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[Headline]

Learning What Customers Value

[Subhead]

*The first in a series of six white papers
on the topic of
“Managing Customer Value”*

[Inside front: Overview, acknowledgements - pg. 2]

[Subhead] *About This White Paper*

This is the first in a series of six white papers that provide an overview of the customer value management process. The topics covered in this series include:

- #1: *Learning who your customers are and what they value* (this white paper)
- #2: Selecting customers carefully and increasing their value
- #3: Designing products & services that deliver the desired value
- #4: Designing effective sales & service channels
- #5: Recruiting & training employees to deliver & increase customer value
- #6: Building customer retention through the constant refinement of the value proposition

Executive Summary

There are many types of corporate databases, but none as important as the customer file. Not only do today's customers provide revenue, they can also help you predict and build long-term profitability. In many cases, a significant portion of your future profits will come from selling new products or services to your current customers. The success of these new offerings depends largely on how well you know your customer base.

Successful long-term marketing is *customer-centric* — that is, it analyzes and acts on the motivations and behaviors of customers. Furthermore, it recognizes that not all customers are equally valuable to the organization. Some customers are highly profitable while others actually cost you money. The wise marketer will measure the value of each customer and will apply different, but relevant, strategies to each.

For a large and diverse customer base, the process of managing customer value is not simple or intuitive. It requires an interdisciplinary effort known as *Convergent Marketing* — it requires the careful, step-by-step use of methods designed to make all marketing programs truly customer-centric. For this process to work properly, all tools and methodologies must be driven by customer needs and behavior, *not* products or services.

The first, and most the important part of a customer-centric approach is a powerful database. Most corporate databases are transaction-oriented, not customer-oriented. Enterprise-wide data warehouses are designed to deal with summary-level information and are unable to access, link or analyze customer-specific data.

Marketing should be customer-centric. Effective marketing is a one-on-one interaction with every member of its audience. It's about appealing to individual tastes and needs — but only you know the *details* of those tastes and needs in advance.

A true customer database is customer-centric. It is able to *profile* customers by capturing, tracking and analyzing their demographic, psychographic and historical details. It can also identify groups of customers — or *segments* — that have key factors in common and will likely respond in a similar fashion.

There are six milestones in implementing a customer-centric solution:

- #1: BUILD a database by importing and enhancing data.
- #2: PROFILE the similarities & differences of customers.
- #3: IDENTIFY true customer value.
- #4: SEGMENT the customer base.
- #5: DETERMINE lifetime value.
- #6: REFINE segments and marketing strategies.

Customer databases are specifically designed with powerful statistical capabilities and the ability to process and modify massive amounts of data. This allows marketers to run fast, ad hoc analyses and find relationships in the data that would not otherwise be apparent. This leads to new insights into customer motivation and behavior.

This white paper focuses on understanding value from two different perspectives: 1) What do your customers value and want from your organization? 2) How can you evaluate and manage the value of your organization's customers, to mutual benefit? Subsequent white papers will examine how Convergent Marketing translates that knowledge into company-wide programs that maximize the value of your customers.

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Introduction

Everyone seems to agree — finding and keeping good customers is the essence of successful marketing. As a result, direct marketers spend massive amounts of money and effort to acquire and retain customers. They rent lists, build databases, conduct focus groups, test promotions and analyze the results. In the end, however, they may still have only a vague idea of why their customers do business with them.

Understanding your customers through-and-through is absolutely essential. In today's highly competitive marketplace, marketers are increasingly emphasizing *customer-centric* methodologies, as opposed to the traditional focus on product or service offerings. That's because *there are really only three ways to grow a business*:

- Get customers
- Keep customers
- Grow customers

Many companies spend a lot of effort and money on *acquiring* customers and not nearly enough on retaining and growing their existing customers. This is unfortunate because it's almost always more profitable to sell to your existing customer base than it is to acquire new customers.

