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# How Leading Companies Achieve Profitability through Accelerating Customer Relationships

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*Abstract: Leading companies around the world have implemented strategies for understanding their relationships with their customers, suppliers, partners, stakeholders, stockholders, and channels. In the Electronic Commerce world that is fast emerging, marketshare and product awareness may be tantamount to potential success, but world-class companies have clearly delineated themselves through profitability management. This requires a short and long-term process of managerial enlightenment and action through a customer centric knowledge system. To achieve high profitability in the future, firms will be focused on customer acquisition, customer profitability, customer retention, customer service/satisfaction, and customer individual requirements fulfillment. This session will discuss the strategies and methods utilized by leading firms whose profitability and stockprice have accelerated in these dynamic times of competition and high customer expectations.*

The most powerful effect of Customer Relationship Management is on the bottom line. Unfortunately, many people see CRM as a technology issue, when in fact it is about economics – profits and business effectiveness. The right technology is essential, of course, but only to serve the ultimate end of developing a more effective business. Otherwise it can wind up, as The Rolling Stones might have put, “telling me more and more, about some useless information, supposed to try my imagination” and contributing little to the bottom line. CRM must provide answers to real business problems. The power of information technology is such that it can go on indefinitely documenting such self-evident bits of demographics correlated to behavior, as the fact that few senior citizens buy rap music, when what the company needs to know is why it is losing customers to competitors. The proper use of CRM begins with identifying opportunities that can be achieved – even hiring Art Linkletter for endorsement purposes isn’t going to sell rap music to seniors – and then developing realistic offerings, communications, interactions, and sales orders. Decades ago, department store magnate John Wannamaker made the oft-echoed observation that half the money he spent on advertising was wasted, but he didn’t know which half. That can be said of many business initiatives, but with modern parallel analytical databases and CRM, it is finally becoming possible to know which “half” is the winner and which the loser. These technologies and a new set of marketing and discovery processes can bring companies much closer to “one-to-one marketing.”

### **Creating “Micro Markets”**

At Royal Bank in Canada, managers knew that a certain percentage of their customers and products were unprofitable, but their systems limited their knowledge of who these customers were and why their transactions were a drag on profitability. By using analytical databases and CRM, the bank created “micro-markets” to differentiate customers and offer distinct products, rather than offering all customers the same products at the same prices. Other banks have reduced the interest rate paid to customers by one-tenth of one percent without changing the total amount of deposits, saving millions of dollars each year. These banks are learning to reinvest high returns in an integrated “single customer view” info-structure. Many of these “intelligent” companies are reporting over 40% conversion rates on their offerings to customers and also an ROI (on CRM) of over 200% per year and growing exponentially. Once a customer relationship problem or opportunity has been defined, such as profil-ing high value/high risk customers of long distance services, the process of CRM may involve mining through data collected from various sources and systems. Data is analyzed for meaningful patterns about a customer’s behaviors to derive valuable profiles that can be used in a target market campaign to retain them. These campaigns involve deployment through a customer care system and the results (both in terms of the campaign and order provisioning) feed back into the data warehouse or “knowledge repository.” This requires carefully transforming all of the data from the many technologies touching CRM, such as ordering, billing, collections, servicing, customer inquiries, product enhancements, transactions or interactions with the company, all customer care interactions, and even (in some leadership companies) recording the denials of offers to customers or prospects.

### **Generating Actionable Leads**

Effective CRM is driven by an analytical or business intelligence process, which must be fed with both, internal operational and, increasingly, external data sources. To be enterprise-enabling, CRM must cut across management functions and operating activities to generate “actionable leads” to resolve or reduce such problems as high-value-customer churn. Poor quality integration of CRM strategies, policies, architecture, databases, and technology standards, or use of existing operational platforms can lead to inconsistent results. CRM solutions must bring a broad range of actionable analysis and modeling capability based on events or rules that drive the business. By savings and re-using these analysis steps as well as their results, managers gain understanding of actions already taken and those to be taken. Additionally, CRM must have a cross-channel view to understand the whole customer, which includes all transactions, interactions, and customer preferences, in other words, “knowing the customers.”

