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Management Update: Ten Tips on How to Lower Your CRM TCO

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A Review of 251 Client CRM Initiatives Provides Insights

Gartner's recent review of 251 CRM initiatives revealed that 71 percent of enterprises claim to have completed a TCO assessment and 60 percent of enterprises calculate a TCO of only one or two years. However, most enterprises do not account for all costs within their CRM initiatives, so they risk underbudgeting.

Costs for CRM projects vary greatly, depending on many assumptions and estimates about the projects. Many enterprises do not understand the components of a CRM TCO model, and, by calculating only a one- or two-year TCO, enterprises miss several of the costs.

A one- or two-year TCO is not a TCO at all. Rather, such "short time frame cost estimates" represent the acquisition or purchase cost for the projects. Gartner estimates that these enterprises miss as much as 65 percent of the costs in the latter years of their projects. Many enterprises neglect ongoing support costs in the later project years and leave several cost components out of the calculation.

Through 2008, enterprises that complete CRM TCO models for time frames of only one or two years will underestimate the costs of their CRM programs by 35 percent to 65 percent (0.8 probability).

To prove value from CRM initiatives, a TCO must also be balanced by a process for defining and measuring benefits to prove their return on investment (ROI).

Here, Gartner assists enterprises in understanding what TCO consists of, provides guidelines on what to budget by category and, most importantly, suggests the most effective actions enterprises can take to lower TCO.

TCO Defined

Calculating a TCO for CRM is complex. It involves a holistic assessment and is an all-encompassing collection of the costs — including capital investments, license and maintenance fees, direct and indirect labor expenses, training costs, and travel and expense (T&E) — that will be incurred throughout the life cycle of the CRM program. It includes costs wherever they occur in the enterprise (in sales, marketing and service), as well as costs for the IT and technology components of the program. Costs during each phase of the project or program should be included (for example, planning and acquisition, deployment and management, and ongoing support).

Gartner recommends that TCOs be completed for at least a three-year time frame, but best practice dictates taking a longer-term view and completing CRM TCOs for a five-year time frame. Enterprises that use shorter time frames run the risk of lack of support for the long term, which is unrealistic when investing in CRM.

Components of a CRM TCO

The standard categories of cost follow.

Software License. This includes the CRM software that will be placed on desktops, laptops and mobile devices, as well as the server license fees associated with the software. All third-party software and server license fees should be included (such as database, application server, security software and integration software). For example, in a sales force automation (SFA) initiative, in addition to licenses for salespeople, which includes opportunity management system (OMS) and forecasting, it may be necessary for an enterprise to license a sales methodology and embed it into the OMS. The license cost for all software types that will be needed to render a production implementation must be included.

Software Maintenance. Maintenance costs are generally a certain percentage (15 percent to 25 percent) of the list or discounted price of the software. Unless negotiated otherwise, these are yearly payments made to vendors, above and beyond the initial software cost. Maintenance generally entitles an enterprise to bug fixes, upgrades and access to the software vendor support desk. Vendors generally do not include entitlements to new functions and modules not originally licensed. If you customize base software, you may need to budget for additional maintenance, because standard maintenance usually applies to the software as delivered prior to customizations.

Hardware. This includes laptops, handhelds, desktops, servers and other peripheral hardware, plus the associated maintenance costs for the upkeep of these items.

Telecommunications. These are costs associated with data and voice connections that result from the project. Some enterprises include in their CRM TCOs the cost of services above and beyond that which the enterprise is already incurring; others consider costs in this category as necessary to conduct business and do not directly charge these costs to CRM projects.

External Service Providers, or ESPs. This category includes the costs for all of the services provided by consulting, systems integration and outsourcing vendors. Services include the configuration of the technologies, as well as the strategy planning, design and training, change management and business process consulting in support of CRM initiatives.

Software Vendor Professional Services. This is similar to the ESP category and includes all of the consulting services provided by software vendors' consultants. Services include design reviews, configuration reviews, technical service reviews, and developer and end-user training.

Internal Staffing. Internal staffing consists of the business, technical, financial and help desk personnel assigned to the CRM project. Be sure to include the fully burdened cost (including all fringe benefits beyond the employees' base salary) of each resource assigned to the project — for example, the personnel who will be needed to maintain the solution after initial acquisition.

Other. This category involves TCO costs that fall outside the above categories to cover errors and omissions made during the project estimation process and as the assumptions and business conditions change during project execution. Examples of costs that many companies include are project contingency, real estate, additional and ongoing training, and T&E.

Building Your Own TCO

When developing a TCO model, include initial acquisition and ongoing support costs.