Consider this: As a rule of thumb, 20% of your customers generate at least 80% of your revenues. However, revenue doesn't always equal profit, so you must go deeper into your database to identify the most profitable customers. With this clear understanding in hand, you're prepared to answer many crucial questions:

- How do I retain my most profitable customers?
- Can I convert my second most profitable tier of customers into the top tier?
- What factors indicate a good customer?
- How can I use these factors to identify hot prospects?

This customer-centric approach reflects the concept of *managing customer value*. Not all customers are equally valuable to you — some generate high profits while

others actually cost you money. It's critical to measure the true value of each customer and to tailor your approach accordingly.

Convergent Marketing

At its core, marketing has always been a matter of creating and maintaining one-to-one relationships with customers. For small businesses, it's still possible for customers and vendors to know each other on a face-to-face basis — for example, the local coffee shop waitress who immediately knows what you want when you order “the usual.” However, when the clientele climbs into the thousands or millions, this detailed understanding of customers is generally lost.

Convergent Marketing is based on six principles that can help companies shift their focus from a traditional product-centric approach to a more effective customer-centric approach. It also helps integrate technology, training, and data enrichment services with a goal of developing and maintaining an intimate, one-to-one marketing relationship with its customers. The benefits of Convergent Marketing are not just limited to the marketing function; it also helps the entire organization to focus on the customer.

To implement a customer-centric approach, you need to commit to an analytical, data-driven effort that focuses on customer needs and behaviors. Three basic types of data are necessary:

- Demographics — identifiers and “vital statistics”
- Psychographics — lifestyle or attitude data
- Historical — purchasing and customer service contacts

A special kind of technology is required to collect and analyze this data — a *marketing database*. These databases are specifically designed to process immense amounts of customer-specific detail. That is why a true customer database is absolutely essential to any customer-centric marketing effort.

[Graphic AA (“Placing customers at the center”) - supplied by CIC]

[Caption: “Convergent Marketing recognizes that customers are your greatest asset and that you must put them at the center of your business plan.”]

Choosing a Customer-Centric Database

Not all databases are the same. Most corporate databases are *operational* in design and don't handle customer-specific detail very well; they are transaction-oriented, not customer-oriented. Operational databases for order processing, inventory and accounting excel at producing summaries for management analysis but generally can't “drill-down” to the level of detail that captures a customer's buying preferences and behavior.

Some companies implement *data warehouses* in the belief that doing so solves all corporate information needs, including marketing needs. Data warehouses are large repositories of corporate information pulled from various operational systems (order processing, billing, customer service, etc.) and are typically used for enterprise-wide management reporting.

Unfortunately, data warehouses generally make poor customer databases. A data warehouse is optimized for data storage and high-level reporting, not complex data analysis. They usually lack the specialized statistical, analytical and data processing

tools required by the customer-centric databases known as *datamarts*.

The Two Sides of Customer Value

Customer-centric organizations focus on answering two key questions related to customer value: 1) *What value can your organization offer the customer?* 2) *What is the value of each customer to your organization?*

A datamart can help you answer both questions. First, get to know your customers in detail. Gather and analyze the data that tells you who they are — their lifestage, economic situation, household makeup, activities, buying preferences and much more. This helps you understand the products or services they might want and how to best approach them.

Then, offer them more of what they want, in the manner they want it. For example, some customers respond better to personal sales or service contacts, while others prefer catalogs. Some like to gather information or make purchases via the Internet. Each preference dictates a different marketing approach.

Customers will reward you for understanding them so well. By offering them what they want, when and how they want it, you can expect higher revenues and profitability. Perhaps even more important, you will be rewarded by their loyalty, thus increasing their long-term value to your organization.

By increasing the value of your organization to its customers, you increase their value to you. Your customer database will help you collect and analyze customer data and determine the value of each customer. But how will we measure their

value to us?

Simply put, “value” is the level of profit generated by a customer — revenues minus expenses. But identifying customer value is not as simple as it might seem. For example, companies in the financial services industry often use account balances to identify their best customers. This makes sense at first glance — an affluent customer with a high balance certainly sounds like a good customer. However, the most *profitable* customer is often someone with a moderate income who takes advantage of more services and, thus, pays more in fees.

