



Business Consulting Services

Driving an Operational Model that Integrates Customer Segmentation with Customer Management

Summary for Person-to-Person Event

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IBM Business Value Alliance

IBM Institute for Business Value



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The 2003 IBV series explores how knowing your customers and aligning your organization to serve them is essential to corporate growth

Customer and Marketing Strategy Series

Part I:
Integrating Customer Segmentation and Customer Management



Make knowing your customers a way of life for your company

Part II:
Operationalizing CRM: Transforming Your Company



+
Make CRM work in your company

Part III:
Customer Loyalty: Keeping your Best Customers



+
Build strong relationships with high value and high potential customers

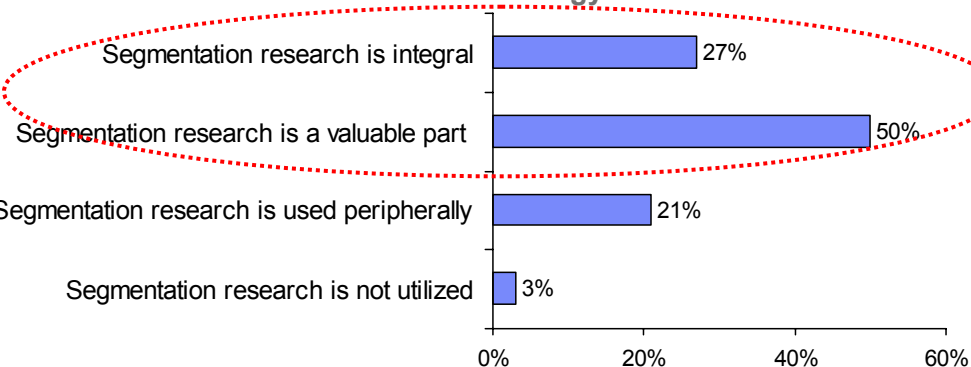


Grow profitably, one customer at a time

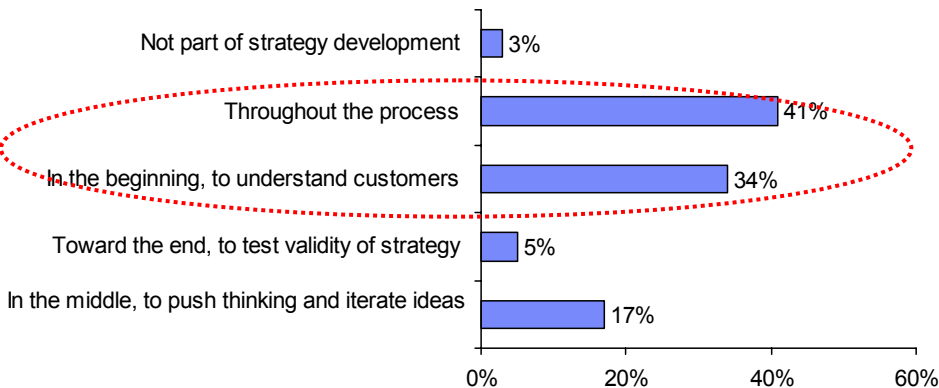
Today, customer segmentation is no longer a simple, or static, marketing technique; it is core to the way successful companies run their business

Segmentation Impacts More than Just Marketing

Influence of Customer Segmentation Research on Go-to-Market Strategy



Use of Customer Segmentation Data in Strategy Development



Note: *IBM quantitative online survey, number of responses = 122

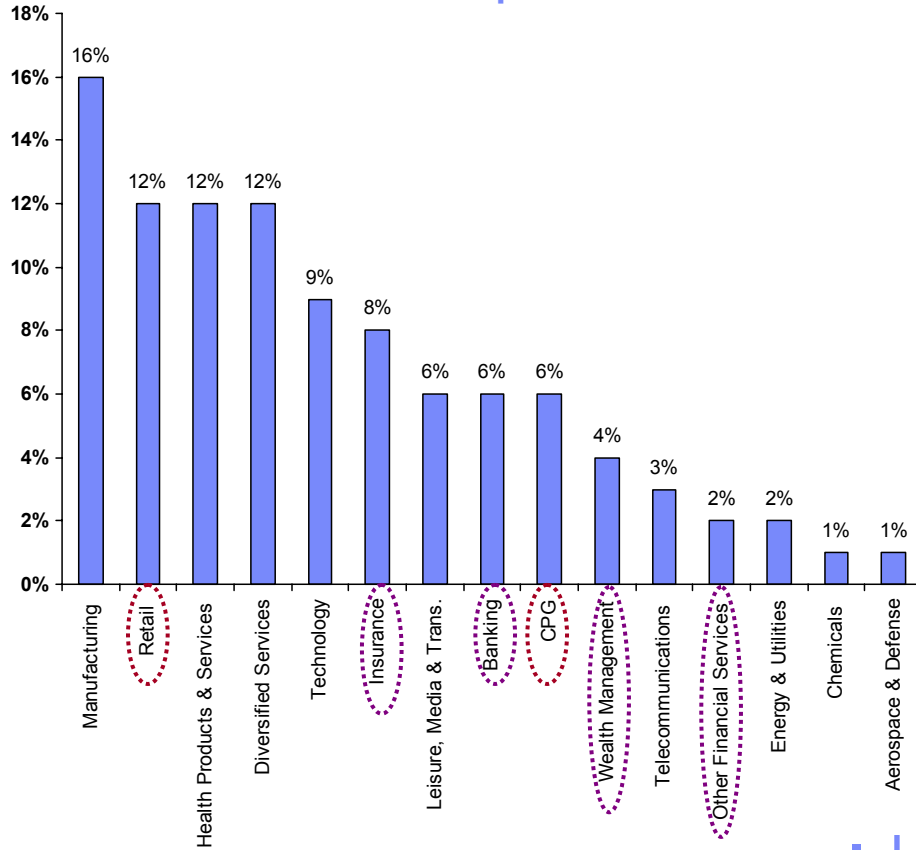
Source: IBM Institute for Business Value survey, interviews, and analysis, 2003.

