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## **If You're Not Using RFM, You MUST Read this!**

Arthur Middleton Hughes is Vice President / Solutions Architect for The Database Marketing Institute, Ltd. ([www.dbmarketing.com](http://www.dbmarketing.com)). He is also the author of *Strategic Database Marketing* 3rd Ed. (McGraw-Hill 2006), and he has done considerable work with RFM models. Mr. Hughes reports:

*It often comes as a shock to people new to direct marketing that the response rates are so low. Successful, profitable promotions often result from sales to 2% or less of the mailed universe. Database marketers, today however, are finding that they can greatly increase these response rates in marketing to their existing customers by use of Recency, Frequency, Monetary (RFM) analysis. The results are nothing short of amazing. Let me give you one example.*

*An educational products company in the South had a two million name customer database, built up from sales over a five year period. Every spring they mailed their entire list with an attractive video offer which regularly got a response rate of about 1.3%. It did not produce much profit, but moved a lot of product. Last year, one of their marketing officers went to a seminar where he learned about RFM. On his return he directed his programmers to code the customer database for RFM, creating 125 RFM "cells". He did a promotion to a representative test sample of 30,000 which produced a net loss. From that test, however, he learned the response rates of each of the 125 "cells". For his rollout, he mailed only 554,000 of the two million who were in the 34 cells that did better than break even on the test. The result: a response rate of 2.76% and a net profit of \$307,000.*

Mr. Hughes' experience is not unique. All across America, database marketers are waking up to the gold mine in their customer databases that can be opened up using RFM.

### **How RFM Works**

RFM has been used in direct marketing for more than thirty years. It is based on both a priori reasoning and empirical evidence of customer behavior. People who have bought from you recently are much more likely to respond to a new offer than someone who had made a purchase in the distant past. This can easily be illustrated by anyone with a customer database that includes purchase history in every customer record including the most recent discretionary purchase date. The database is sorted by that date, and the top 20% (in terms of recency) is given a code of "5". The next 20% in terms of recent purchases is coded as "4", etc. Everyone in the database now is a 5, 4, 3, 2, or 1 in terms of recency.

## **Frequency Is Less Powerful**

If your database keeps track of the number of transactions with your customers, you can also code your customers by frequency. Sorting the database by this number – from the most to least frequent, coding the top 20% as “5”, and the less frequent quintiles as 4, 3, 2, and 1.

You will notice right away that frequent buyers respond better than less frequent buyers, but the differences are much less pronounced than those for Recency. That is why RFM is RFM instead of FRM or some other combination.

## **Monetary Is Almost Flat**

When you code customers by the total dollar sales (average by month, year, or since the beginning of time) giving the big spenders a “5”, and the others, 4, 3, 2, and 1, you will get a response rate that shows differences between quintiles, but they are far from as dramatic as those for Recency. Is this true for all products and services? Not necessarily. Response does not measure ability to respond as much as willingness to open the envelope and read the contents.

## **Putting the Three Codes Together**

RFM analysis depends on recency, frequency and monetary measures, but the real power of the technique comes from combining them into a three digit RFM “cell code”. Using the quintile system explained above, all customers end up with three digits in their database records. There are 125 different “cells” in all. If the coding is done correctly, all cells will have virtually identical numbers of customers. Using these three digit codes you can turn any test into a highly profitable rollout.

## **New RFM Service Can Improve Your Profits**

RFM provides a qualitative measure for selecting customers, even when they are not part of recognized school systems. Bob Stimolo, President of SMRI in connection with Arthur Hughes, has developed an affordable RFM service that can easily be applied to your customer file. It’s designed to cut mailing costs and improve profits. If you would like to learn more about this service call Bob Stimolo at 1-800-838-3444, x205 or email [rstimolo@smri-inc.com](mailto:rstimolo@smri-inc.com).

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