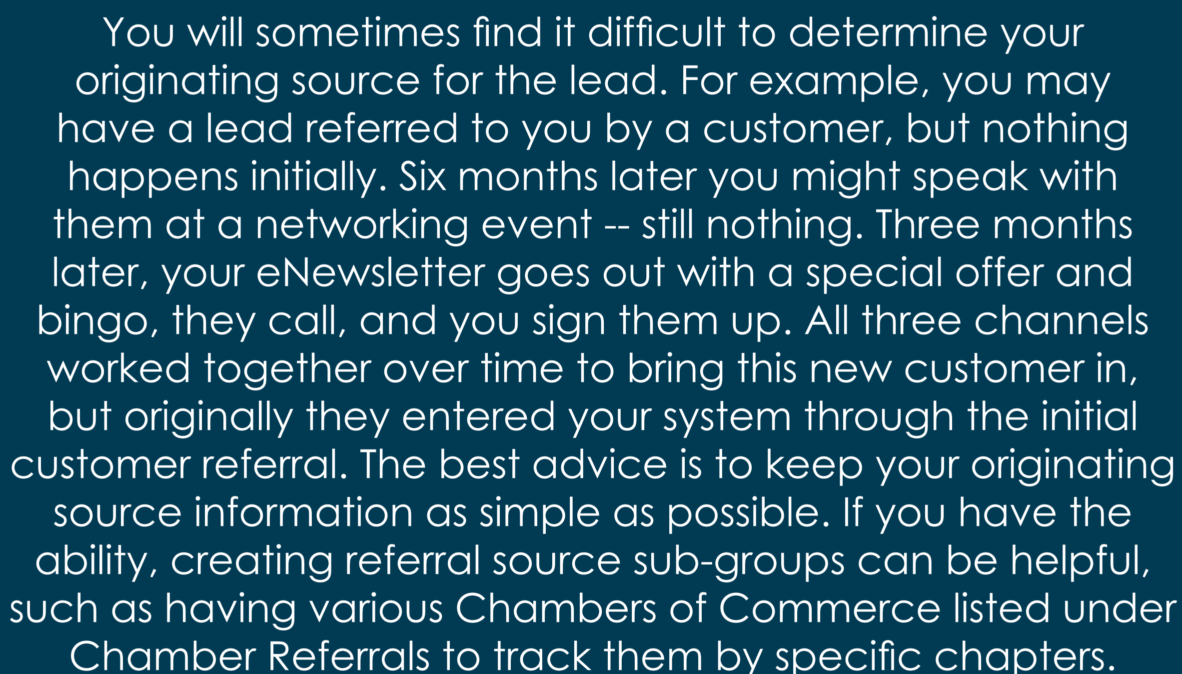
- how a prospect came to us
- when they became a customer
- how much it cost to get that customer
- how much that customer will be worth to the company over their lifetime

Having access to this kind of information has helped us make educated and successful decisions over the 16-year history of our business. Over the years, our methodology has evolved from a shotgun-style marketing approach to systematically collecting and analyzing the metrics listed above, enabling us to focus on the most profitable marketing channels and strategies for our company.

Here are the four steps to our proven ROI process:

Step 1 - Determine your client's **Original Referral Source.**

Be sure a process is in place to continually gather and record this information. When a prospect becomes a customer, the referral source should be entered into your CRM and in a reportable field within your accounting system. Create a primary list of lead sources (such as customer referral, networking, and website lead, to name a few) and use them consistently so that when multiple individuals collect and enter this data there is no ambiguity or confusion that can affect the accuracy and reliability of your reporting.



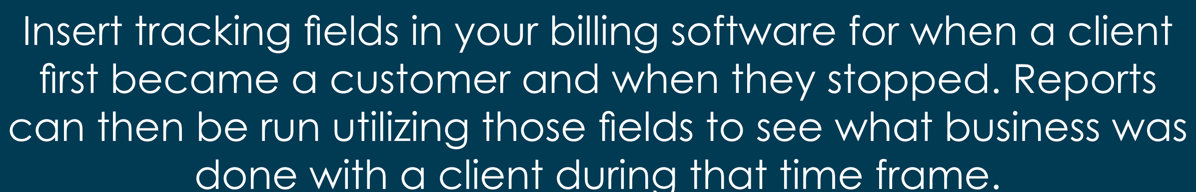
You will sometimes find it difficult to determine your originating source for the lead. For example, you may have a lead referred to you by a customer, but nothing happens initially. Six months later you might speak with them at a networking event -- still nothing. Three months later, your eNewsletter goes out with a special offer and bingo, they call, and you sign them up. All three channels worked together over time to bring this new customer in, but originally they entered your system through the initial customer referral. The best advice is to keep your originating source information as simple as possible. If you have the ability, creating referral source sub-groups can be helpful, such as having various Chambers of Commerce listed under Chamber Referrals to track them by specific chapters.