Why, in this example, was account balance used as the measure of a good customer? The reason is very often a matter of data availability. In financial services databases, account balance information is readily available. Customer-specific *profitability* information is often not. As a result, high balance customers may be targeted for marketing efforts while the more profitable (but lower balance) customers are ignored.

With customer value now clearly defined and a suitable database technology identified, it’s time to research what our customers want from our business relationship. The six basic steps in this discovery process are:

Step #1: BUILD a database.

Step #2: PROFILE the similarities & differences of customers.

Step #3: SEGMENT the customer base.

Step #4: IDENTIFY true customer value.

Step #5: DETERMINE lifetime value.

Step #6: REFINE segments and strategies.

Step #1: Building the Customer Database

The largest and most critical task in building a customer database is identifying and integrating the source data. Careful planning is required or the end product may be unusable — “garbage in, garbage out” as the IS/IT professionals sometimes refer to it.

The first requirement is a comprehensive *needs assessment*. It starts with a careful review of marketing goals — past, present and future. Key individuals must be interviewed to determine the overall objectives, strategies, applications, obstacles and the criteria for success.

Then, a *data source review* evaluates the full range of data within the organization and charts its flow. Key users select and describe relevant source systems on a field-by-field basis, to document the precise data characteristics.

The project team then presents specific *database recommendations* to management that identify implementation issues, data “gaps,” resource requirements, timetable, and other relevant issues. These recommendations should include proposals on how the database can facilitate and cost-justify high-priority projects. The team uses feedback to fine-tune the database design and implementation schedule.

The next step is to export all relevant data from its original sources and *scrub* it. This process eliminates redundancies and errors in the customer data and puts it into a reliable and consistent format for import into the new customer database.

The last step is to *export* the data into the new customer database. This database has

already been customized to reflect the requirements identified in the needs assessment. Before going into service, the new database is extensively tested, all users and support staff are trained, and preliminary analyses are run to test the key operating assumptions. The new database is ready for real world use.

[Sidebar A - see sidebar section at the end of this document]

Step #2: Profiling Customers

To understand your customers, you must first describe them in a process known as *profiling*. A customer profile is a collection of the historical, demographic and psychographic data you will track. This is the customer-specific level of detail that will help you understand their behavior, needs and overall value to you.

Profiling helps you understand why a customer does business with you and how to make it easier for them to continue as your customer. It identifies the key factors underlying the one-to-one marketing relationship. For example, catalog companies will sometimes send out seasonal mailers that include a note reminding you of what you ordered last year for Mother's Day or for your dad's birthday.

Profile information falls into three basic categories:

Demographics, or the "vital statistics" — Age, gender, marital status, occupation, income, home ownership, length of residence, make and age of vehicles, or other data that provides a "snapshot" of your customer.

Psychographics, the lifestyle or attitude data — Hobbies or sports, magazine subscriptions, memberships, political or religious affiliations, and other “elective” indicators.

Historical, the behavioral data — Marketing contacts, customer responses, date and amount of last purchase, items ordered, payment method, history of returns, complaints, inquiries, and other purchase-related data.

Historical data is especially important. This transaction-level data allows marketing to analyze past purchase behavior to reveal the customer’s habits. For example, how often do certain customers buy from us? Are they chronic complainers or product returners? Do they only buy at discounted prices? This is critical information for calculating a customer’s true value to your organization and predicting their future behavior.

[Sidebar **B** - see sidebar section at the end of this document]

Profiling is not limited to individual consumers; *corporate profiles* can be created for business-to-business marketing purposes. You can also develop *blended profiles* for individuals who have the potential for both consumer and business-to-business marketing. For example, banks will sometimes make special offers to individuals who maintain both personal and business accounts with them.

Profiles can be enhanced by *appending* data. Very few customer databases start with 100% of the desired profile information. However, you can purchase, import and match additional data to existing customer records by using the sophisticated match-check capabilities of most sophisticated customer databases.

For example, business-to-business marketers may want to append Dun & Bradstreet (D&B) or American Business Information (ABI) statistics such as sales volume, number of employees and industry classification (SIC) codes to their customer files. Consumer marketers will often append phone numbers to basic address files, for telemarketing campaigns. Appending data is a very powerful way to enhance the value of a basic customer file.

