Return on Community: Proving the Value of Online Communities in Business

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SYSTEMS™

Today, many companies are implementing Online Communities to drive greater value from their e-business initiatives. They understand that Online Communities address ongoing business challenges in many ways, including:

- **BUILDING LOYALTY AND COMMITMENT ON THE PART OF CUSTOMERS, SUPPLIERS, OR OTHER BUSINESS PARTNERS**
- **PROMOTING INNOVATION THOUGH BETTER SHARING OF BEST PRACTICES AND OTHER INFORMATION**
- **DRIVING EFFICIENCY IMPROVEMENTS ALONG THE SUPPLY OR DEMAND CHAIN**
- **GENERATING REVENUE GROWTH THROUGH HIGHER SALES OR TRANSACTION FEES**
- **PROVIDING INSIGHT INTO THE OPINIONS AND EXPERIENCES OF CUSTOMERS OR PARTNERS**

Nevertheless, companies seldom calculate the impact of their Online Communities in economic terms. This prompts the question: Are these benefits really being achieved? Like any other business initiative, Online Communities must be measured to be successful. At Participate Systems, measurement and reporting is an integral part of our community management services. It is common for our clients to achieve positive return on investment (ROI) on community in the first year of operation, as illustrated in the scenarios presented in this report.

This report is the result of a recent analysis of community value creation across our client base. In the following pages, we combine client-specific data with data from industry studies to create scenarios for e-business in both the business-to-business (B2B) and business-to-consumer (B2C) sectors. The scenarios demonstrate the value of Online Community and illustrate methods for measuring this value. The purpose of this report is to help you think about the ways Online Community can address your ongoing business challenges.

Defining Online Community

Online Communities are groups of businesses, customers, or employees with common interests interacting via the Internet. Online Community programs enable members to create something that all other members can see and respond to.

Online Communities take many forms, but they generally include four types of programs. These are identified below, along with some of the most common examples.

MEMBER-GENERATED CONTENT

- Profiles/Home pages

- Product ratings

- Product reviews

MEMBER-TO-MEMBER INTERACTION

- Discussion forums

- Technical forums

- Question and answer forums

EVENTS

- Guest events

- Expert seminars

- Virtual meetings/trade shows

OUTREACH

- Newsletters

- Volunteer/leader programs

- Polls/surveys

Of course, communities consist of people, not programs. In an e-business environment, community members can include customers, suppliers, distributors, or other parties. Some take an active role in the community, contributing to discussions or providing assistance to other members. This is what we refer to as participation. Other members simply read what others have posted without taking an active role themselves. For community managers, encouraging involvement is called driving conversion.

In almost every case, the more participation that occurs in the community, the greater the value created for both members and community creators. However, the value of conversion should not be underestimated. In most communities, readers outnumber posters by 10 to 1 or more. That means people who visit a community regularly but do not post typically represent 90% or more of the total community population. Perhaps more important, passive members may be actively using the information they gain. For example, in a B2B setting, they may be learning about best practices that will help them generate top-line results. In a B2C environment, they may be purchasing products based on what they learn in the community. The fact is, their involvement often produces economic results for the community creator.

The scenarios presented in this report are based on community conversion. Usage and purchase patterns for individuals converted to community members are then used to compute the economic value created by a community over a single year.

How Online Communities Create Value

We divide Online Communities into three segments: B2B, B2C, and employee-to-employee (E2E). The segments differ in terms of member composition and business objectives.

Although the segments are distinct, they have two themes in common: relationships and insight. Both are critical to long-term success in e-business, and neither will result from the purely transactional approach many companies have adopted. In a business-to-business community, closer and more effective working relationships are the primary aim of Online Community efforts. These are not platitudes — close relationships can translate into substantial cost savings as well as increased revenues from better coordination in inventory management, logistics, sales, and marketing. Success comes from driving conversion and participation. A supply chain community, for example, drives more value if three quarters of the company's suppliers are online rather than one-half. It is more productive still if participating suppliers conduct three-quarters of their business online instead of one-third. These are the types of benefits quantified in this report.