- Initial acquisition costs will typically range from 55 percent to 65 percent of a five-year CRM TCO.

- Ongoing support costs are the costs an enterprise will incur beyond acquisition, which typically make up 35 percent to 45 percent of the total five-year CRM TCO.

- Generally, costs incurred in Year 1 and Year 2 will be acquisition-related; Year 3 through Year 5 (or beyond) will be the ongoing support and maintenance related costs.

Figure 1 provides a sample CRM TCO (see Figure 1). Figure 2 shows the percentage breakdown of the costs (see Figure 2). (These TCOs are representative, and the costs indicated are for illustration purposes only.)

Figure 1

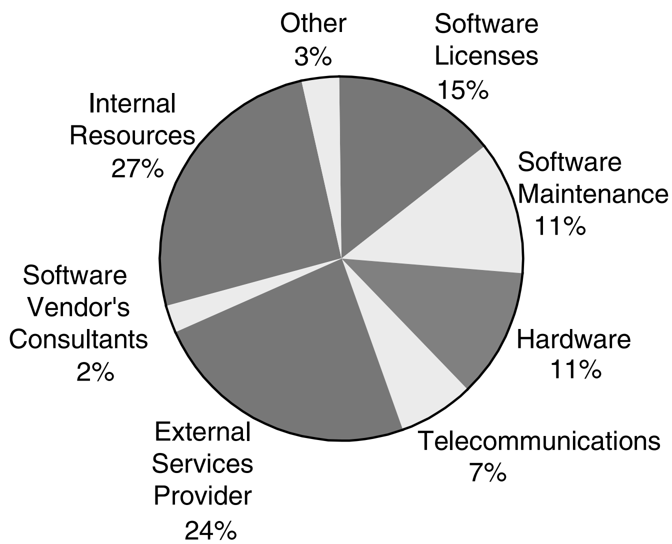
Sample CRM Five-Year TCO (enterprise revenue >$1 billion; 2,000 to 3,000 users; seven models of a CRM suite)

TCO Category	Year 1	Year 2	Year 3	Year 4	Year 5	Five-Year Total
Software Licenses	$1,500,000	$2,000,000	—	$750,000	—	$4,250,000
Software Maintenance	270,000	684,000	$684,000	820,000	$ 820,000	3,278,000
Hardware	1,120,000	1,000,000	500,000	400,000	250,000	3,270,000
Telecommunications	60,000	475,000	550,000	450,000	375,000	1,910,000
ESP	3,100,000	2,200,000	1,500,000	—	—	6,800,000
Software Vendor's Consultants	70,000	500,000	—	100,000	—	670,000
Internal Resources	750,000	2,000,000	1,500,000	1,800,000	1,500,000	7,550,000
Other	250,000	300,000	150,000	150,000	75,000	925,000
Total	$7,120,000	$9,159,000	$4,884,000	$4,470,000	$ 3,020,000	$28,653,000
Percentage of Project Cost	25%	32%	17%	16%	11%	100%
Phase	Acquisition	Acquisition	Support	Support	Support	

Source: Gartner Research (May 2004)

Figure 2

Sample CRM Five-Year TCO Cost Percentages, by Category



Source: Gartner Research (May 2004)

In the TCOs Gartner reviewed, a high variability was noted in what is included and excluded. External services represent the single highest cost category and ranged from 25 percent to 35 percent. Total labor costs (internal and external resources) account for nearly half of total CRM project costs.

Trends in CRM TCO indicate that most enterprises are not including all of their telecommunications costs, and fewer than half of the TCOs Gartner studied included all of the hardware costs in their CRM TCOs. Many enterprises are counting costs such as these as “enterprise infrastructure” costs and are not allocating them to their CRM projects. As you build your CRM TCO, use the following recommendations to plan, manage and lower your overall CRM TCO.

Recommendations on CRM TCO

1. Plan Ahead. For planning in Year 3 and beyond, enterprises should designate:

- 15 percent to 20 percent of overall project costs per year to keep the system running (keeping up with bug fixes and point releases)

- 20 percent to 25 percent per year to achieve competitive parity (bug fixes, point releases and minor functionality increases)

- 25 percent to 40 percent per year to achieve competitive advantage (bug fixes, point releases, version upgrades, major additions in functionality, modules or changes in technical architectures)

2. Don’t Purchase All Licenses Immediately. Purchase only what is needed to get the project going for the pilot or initial implementation. Spread the cost of licenses into Year 2 and beyond, purchasing licenses as needed to support the expansion beyond a pilot or initial implementation. That will help to decrease costs early in the project and move the costs out to years when they will correspond to the rollout and to the benefits (see “Unused CRM Software Increases TCO and Decreases ROI,” SPA-19-4655).