Grouping is another important part of the profiling process. This is the linking of individuals who share similar characteristics; for example, family members living at the same address. By defining a grouping unit, direct marketers can make an offer once to a group unit rather than multiple times to the individuals in the group. This reduces marketing expenses and makes your marketing message seem more custom-tailored to the realities of its audience.

[Sidebar C - see sidebar section at the end of this document]

Step #3: Segmenting Customers

Now that know the details of individual customers, the database is ready to be split into *segments* —subgroups, each of which has one or more special characteristics in common. However, the elements in common are not always obvious or intuitively grasped. We need to use statistics to sift through the immense sea of detail on individual customers and their actions.

Segmentation can be simple or complex. *Top level segmentation* involves grouping customers by high level characteristics such as demographics or behavioral factors. Once these high level segments are established, we can enhance our data by

identifying *sub-group segments* based on profitability or other relevant data.

Traditional, product-centric marketers often use top-level segmentation to identify prospects for a specific product or category. For example, they may target all registered owners of pickups for a promotion on camper tops.

[Sidebar **D** - see sidebar section at the end of this document]

Segmentation is a continuous process, not a one-time activity. Marketers start with the best available information, segment their customers, and try to gain new insights into each segment. But where do these insights come from, once the obvious segments have been created?

Data Mining

Data mining is the next step in the segmentation process — using statistical tools to uncover new, valuable, and actionable information in the customer database. These powerful tools can find hidden relationships or complex interactions in the data that may be difficult for the human eye to detect. However, human knowledge and business experience is required to determine which of the newly-uncovered relationships are relevant to the organization.

Data mining, in effect, is the process of developing a more intimate understanding of our customers' needs and behaviors. The process starts when marketing defines an issue or hypothesis to be tested and identifies the relevant database variables. They can then run exploratory analyses and confirm the quality and availability of data. Typically, a database sample is used and outliers in the data may be discarded, to avoid skewing the results.

The statistical methods used in data mining are complex and need to be customized to reflect the organization's specific needs. In general, these methods fall into one of the following classes:

- CHAID analysis
- Cluster analysis
- Regression analysis
- Discriminant analysis
- Factor analysis
- Neural networks
- Decision trees
- Genetic algorithms
- Visualization
- Induction

CHAID, cluster analysis and regression are perhaps the most frequently used, but the other tools are also valuable, depending on the goal of the analysis. For a brief definition of each of these methods, refer to the glossary in the back of this document.

Data mining and statistical analysis can support marketing's efforts to identify and measure opportunities. These methods can help us score individual customers as group customers into clusters, based on significant shared characteristics.

Data mining is an ongoing process, with data preparation being the most time-consuming part of the process. Also, it's important to select the appropriate statistical models — each is useful for different business purposes. For example,

data mining can predict customer profitability. It can analyze the risks of a proposed campaign. It can also be used to understand trends... in doing so, it gives marketers a solid basis for sending the right message to the right people at the right time.

[Sidebar **E** - see sidebar section at the end of this document]

Step #4: Identifying True Customer Value

With your profile and segment information in place, you're ready to calculate the total profitability, or value, of your individual customers. The method of calculation is somewhat different for service vs. product marketers:

Service marketers typically calculate customer value by:

- a) *Identifying all the ways income is derived*, on a service-by-service basis.
- b) *Developing calculations for income*. (This may involve creating tables for non-database elements and defining assumption factors.)
- c) *Developing calculations for expenses* by applying costs to each type of transaction and customer maintenance activity.
- d) *Summing the results* for each service category.
- e) *Calculate the net profit for each customer or household*; this is the value of that specific relationship.

Product marketers take a similar approach:

- a) *Identify the net profit for each item sold.* (If this data is not available, apply an average margin per item or product category.)
- b) *Assign customer servicing costs,* based on the number of orders (for catalogers) or the number of visits (retailers).
- c) *Factor-in miscellaneous expenses and revenues;* for example, the cost of returns, the income from shipping and handling, etc.
- d) *Sum the results* on either the individual or household level; this is the value of that specific relationship.