Insight may be the most underestimated and unexploited benefit of the Internet economy. The conversations between suppliers and distributors contain priceless market and customer intelligence, not to mention insights into process bottlenecks that create inefficiencies. In a retail setting, the rewards can be equally great. Online Communities enable a deep, ongoing conversation with the 20% of customers who drive 80% of a company's business. Insights from these customers can be used to produce profitable new products and a more satisfying experience for customers. While the benefits of insight are not quantified in the following pages, they play an important role in the overall value created by Online Communities.

Online Community Member Composition and Business Objectives

	B2B	B2C	E2E
MEMBERS	Customers, suppliers, distributors, etc.	Customers	Employees
OBJECTIVES	Strengthen relationships with trade partners and customers	Increase stickiness (customer loyalty) and viral marketing (word of mouth)	Strengthen working relationships and coordination among employees
	Actively listen to gain insight into issues and opportunities in real time	Actively listen to gain insight into issues and opportunities in real time	Foster knowledge sharing (best practices) to drive process efficiency and innovation
	Foster knowledge-sharing to drive process efficiency and innovation	Reduce cost of customer acquisition and drive higher transaction levels	Improve company communications

Measuring the Value of Online Communities

The scenarios in this report demonstrate the significant value that Online Communities create for e-businesses. They depict the economic value that an Online Community adds above and beyond what the business would generate without a community. To calculate this benefit we measured the additional value that a community member represents in comparison to the average site visitor. For example, if the average community member purchases twice as much per month as the average user, then the business generates more revenue with a community than it would without one. Average site-visitor data such as usage and purchasing behavior were compared with data for community members to calculate the impact.

The impact of community was analyzed for four different business models:

- B2B Demand Chain
- B2B Net Market
- B2C Commerce
- B2C Subscription

Scenarios developed for each model are presented in the following pages. Client-specific data was combined with data from industry studies to complete the scenario for each model. These scenarios enable us to demonstrate the benefits of community without compromising the confidentiality of client data.

Each scenario presents the impact of community across a wide range of conversion rates. Active Online Community management practices are aimed at driving these rates higher, thus producing higher returns. Communities that are not actively managed typically exhibit very low conversion and participation rates, and therefore produce limited return.

The scenarios incorporate very conservative assumptions, and in each case omit additional ways in which Online Communities create value. For each scenario, we explicitly identify the benefits that we have not included in the calculation. Each scenario measures the benefits of an actively managed community in two ways: the additional (or "incremental") value of community in revenue terms and ROI in community.

SCENARIO 1: B2B DEMAND CHAIN

Scenario 1 measures the incremental value and ROI from the implementation of an Online Community in a B2B demand-chain environment. This scenario depicts the benefits that accrue to a company creating an Online Community for its network of 750 independent resellers.

The scenario assumes that the members of the network represent a normal distribution in terms of performance. To portray this distribution, we segmented the resellers into three tiers. The average sales of each group differ by $20 per square foot of selling space. Twenty-five percent of the resellers are in the high-performance tier ("leaders"), and 25% are in the low-performance tier ("laggards"). Each reseller has 10,000 square feet of selling space. Leaders average $370 per square foot in sales, middle resellers average $350 per square foot, and laggards $330. Therefore, stores in the leading tier realize $3.7 million in revenues, average stores realize $3.5 million, and laggards realize $3.3 million. The scenario shows the economic impact of best practice sharing among community members, which results in some participants moving up one tier in sales per square foot.