Step 2 - Know the **Lifetime Value (LTV)** of your Customers.

In short, how long were they a customer
and what was their total customer revenue?

Ideally, knowing when a customer started and ended and capturing this information in your accounting software enables you to run reports to determine LTV. There is an averaging that goes on here regarding the difference between existing/ongoing customers and former customers. Also, you may not want to include new customers in your research. If you've had an influx of new customers in the last year or two, that can drive down your overall lifetime average. If you have enough data that goes back far enough, determining the lifetime value of accounts that have been customers from, say, 2008 to 2016 (leaving out the last few years) will give you a more accurate idea of your clients' lifetime. If you have a good feel for the average lifetime of your customers, (let's say 8 years), you can use that number to determine the value of relatively new clients by multiplying their annualized sales volume by the eight years.

$3,000 in annual sales x 8 years = $24,000 Lifetime Value.



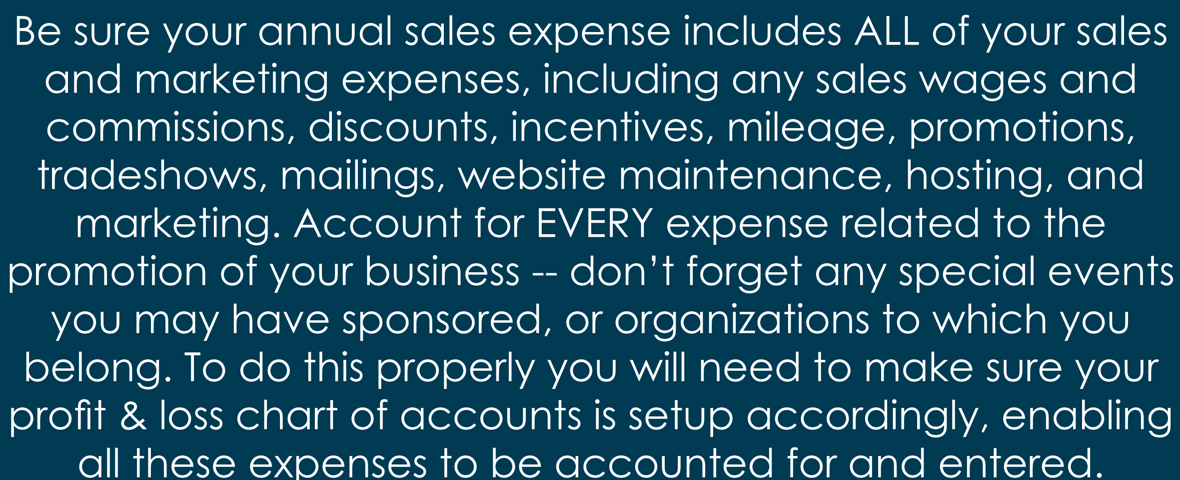
Insert tracking fields in your billing software for when a client first became a customer and when they stopped. Reports can then be run utilizing those fields to see what business was done with a client during that time frame.

Step 3 - What is your **Customer Acquisition Cost (CAC)?**

Take the total of your sales & marketing expenses for the year and divide it by the number of new clients for that year and you will have your customer acquisition cost.

Example: 2017 Sales and Marketing Expenses:
$50,000 / 50 New Customers = $1,000 CAC.

This is where good tracking comes into play. We utilize an account-numbering system that includes the year they became a customer; e.g. 2017-23 would be our 23rd new customer entered in 2017. In most cases you can go back into your accounting system and assign this number based on when they first became a customer. Once you've assigned the account numbers to each client you can run a report to determine how many customers you added each year, then divide that into your sales expenses for each year and you will have a year-by-year history of your customer acquisition costs.



Be sure your annual sales expense includes ALL of your sales and marketing expenses, including any sales wages and commissions, discounts, incentives, mileage, promotions, tradeshows, mailings, website maintenance, hosting, and marketing. Account for EVERY expense related to the promotion of your business -- don't forget any special events you may have sponsored, or organizations to which you belong. To do this properly you will need to make sure your profit & loss chart of accounts is setup accordingly, enabling all these expenses to be accounted for and entered.

Step 4 - Determine your **Sales Return on Investment (SROI).**

Compare your Customer Acquisition Cost (CAC) to your Lifetime Value (LTV). Depending upon your type of business, this number can vary significantly.