With this quantified understanding of our customers' true value, we're ready to define our marketing strategies. These strategies will reflect three basic attitudes:

- 1) *"Take good care of your best friends."* These are Tier One customers, your most profitable segment. The marketing goal is to retain them, extend their longevity and maximize their value to you.

You can do this by giving them feedback that they are valued clients and extending "preferred customer" benefits, such as special services, discounts or perhaps a deluxe version of your catalog.

- 2) *"Work hard to turn acquaintances into best friends."* These are your Tier Two customers, your next-most profitable segment. Your goal is to increase their overall value by encouraging them to buy new kinds of items (*cross-selling*) or higher-priced items (*upselling*), based on your knowledge of their needs and preferences.

For example, you may promote a broader range of products and services, but use a less expensive but more frequent version of the catalog sent to Tier One customers.

- 3) *“Try to salvage the marginal relationships.”* These are your least profitable customers; some may even cost you money. This category may include new customers, those doing business with competitors, infrequent buyers, bad debt customers, complainers, or chronic returners.

In this stage, your marketing goal should be to identify those customers with potential and pull them above the level of “marginally profitable.” You will aggressively cross-sell at standard pricing, to assure that their response is not just tied to deep discounts. You can try different product mixes and promotional pitches until these customers become more profitable. If they still fail to respond, you’ll want to taper-off your promotional efforts, recognizing that they still may support part of your cost base.

Figure 2 summarizes the recommended strategies for customers of different value.

Tier	Value	Goal	Strategy
One	High	Retain	Recognition, Service (<i>“deep respect”</i>)
Two	Medium	Build	Cross- and Upsell (variable pricing) (<i>“strong encouragement”</i>)
Three	Low	Salvage	Cross-sell (standard pricing) (<i>“tough love”</i>)

The assumptions underlying these strategies include:

- Profitability tiers exist within every customer segment.
- Profitability determines customer value.
- Strategies should appropriately reflect customer value.
- Be persistent in trying to upgrade customers.
- Constantly refine your data; there’s always more to discover.

Regardless of customer tier, it’s always important to:

- Define a followup strategy for each segment.
- Follow through on your strategy and work hard to create value for the customer.

- Listen to customer feedback and modify your strategy appropriately.
- Track promotion history and use tests to measure results.

Measurement is especially critical, but be aware that not everything needs to be measured. Measure results, not activities. Measure behavior, not awareness or satisfaction. In customer-centric marketing, the plan is only as fresh and relevant as the last round of database updates.

Step #5: Evaluating the Lifetime Value of Customers

The customer database is now in full operation. Customers have been individually profiled and segments have been identified. Marketing strategies have been defined and are being tracked and scored. The database is increasing in value every day. It's time to estimate the lifetime value of your customers.

Lifetime value is the total profit or loss associated with a customer during the lifespan of their record in the database. Your calculation should start with current profitability, knowing full well that this number is a static snapshot of a dynamic, ever-changing process. You expect that your marketing strategies will increase profitability... but in which segments and by how much?

You start by clearly understanding your profitability scores. For such industries as financial services, profitability will be an "as-of" date, a single point in time. For retail operations, it will be the total purchases in a given period.

Next, you calculate the average lifetime of a customer. This is usually done on a segment-by-segment basis, by calculating the average length of time those

customers do business with you.

[Sidebar **F** - see sidebar section at the end of this document]

You then take present profitability and project it forward, based on average lifetime factors. You can make a straight line projection of current profitability, or can include assumptions about the marketplace or the positive effects of cross-sell or upsell efforts. In any case, use a Net Present Value (NPV) approach that expresses future profits in terms of today's dollars.

Like all forecasting, lifetime value forecasts are not infallible, but they do serve two very important purposes: 1) they reinforce the long-term, customer-focused mindset behind Convergent Marketing; and 2) they can be very helpful in cost-justifying projects or in allocating marketing budget dollars.

You're now ready to take the next step in your iterative process of discovering and managing customer value.