*The essential criteria that differentiates companies lagging from those leading in CRM (e.g., marketing and interactive commerce) are:*

- The ability to manage all aspects of a customer relationship
- Regulating frequency and quantity of contacts (and pre-determining quality)
- Privacy-enabling the integrated customer database and managing permissions (and store all opt-ins and opt-outs on a detailed basis)
- Personalizing offerings and messaging based on customer transactions, interactions, advice, surveys, queries, and preferences

*To successfully achieve these criteria:*

- Be able to modify rules to optimize each customer communications stream.
- Integration and manage across all channels – right content by touch point
- Capture learning based on all interactions (and associated analytical models)
- Build two-way interactions to sell, service, or learn the customer's needs/issues CRM offers a radical departure from traditional mass marketing. Instead of one-size-fits- all promotions and customer approaches, CRM allows for personalization to dramatically build customer loyalty, achieve operational and servicing goals, and gain a sustainable competitive advantage.

### **Integrated Capabilities**

Companies will not gain the strategic and economic benefits associated with CRM without integrating their organizational capabilities – structure, processes, skills, and metrics – into the added intelligence from CRM technologies to either confirm or change past decision-making criteria. One insurance company has documented a valid relationship between customers who purchased insurance policies and employment length. Another financial institution found that their most profitable customers were those with more than five different financial products. Airlines are now correlating all mileage data to the actual financial data to identify their most profitable customers (rather than those with the most mileage). An entertainment company is performing cross-market analysis and making personalized specific offers to their best customers (and achieving major ROI and frequent visits). Unless this new information is imbedded in business processes and used to drive CRM operational sales activities or selecting campaigns, it remains useless. Without the necessary skills to transform these new “opportunities” into a business action (e.g., customer interactions), the mined information adds little value. To realize the full impact of this new approach to target marketing, business managers are becoming more computer and CRM literate, particularly where decision-making authority is moved to the marketing/sales/services/ product manager level. Many successful companies bring them in the planning/implementation process. Marketing processes and techniques are evolving to take advantage of flexible CRM infrastructure, requiring stronger CRM analytical skill levels and experience in the marketing organization, including rewriting job descriptions, adjusting salaries,

and other managerial issues. CRM technologies are “different” than traditional operational or process automation technologies and applications. Data warehousing, unlike its operational brethren, is an approach that provides the capability of “asking any question, at any time, of any combination of data, with complex correlation,” offering great potential for finding new knowledge. Massively Parallel Processing and data warehousing offer these new possibilities of bringing customer intimacy, operational efficiency, and product superiority to new levels. Early investors in the financial services industry found swift ROIs, often much higher than for traditional technology investments. Most recouped their investments in one to four years, but the real issue was not the break-even point but transforming their competitive approach to their markets. Once accomplished, these transformations could yield ROIs 50 times greater than normal ROI, on an entirely different order of magnitude from such traditional ways of building revenue as introducing new products or branches. Gains were registered most quickly in sales and marketing, with profitability, debt management, distribution, and risk management following closely behind. The common factor was the speed with which the organizations were able to react to changes in the market. Time and again, superior information enabled them to identify a market, enter, and take market share – all before their competitors had understood what was happening.