3. Use Caution When Looking at per User Costs. Per user costs are not the metric by which enterprises should solely make evaluation and selection decisions, because enterprises have different strategies, customers and ways of doing business. CRM is first a business strategy and second a technology that is purchased and deployed to enable that strategy. Realize that not every CRM module is sold on a per user basis. For example, modules (such as marketing or analytics) are sold based on the number of contact and prospect records, or they may have server-based pricing. Gartner urges caution when evaluating per user costs because they may be useful in some circumstances, if they're used carefully and compared correctly.

4. Software Licenses Are a Small Percentage of Overall Project Cost. The largest elements are the service costs: ESP, internal and software vendor. To reduce these costs, you should staff the project with an appropriate number of internal resources throughout the project, especially after Year 2. The fully burdened cost of internal resources is generally less than the cost of external consultants. To further decrease services costs, train your internal staff as early in the project as possible, so they can perform most tasks, including upgrades. Ensure that knowledge transfer is conducted throughout the project so that, as internal employees learn, they can assume more of the work as the project progresses, thereby decreasing your reliance on consultants earlier, rather than waiting until the end.

5. Clarify the Benefits to Justify the Cost of the Upgrade. Don't just upgrade for the sake of adopting new technology.

6. Allocate 10 Percent to 15 Percent of the Overall Cost in Contingency Funds. This should cover the errors and omissions made during the project estimation process, as well as additional training required and the costs for specialist consulting firms, such as technical infrastructure consultants.

7. Budget for Internal Resources — Which Aren't Free. Some organizations do not account for internal labor costs when considering CRM projects. Their philosophy is that they are paying their people whether they do the project or not, so that a project's labor is basically "free." This is dangerous because labor is not "free."

Most enterprises complain that they're understaffed. Undertaking a CRM initiative will require using employees or consultants to do the project. When your internal resources are working on your CRM project, they're not performing other important tasks. Backfilling your permanent employees with "new" employees or temporary workers will cost money. It's a best practice to include the fully burdened cost of at least the incremental resources (internal and external labor) required.

8. Account for Ongoing Maintenance. Once the initial project has been "implemented," your internal employees will have to maintain the system throughout its life cycle to perform bug fixes, maintenance, upgrades (for software and hardware) and so forth. This means that you must plan for ongoing life cycle management and for internal staff to be "on" the project in the later years. At a minimum, the best practice is to plan the fully burdened cost for each employee (or consultant) whose job it is to perform ongoing operations and maintenance in Year 3 through Year 5.

9. Realize That Training Is Not a One-Time Exercise. In addition to planning for initial training for all employees (and, potentially, customers and business partners), you need to schedule ongoing training. For example, if you're rolling out an SFA solution to your field sales representatives, you should offer refresher training at periodic intervals. Because employees come and go during the life cycle of a CRM program, you should plan for "new hire" training as an ongoing cost.

10. Consider Cost Allocations. In the categories of hardware, software and telecommunications, consider assigning a percentage of the cost of some items to "enterprise infrastructure." For example, if you buy automated software-testing tools for the CRM project, you could use it for subsequent projects as well. Working with your finance group, you could agree to allocate only 50 percent of the cost to CRM and the remainder to enterprise infrastructure.

Key Facts

- CRM TCO is a holistic assessment of all the costs of the initiative over its entire life cycle.

- When building a CRM TCO, think of costs from two perspectives: initial acquisition costs and ongoing support expenses.

- Estimate costs for each TCO category and document the assumptions that correspond to each estimate.

- Realize that a TCO is not static; it should be continually updated to reflect changes to monitor program costs throughout the life cycle.

- TCO is a powerful framework for assessing costs, but it is misleading when used alone. It must be balanced by an equally rigorous framework for assessing benefits.

Bottom Line

- When a TCO model for CRM is to be used as a project analysis tool, consider initial and ongoing costs during the planned life of the project.

- Evaluating license and initial implementation fees alone will not provide a true estimate of the cost to the enterprise.

- Through 2008, enterprises that do not take a holistic approach to figuring their CRM TCOs will exceed their CRM budgets by 35 percent to 65 percent (0.8 probability).

- TCO is a powerful framework, but it can be misleading when used as a stand-alone value metric.

- Through 2006, project managers who build an accurate TCO model to guide CRM project decisions will increase their chances of success by 30 percent (0.8 probability).

- Despite the importance of a proper TCO assessment, enterprises must push past TCO to construct a return on investment model, which Gartner will cover in future research.

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For related Inside Gartner articles, see:

- “CIO Update: Use Creative Cost Containment,” (IGG-10012003-01)