[Sidebar **G** - see sidebar section at the end of this document]

Step #6: Refine Customer Segmentation Strategies

With lifetime value factored in at the profile and segment level, you now need to review and refine strategies on a segment-by-segment basis. If revenue was one of the variables used in our original segment assumptions, you will need to re-evaluate all segments by considering true, long-term profitability.

This is the time to evaluate your progress. How are your segments responding to your marketing efforts? Which segments have moved up the value tiers, and why? Which promotional strategies are working? What conclusions can you draw from all this? How should you modify your strategies?

At this stage, you can begin to see the value of detailed, long-term marketing data. Companies used to consider three months of customer data sufficient. For customer-centric marketers, three *years* of detailed customer history is ideal — this much data enhances analysis on both the individual and segment level. Campaigns can be tracked over time and their long-term effectiveness measured.

[Sidebar **H** - see sidebar section at the end of this document]

This is also the time to refresh your data and re-run your analyses. It's especially important to update demographic data, to assure that segments are still defined correctly. For example, if your strategies are influenced by lifestage data, you need to update that frequently — after all, single people get married and have children, students become wage earners, people retire, income changes, and factors such as these can dramatically impact our segmentation.

There will always be new insights into your customer base when you refresh your data, mine and re-analyze that data, and evaluate your progress. You will discover new factors that create opportunities for lower tiers to perform more like the top tier. Even within segments, sub-group strategies can be refined to improve overall profitability.

Again, the key to success is a powerful, responsive and up-to-date customer database. The more accurate your information, the better you'll understand your

customers. The better you understand our customers, the easier it is to increase their value *and* find new customers just like them.

Conclusion

All good marketing is focused on the customer. By learning the details and behaviors of your customers, you can understand and better meet their needs while at the same time managing their value to your organization.

A true customer database is the essential tool for managing customer value. The use of operational databases or even a data warehouse can lead to mistaken or unfocused marketing efforts. There is no substitute for the intimate, one-to-one relationship management that comes from the wise use of a customer database.

The task of building and managing a marketing database is formidable, but the benefits are many: Increased customer retention and segment profitability. More cost effective marketing to prospects. New profit opportunities through cross-selling and upselling. Focused support for the sales organization.

Technology alone is just a tool — you also need to recalibrate the organization to customer-centric philosophies and methods. Use the guiding principles of Convergent Marketing to help integrate your technology, applications, educational efforts, and data services. This will create a strategically-focused, customer-centric marketing process. Then, ensure that the new strategies are implemented, performance is constantly measured, and that customer feedback is the basis for all plan modifications.

The transition to customer-centric marketing typically requires specialized

technical support, staff training, ongoing education, and the regular use of data enrichment services. However, by making this long-term commitment to your customers, you will be investing in your future.

By focusing on customers, you will create more profitable and longer-term relationships. Customers will sense the increased intimacy and relevance of this marketing relationship and will reward you with their ever-increasing business and loyalty.

SIDEBAR TEXT

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[Sidebar A]

BUILDING A MARKETING DATABASE

In the Real World

[DO YOU WANT TO USE THIS EXAMPLE? The following text was crossed-off in the edited draft returned to me...]

The Scenario:

A national catalog company is building its second-generation marketing database. It plans on pulling data from many different internal sources, including its order entry, customer service and the existing marketing database.

The Solution:

The catalog company works with CIC's Consulting Applications Group and receives a comprehensive analysis of their needs.

A data source review charts the organization's flow of data and highlights several areas where key data is missing. The internal data needs to be enhanced with new, rented data. The CIC project manager arranges to use Metromail's Behaviorbank data to add the missing demographic and psychographic data.

The new data set, including the rented Metromail data, is scrubbed and imported into the cataloger's new AnalytiX marketing datamart. The AnalytiX Import function groups the data into the pre-defined households.

[Sidebar **B**]

PROFILING

In the Real World

The Scenario:

Kyle is a 28-year old sales representative with a modest condominium. He deposits his paycheck twice a month and writes an average of 18 checks monthly that total most of his pay. About once a quarter, Kyle is late making his deposit and as a result he incurs an overdraft charge.