### **Speed is of the Essence**

Windows of opportunity open and close all the time. All too often, firms see one, but by the time they’ve organized an approach to it, conditions have changed and expensive campaigns prepared for one set of conditions are launched into another without success. CRM information engines permit companies to recognize and move instantly to exploit changes in market conditions. And because historical information offers a guide to future behavior, companies can build a high degree of prediction into their operations by capturing marketing conditions and people’s behavior and then correlating them to actions under specified conditions. Swift access to essential information also cuts the time needed to develop applications in response to quickly changing conditions. Detailed knowledge of each customer’s past behavior can be quickly turned into intelligence about how they will react to the competing offer. Armed with that knowledge, counter-offers tailored to the needs of each segment are presented. Beyond marketing, many financial organizations have found they have been able to improve their portfolio management as they discovered behavior occurring after the initial transaction that significantly changed the complexion of their spread on individual loans. They were able to quickly restructure and reprice these loans. An airline saved enormous cash flow and future aircraft investments by signing a code sharing agreements, based on their projections of future business (e.g., passenger and cargo) over the next 330 days. Ease of access to essential information substantially boosts productivity, allowing companies to do more with fewer people. Business intelligence, combined with CRM analytics and actionable information, provides ongoing accelerated

ROI. Organizations provide many services to their clients, and strive to introduce new ones, in order to stay competitive. However, some of these are of little value to customers and seldom used. The detailed information in the CRM data warehouse allows such marginal performers to be quickly identified and eliminated. One company managed to save \$1 million per service. Similarly, better understanding of the fees for services points to ways to fine-tune fee structures to generate more income.

### Measuring Success

The first question asked about a new product launch is: “Did it succeed?” The sooner that question is answered, the sooner companies can make their next moves. Those moves can range from stepping up product deliveries to meet unanticipated demand, fine-tuning marketing to correct for weaknesses, or even cutting losses in a timely – and economical – fashion. Equally important is swift knowledge of where business is coming from. “Are we simply cannibalizing our other products?”

Examples of CRM & Retention Value						
General Business Assumptions	A	B	C	D	E	F
	Base Example	Lower Churn	Reduce Mktg	Increase Sales	Add 1 Year	Lower Churn
Items that affect Customer Net Present Value						
Total number of customers	500,000	500,000	500,000	500,000	500,000	500,000
Average annual voluntary churn rate	24%	20%	24%	24%	24%	18%
Average annual revenue per customer	\$1,200	\$1,200	\$1,200	\$1,440	\$1,440	\$1,440
Average acquisition cost	\$500	\$500	\$450	\$450	\$450	\$450
Customer life time (years)	2	2	2	2	3	3
Customer gross margin	25%	25%	26%	26%	26%	26%
Current customer net present value (NPV)	\$36,756,364	\$40,727,273	\$51,196,364	\$87,427,636	\$177,583,437	\$223,050,518

Table 1: Customer Value in Net Present Value (NPV) from CRM-Actions

Are we cutting into competitors’ markets? If so, which competitors?” This kind of knowledge helps direct the CRM campaigns to address one’s own and the opposition’s weaknesses. Organizations like banks and airlines know that most of their customers are, at best, only marginally profitable and that a disproportionate share of their profits come from a relative handful of customers. Identifying and catering to them with loyalty programs makes retention a vital task. Additionally, among the firm’s other customers are those with the potential to generate more profits who can also be singled out for special attention. Superior attention to customers’ needs keeps them happy, minimizes defections, and even ensures that those who do defect will be receptive to appeals to return. Recently, our team has developed