Lifetime Value: $24,000.00 less CAC of $1,000.00 = $23,000 Gross Sales Profit
Gross Sales Revenue: $24,000 / $1,000 Customer Acquisition Cost = SROI: 24:1
To summarize, for every $1.00 you spend you receive $24.00 in sales = 24:1 SROI
If you have a 30% profit margin then for every $1.00 spent you make $7.20 in profit.
The net value of your $1.00 investment is now $7.20, a 720% ROI.

How to calculate profit margin

1. Find your revenue (how much you sell goods or services for).
2. Find your COGS (cost of goods sold)
3. Calculate the gross profit by subtracting costs from revenue
4. Divide gross profit by revenue: $20 / $50 = 0.4
5. Express it as percentages: 0.4 * 100 = 40%

Sales Revenue $_________ less Cost of Goods Sold $_________ = Gross Profit $_________

Gross Profit $_________ divided by Sales Revenue $_________ x 100 = Profit Margin % _________

Know your budget and what you should be spending. The U.S. Small Business Administration (USSBA) recommends spending 7 to 8 percent of your gross revenue for marketing and advertising if you have less than $5 million a year in sales and your net profit margin — after all expenses — is in the the 10% to 12% range. If your sales and/or profit range is higher, then your budget should be, too.

Bonus Metrics

These numbers can be very helpful for determining exactly how many leads you need to meet your sales goals:

Determine your Lead to Customer Ratio (LTC).
How many leads does it take to get one customer? Most businesses I talk with indicate they acquire one customer from every three to five leads. Knowing your lead-to-customer ratio can be very helpful, particularly when you have determined your acquisition and value costs as well. For example, you may find that your conversion rate or acquisition cost is much higher for customers that come to you via social media advertising, but that those customers have a much higher lifetime value. This additional data will help you in determining your marketing channel focus.

Determine your Costs per Lead and your Lead Value.
This is fairly simple once you have your customer acquisition cost. If you've determined your CAC is $1,000.00, and you have a 4:1 lead-to-customer ratio, then your cost-per-lead is $250.00. If each new customer is worth $24,000 LTV than each lead is worth $6,000! I know it sounds crazy, but if you know that 4 leads on average turns into one customer worth $24,000 to your company over 8 years, then the leads have a $6,000 value. So value your leads, follow-up with them, and keep marketing to them!

Bonus Metrics

Determine your Conversion and Close Rates.

a. How many leads inquired in some way about your services? (Raw Lead #)
b. How many leads requested a quote? (Lead Conversion Ratio)
c. Of those quotes, how many placed an order? (Close Ratio)
d. How many leads became immediate customers without a quote?

After gathering this data for some time you can determine your customer conversion rate. Example: you received 20 leads to which you provided 8 quotes; 4 of those became customers and placed an order. So your close rate is 50% and your customer conversion rate is 20%, meaning for every 20 leads, 4 became new customers. This can help you determine how many leads you need to meet your sales goals.

Knowing this metric could be huge for you. For example, you may find that a higher percentage of customers you get through your website or a customer referral usually don't request a quote. They may have a greater need for quality customer service and are willing to pay whatever it takes without you having to provide a hard quote every time you do a job. These types of customers are usually preferred and could help you in targeting a specific marketing channel. Sometimes the detective work can be fun and eye opening.

Important Tools to Consider

Customer Relationship Management (CRM) Software
This is critical, particularly for tracking sales activities, leads (remember, each lead is worth X number of dollars to you), client marketing, lead origination data, and the time and financial investment to acquire those leads.

Project Management Software
Important for time management, cost tracking, open order sales volume, as well as providing the tools necessary to handle the production management side of your business. Keeping good PM records will assist in project reviews to ensure proper quoting, billing, and profitability down the road.

Accounting Software
In addition to the obvious requirements such as invoicing, financials, paying bills, managing A/R and A/P, payroll, etc., accounting software is critical for tracking client sales history, lead sources, sales person assignment and reporting, and so on.

Better data for better decisions.
Determining an accurate ROI on your marketing investment takes a little homework and some disciplined record-keeping. But once you have a system in place and the appropriate software applications to support it, determining your ROI will become much easier.

From understanding where your leads came from and how many became customers, to how much your customers are worth and how much it cost you to get those customers – you'll be armed with the data that will help make some of those tough marketing decisions a little bit easier. We all know the saying "It takes money to make money," the question is, how much money does it take? If you go through the process I've outlined here, I'm confident you'll have a much better idea. Please feel free to reach out to us here at inConcert with any questions you may have. I look forward to the opportunity of helping you and your business succeed.