The Solution:

Kyle's bank used CIC's Explore marketing database to determine his consumer profile. Then, the bank appends Metromail demographic data and profiles the customers in Kyle's geographic area. It discovers that Kyle falls into its "emerging professionals" customer segment — young, single customers with two banking products (usually a savings and checking account), living in the metropolitan area, with one car, an income of \$35,000-\$50,000, and an active lifestyle. Unlike most of the bank's customers, however, Kyle didn't have overdraft protection on his checking account and would occasionally incur NSF fees.

This profile marked Kyle as one of 1,200 customers who were ideal candidates for the bank's overdraft protection service. The bank mailed a promotion to this

customer segment, touting the benefits of its overdraft program. Kyle, who wasn't aware of the program, signed up immediately. He was happier because the bank proactively offered him a service that would spare him the embarrassment of bounced checks. The bank was also happy since Kyle's overdraft credit line now generated interest revenue for the bank, thus increasing his long-term value.

[Sidebar C]

GROUPING

In the Real World

The Scenario:

Ted and Alice are unmarried working professionals who live together. They have separate cell phone service accounts with the same carrier. Ted is a low-volume caller, Alice a high-volume caller. Based on Alice's greater profitability, the carrier mails her a "preferred customer" offer with significant discounts and benefits. The same day, Ted also receives an offer from the carrier, but at a much smaller discount and with no benefits. Ted is angry when he compares offers with Alice and they both consider switching carriers.

The Solution:

The carrier could have avoided alienating Ted and Alice by recognizing that they were a single buying entity when it came to cell phone service. Using AnalytiX, the carrier selected the relevant links to check during the database build process. This resulted in recognizing Ted and Alice as a grouped unit — in this case, a household.

Grouping allows the carrier to link customers based on a common address, phone number, last name, or any other relevant criteria. Then, the AnalytiX grouping function would allow a business to mail just *one* offer to a household, thus saving money and avoiding the appearance of a “double standard” offer.

[Sidebar **D**]

SEGMENTATION

In the Real World

The Scenario:

A publisher of books and magazines wants to test market a special children’s book club offer to its subscribers. The book club offerings are rather high-end, so the publisher believes that only a small portion of its subscriber base would be interested. How can they identify their best prospects?

The Solution:

The publisher has already segmented its subscriber database on the basis of key demographic and behavioral data, including the presence and age of children, household affluence, and purchase history. They identify a segment characterized by two or more young children of reading age, high household income, and a moderate-to-high frequency of past purchases. The publisher theorizes that this segment will want to encourage their children to read, and validates this theory with a small test mailing. Based on this successful test, the publisher mails to the entire segment and gets a very high 8% sign-up rate. Using segmentation, the publisher has filled a customer need that was previously unknown.

[Sidebar E]

DATA MINING

In the Real World

The Scenario:

An insurance company was experiencing an unusually high number of health claims in the Midwest. The company needed to determine if this was a lifestyle-related trend that would justify an increase in its rates, or if this was just a statistical fluke that would disappear in time.

The Solution:

The company ran decision tree models against its already demographically-rich database. The first branch of the decision tree identified that the majority of its policy owners were between the ages of 35-65, with a 60/40 split of males to females. Because the majority of the claims had been against men, the company split the branch again, focusing on the men in the database. It then identified that 70 percent of the men had high blood pressure. Suspecting a correlation, the company dug further and discovered that only 20 percent of the men with high blood pressure smoked, drank alcohol or ate red meat. Based on these findings, it could not make a correlation to lifestyle and high blood pressure and therefore decided to maintain its rates and re-evaluate the situation in six months.

[Sidebar F]

TRUE CUSTOMER VALUE

In the Real World

The Scenario:

A utility company is considering expanding its service offering and its service area. It needs to determine which services it should offer on an area-by-area basis.

The Solution:

The utility company knows that if it can determine the characteristics of its most valuable customers, it can use those characteristics to predict the most profitable areas for its marketing campaign. First, it uses AnalytiX to calculate customer profitability scores. Various costs are used as criteria, including water, gas and electric revenues per household, average cost of service in peak and off-peak months, number of users, types of services used, cost of supporting the service level, and the cost to repair outages.