The community's ROI varies based on the community conversion rate; that is, the more members of the group who become involved in the community, the greater the ROI. Higher conversion rates are the product of active management of Online Communities. The ROI

B2B Demand Chain Scenario: Incremental Value/ ROI in Managed Community
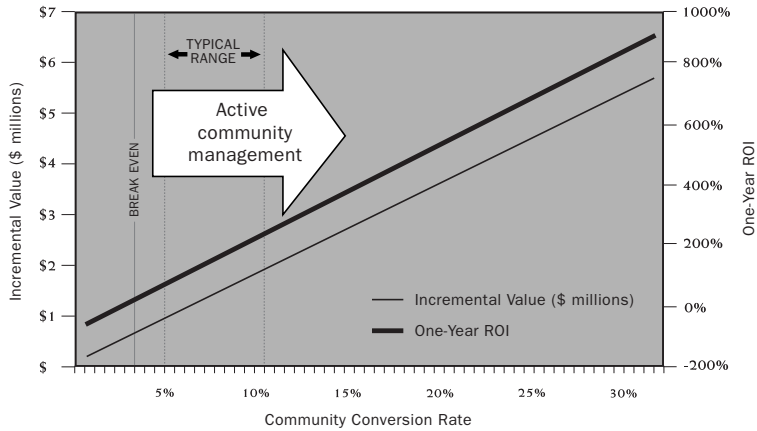
The scenario represents the impact of reduced customer acquisition costs as a result of referral activity by community members. Assumptions include a customer-acquisition cost of $125,000 per customer — a conservative assumption based on current data for publicly held net markets. The scenario also assumes that each community member refers two new companies to the market over the course of the year and that one-quarter of these referrals result in new market members.

calculation includes hardware and software costs (one time and ongoing), community strategy development costs (one time), and the ongoing community management costs.

The analysis shows that a B2B e-business with an Online Community conversion rate of 7% will generate almost $1.3 million in additional revenue. With the community host earning 15% of the incremental sales volume, active community management generates an ROI in excess of 125%.

This scenario does not measure the benefits of the closer relationship that forms between the community host and the resellers, resulting in higher retention rates. It also does not incorporate the benefits that active listening can create for the company, nor the process efficiencies that community collaboration can create.

Higher ROI occurs with higher rates of conversion, which are associated with active community management. The ROI calculation includes hardware and software costs (one time and ongoing), community strategy development costs (one time), and community management costs (ongoing).

As shown here, a B2B net market will accrue more than $1 million in incremental reduced customer acquisition costs at a community conversion rate of approximately 7%. At the same conversion rate, ROI is more than 130%. The incremental value and ROI in this analysis result from avoided customer acquisition costs through referral activity undertaken by community members.

This scenario understates the quantifiable benefits of community. It does not account for the increased

SCENARIO 2: B2B NET MARKET

Participate Systems' B2B net market scenario measures the incremental value and ROI resulting from the implementation of an actively managed community in a B2B net market. The scenario assumes a 100-member B2B net market in which the member base grows 200% in one year.

**B2B Net Market Scenario: Incremental Value/ ROI in Managed Community**
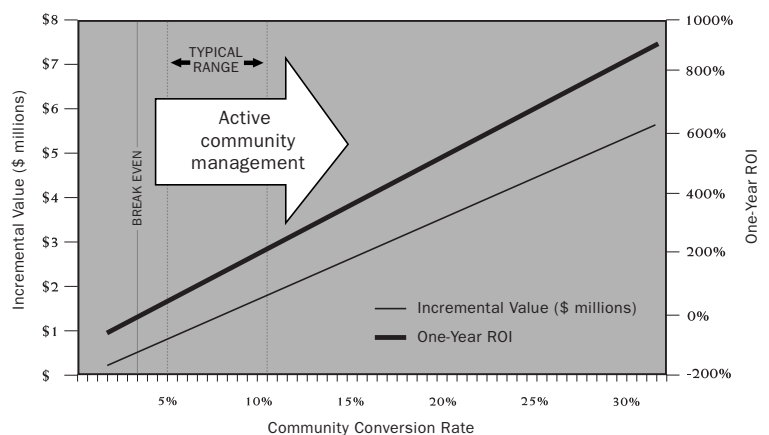
customer retention that is a key benefit of active community management. It also does not account for the revenue stream from those customers acquired through community.