several approaches to predicting benefits, or ROI, on CRM investments. Some of this applied learning and out-of-the-box thinking, uses a methodology for determining ROI from normative information about the business. An example of ROI can be an increase in customer retention and/or an increase in customer net present value (NPV). NPV also provides an initial financial view leading to determination of Lifetime Value (LTV). The highest level of customer profitability is achieved from the “loyal customer,” who is retained for long periods, and also the customer who brings more and more business e.g. product volume increases, up-sales ordering, version reordering, cross selling orders, new product buying, or referrals). Figure 1 shows the six basic business assumptions for initially determining NPV. There are numerous methods to accomplish this task, but this is an easy method we use in my CRM Workshops. Non-Financial managers can easily see the affects of CRM and changes to their investments in marketing to their customers. Begin with the “base example” in column A, showing the company’s volume of customers, followed by statistics on the annual revenues, cost of acquisition or marketing and administrative costs, the volume of churn, years of retention, and the estimate of margin on sales. These facts must be known. The most important calculation is about each individual customer’s profitability, so that each customer is “known” (and through profit and longevity, subsequently determining LTV). In column B there is a reduction of churn from 24% to 20% resulting in additional NPV of \$4 million. In Column C, there is the same churn of 24%, but a reduction in average acquisition cost by 10% to \$450 per customer; and this itself achieves an even bigger result of \$11 million. “Is it worth more to the company to save money on mailings, collateral, contacts, sales calls, telemarketing, and advertising, or in reducing churn by 4%?” Do you know? In Column D, we again use the original 24% churn, but reduce the acquisition costs (as was done in column C), and also increase the effectiveness of marketing and contacting customers by \$220/customer per year. This revenue increase lifts the NPV another \$36 million from column B calculations, or \$51 million increase over Column A. In Column E, we maintain the benefits of Columns C and D, and emphasize retention. By adding one year to a customer relationship, the NPV doubles to \$177 million. In Column F, we maintain the benefits of Columns C, D, and E, and now reduce the churn by 25% to the level of 18% per year, with a result of \$233 million NPV. Clearly, churn is a most important factor, but length of relationship or retention creates a greater magnitude of benefit. Retention may be the most rewarding of all of the CRM activities. Generally, the values presented here can be achieved through actionable information and people using that information to interact with customers on a timely and meaningful basis. Similarly, by using “behavior scoring” to develop propensity buying models, companies can drive use of their most profitable products. In one case, cross-sell ratios tripled. In another, a bank discovered how to increase loans without increasing bad debt. Anyone who has ever wondered how they wound up on a mailing list understands the futility of most direct mail campaigns. By correlating customers to products, marketers can cut the quantity and cost of mailings, and increase response rates. Indeed, the data ware-



house is invaluable in overall channel management. Changing the structure of the channels without losing business has always been a tough nut to crack. Customers tend to resist change, and they must be managed with care. Detailed customer information allows planners understand who stays and who goes when changes are made and when customers can use an alternative location or when they would be driven to competitors.

### **Five Stages of Growth**

Once the CRM process has been initiated, developing and integrating the info-structure to support the new value-chain environment, ROI accelerates each year as the organization assimilates CRM into its thinking and operations. As suggested in the book *Accelerating Customer Relationships* (Prentice Hall PTR, 2000), CRM implementation goes through a five-stage process. In the entry or learning phase, the company adopts and learns to work with the basic information and does reporting and some analysis. In the mature stages, it has learned to tailor these applications to the specific needs and preferences of its customers – both active and potential. When it has reached the worldclass stage, it has integrated the best components, designs, inventions, and previous investments in software and relationship technology into automatic responses to real-time events. In the most mature stages, a company uses the data warehouse as an “active” resource and drives on-going interactive analytics to drive CRM.

### **In Conclusion**

Data warehousing and CRM do not implement themselves, however. Organizations that do not use proven methodologies, develop the strategic objectives to manage (or measure) profitability, or develop a culture that embraces CRM risk frustration and failure. Experienced consultants clearly make a difference. Success, on the other hand, compounds itself. Companies in many industries, including banking, insurance, communications, manufacturing, airlines and retail stores, and governments as well, have achieved high rates of ROI by implementing CRM through a customer-centric data warehouse. The value of CRM only increases with age, as relationship technologies are refined and set to work on an ever-growing volume of highly detailed historical customer transaction and behavioral data. The lesson of the early experiences of sophisticated CRM operations is simple: Those who do not master the art of detailed information will be mastered by those who do. Those who understand the info-structure requirements and really implement the single view of the customer will succeed. The successes of tomorrow are generated by accelerating customer relationships today. The future successes are achieved through thoughtful action and re-investments in knowledgeable processes, people, tools, ideas, actions, and customer information.

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and metrics – into the added intelligence from CRM technologies to either confirm or change past decision-making criteria.