The company sums the results for each service category and calculates the net profit for each household. Because it is trying to determine which services are profitable, it calculates the net profit for each household by service type.

This utility discovers that in its electric service is most profitable in the northwest region, its gas service more profitable in the southwest, and its water service profitability seems fairly constant across all regions.

Based on this analysis, the utility company determines that it should emphasize its electric service in the northwest region and its gas service in the southwest. The company develops a new promotions strategy based on this information.

[Sidebar G]

LIFETIME VALUE

In the Real World

The Scenario:

A local department store found that its profitability was not keeping pace with the increase in its customer base. The store ran weekend sales that produced a high volume of sales, but not a large dollars-per-sale value. The store was considering running even more sales to bolster its profits, but wasn't sure if this was the right approach to increasing profitability.

The Solution:

Using AnalytiX, the department store was able to determine the lifetime value for each customer segment. It calculated a profitability score for each household by totaling the number of purchases in the past three months. The store then calculated the average lifetime of the customers in three tiers — the most profitable customer tier had a lifetime of four years, for example.

It then projected the profitability score over the lifetime value of four years to identify a lifetime value score. The store discovered that the sales it ran weekly were attracting the wrong kind of customer. In fact, the most profitable customers were those who came into the store during the week, intent on buying a specific item. While the store wasn't willing to give up weekend sales altogether, it did create a contact strategy specifically for the weekday shoppers, to increase their purchase frequency.

[Sidebar H]

STRATEGY MODIFICATION

In the Real World

The Scenario:

A cable TV company is frustrated that despite its frequent promotional offers (no installation fee, a premium channel free for three months), the overall size of its subscriber base remains fairly constant and profits are relatively low. The cable TV company is seriously considering raising its rates to boost revenues.

The Solution:

The company's problem is "churn" — frequent turnover in its subscriber base. Using AnalytiX, the company can combine all of its analysis, profiling, segmentation, profitability, and lifetime value data to identify the segments most susceptible to churn. It sees two trends: 1) there is a price-sensitive segment that only subscribes during promotions, then drops or downgrades the service when the standard rates kick in; and 2) there are no incentives in place to reward long-term subscribers.

The company implements different contact strategies for different customer segments. Subscribers who only sign up during promotions and then drop the service (which ultimately costs the company money), are deleted from the prospect list. The tier of long-term subscribers is rewarded annually with a free, one month trial of a premium channel, or two free pay-per-view movies. These different strategies are effective in reducing the churn and in building the loyalty of retained subscribers.

Glossary (pg. ___)

CHAID - CHAID stands for Chi-Squared Automatic Induction Detection. It is used to find statistical correlation between variables.

datamart- A high-performance, analytically-oriented database designed to handle the unique requirements of customer-centric marketing activities. Datamarts typically handle large volumes of customer data and allow ad hoc reporting and variable updating.

decision trees- A hierarchical set of rules represented in a tree structure.

discriminant analysis - Identifies variables that explain the differences between two or more defined groups and that classify unknown observations (e.g. prospects) into the groups.

Factor analysis - Reduces the data to a workable form usually in preparation for applying other analyses (e.g. cluster analysis or multiple regression). It is especially beneficial when there is too much data to deal with intuitively or statistically.

genetic algorithms - The use of multiple parameters to predict a behavior or event. Many parameters are identified as possible predictors. Subsets of those possible parameters are then tested to find the best predictors. The process is repeated until the most predictive parameters are identified.

householding - The grouping of individuals into a single purchasing entity, based on significant shared characteristics, primarily address.

linear regression - The use of an appropriate linear formula that can describe or predict an outcome. A simple way to make sense of a data set.

neural networks - A computerized attempt to mimic the way the human brain learns from examples and find patterns in data. A neural network simulates a mass of neurons interconnected in complex ways and organized into layers.

visualization - This involves plotting complex data in three-dimensional displays, to uncover visual patterns and relationships that are not readily apparent in numerical formats.

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