SCENARIO 3: B2C COMMERCE

Participate Systems' B2C sales scenario measures incremental value and ROI from the implementation of managed community for an e-business selling products to consumers through its Web site. The scenario assumes traffic levels of 10 million unique visitors per year.

The scenario assumes a unique-visitor-to-buyer conversion rate of 2.5%, the Internet average. Assumptions

B2C Commerce Scenario: Incremental Value/ ROI in Managed Community
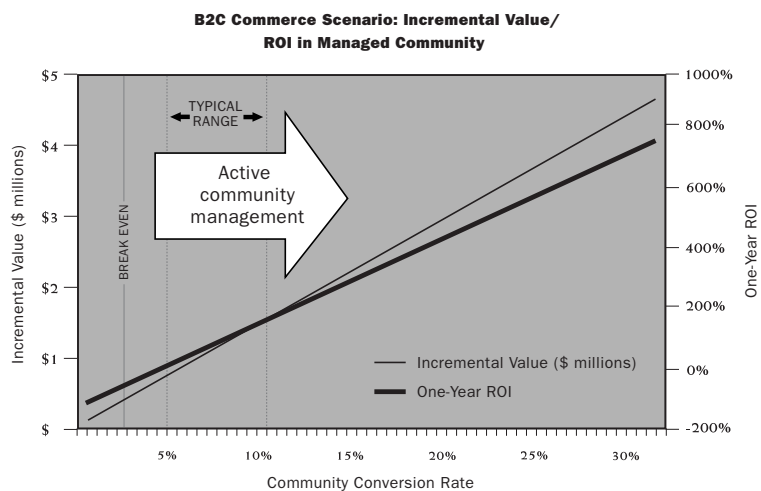
also include an average product purchase of $50 and a profit margin of 20%. Internet averages were used to derive a 7.25% rate for return visits following a purchase, and a 1.5% rate for return visits resulting in a purchase. The average value of repeat purchases is estimated to be 50% higher than first-time purchases, based on a conservative adjustment to Internet averages. It is important to note that return customers in all likelihood convert at a much higher rate than first-time buyers, although this is not incorporated in the scenario.

ROI results again vary based on the community conversion rate. Higher conversion rates are associated

with active community management. The return on investment calculation again includes hardware and software costs (one time and ongoing), community strategy development costs (one time), and community management costs (ongoing).

The analysis shows that an e-business engaging in product or service sales with 10 million unique visitors annually will generate well over $1 million in incremental revenue through a managed community offering that achieves a community conversion rate of at least 7%. With an estimated profit margin of 20%, the business achieves a one-year ROI of more than 90%. Incremental value and ROI result from the incremental increase in usage and purchasing activities of community members relative to average site visitors.

This scenario understates the benefits of Online Community in two ways: it omits the benefits of viral marketing, and it does not account for the increased likelihood of purchase on repeat visits by community members.

SCENARIO 4: B2C SUBSCRIPTION

Participate Systems' subscription revenue scenario measures incremental value and ROI for an e-business generating revenue through subscription sales. The scenario assumes traffic levels of 10 million unique visitors to the Web site annually. It also assumes a base subscription price of $10, an average subscription life of one year, and a profit margin of 80%. The scenario incorporates a unique visitor-to-buyer ratio of 2.5%, which is an Internet average. Based on Participate Systems' experience, community members are likely to remain subscribers to fee-based services an average of 50% longer than non-community members.

The following graph, "B2B Subscription Scenario," shows a range of results based on changes in the community conversion rate. Higher conversion rates are associated with active community management. The ROI calculation includes hardware and software costs (one time and ongoing), community strategy development costs (one time), and community management costs (ongoing).

**B2C Subscription Scenario: Incremental Value/
ROI in Managed Community**

The analysis shows, for example, that an e-business with 10 million unique visitors that generates a community conversion rate of 7% will realize more than $1 million in incremental revenue resulting from the incremental increase in usage and subscription rates of community members relative to the average site visitor. The managed community implementation results in a one-year ROI of more than 90%.

This scenario understates the quantifiable benefits of community in two ways. First, it does not account for the increased traffic that results from the viral marketing activities of community members. Second, it does not incorporate upselling of more expensive offerings to community members, resulting in higher average revenue per subscription, per month.
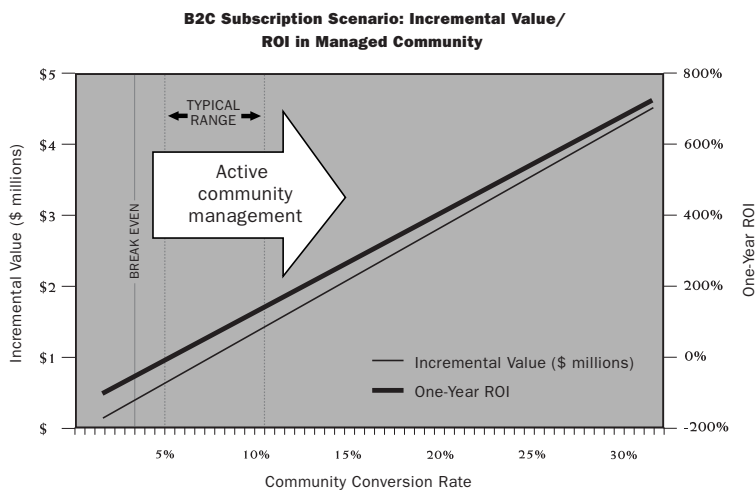
Conclusion

To date, most e-businesses have focused their resources on "Day 1"— putting in place their e-business infrastructure. Now many are beginning to address "Day 2"— what it will take to use that infrastructure to drive value. This transition has fueled the growth in Online Community development that has occurred over the past 12 months.

To make these communities successful, companies will need to set quantifiable objectives and have a process in place to track progress and measure success. This report suggests various ways for companies to think about and calculate the economic value of their communities.

Recognizing the value of communities is only part of the solution, however. As the scenarios illustrate, successful communities require active management. Most companies lack experience in community management. They will have to find partners who offer the requisite expertise, processes, tools, and infrastructure to get the job done. Speed is also critical. It is much easier to attract customers to a community in the first place than to entice them to leave a community where they have already formed strong relationships. Companies who hope to build Online Communities should begin today.

About Participate Systems

Participate Systems drives sales effectiveness for Global 2000 companies through its Participate for Sales™ solution, comprised of enterprise software and management services. Participate Systems' enterprise-grade technology captures experience-based knowledge and best practices from top sales professionals and puts this information to work for an entire sales force. Participate

Systems' software can be deployed independently or integrated into portals, sales force automation tools, and other enterprise platforms. The company's clients include Cisco, IBM, Microsoft, SAP, and the Wm. Wrigley Jr. Co. Founded in 1997, privately held Participate Systems is headquartered in Chicago. For more information, visit www.participate.com.

Research at Participate Systems

The Community Research Group (CRG) keeps Participate Systems at the leading edge of Online Community in business. In the coming years, wireless, broadband, and other technologies will provide new ways for communities to interact. Users too will drive innovation by adopting new software applications and devising more creative uses. In this rapidly changing world, the CRG conducts field research, surveys, and other projects that help drive continual innovation in our services to clients. The CRG also makes its findings available to the general public through research reports, white papers, articles, and conference presentations. Please visit Participate Systems' Web site (**www.participate.com**) for access to CRG reports and white papers. For information on research partnerships, contact us at **researchpartners@participate.com**.

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