Executive Quotes

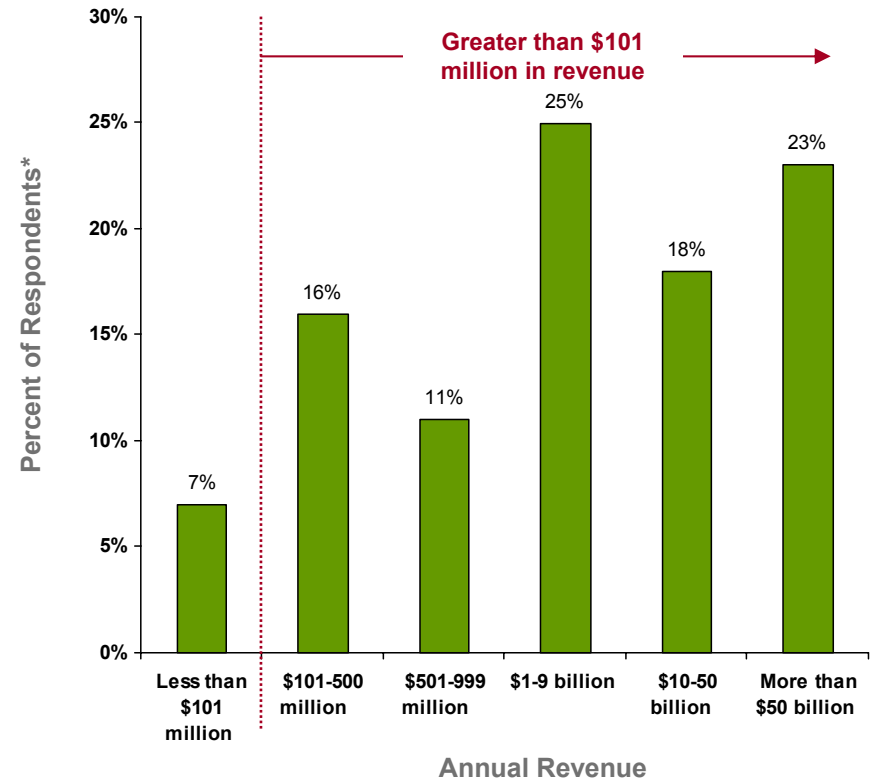
- “Customer segmentation has enabled us to make educated business decisions (strategic and tactical) that have significantly increased company sales.”**
 - International Leader in Health Products and Services
- “Segmentation results are used across the whole organization; segmentation is critical to many departments in our organization.”**
 - Top Five US Financial Services Company
- “Segmentation data is used in developing and refining the business case in support of new product and service ideas.”**
 - Top Tier International Hospitality Company

Survey respondents spanned all major industries and were primarily from companies with greater than \$100 million in annual revenue

Industries Represented



Annual Revenue of Respondents



On an aggregate basis, 21% of respondent were from the Financial Services industry, 18% were from Retail and CPG companies.

Note: *IBM quantitative online survey, number of responses = 122
 Source: IBM Institute for Business Value survey and analysis, 2003.

How well do you know your customers?

Know Your Customers

Having CRM is a Good Start, But Not Enough

- Only 17% of companies with implemented CRM solutions use the marketing and customer analytics features/applications which; can be used to:
 - Determine profitability of customers and segments
 - Determine future purchase propensity
 - Improve customers understanding and profiling
 - Automate targeting marketing efforts
- A survey of 404 IT and Marketing executives found:
 - 97% of respondents plan to increase spending on CRM technology within the next 24 months
 - Only 7% said this spending would go to “Improve profiling and targeting of customers”

Customer Analytics Applications Projections

- While companies are not (yet) using the marketing/customer centric analytics applications, they are buying the applications
- One study estimated that these applications will account for more dollars than operational CRM by 2006, accounting for 53% of projected CRM spend
 - \$5.2 billion in 2001 (of \$9.7 billion)
 - \$8.7 billion in 2006 (of \$16.5 billion)



“Its amazing how many executives...haven't the least idea just how profitable (or unprofitable) individual customers or customer segments are.”¹

Note: ¹ “Will This Customer Sink Your Stock?” Fortune Magazine, September 15, 2002.

Source: IBM Institute for Business Value analysis, 2003; “The CRM Imperative: Organizing for Success in an Expanding CRM Market,” Jupiter Research, Daniels, Schatsky, Bankier, Harrison, Sargent, November 2001, “Will This Customer Sink Your Stock?” Fortune Magazine, September 15, 2002.

Customers today are on the move, always learning, constantly changing; segmentation has to be comprehensive and dynamic

Value of Multidimensional, Dynamic Segmentation: View from the Eyes of a Financial Services Company



Demographics: Male, just finished business school, seeking a job

Life-stage: Recent graduate, active personal life

Needs: Consolidated school loans, car loan, online banking package

Behaviors / purchase patterns: Buys only necessary home goods; spends discretionary money on sporting events, recreation, and restaurants/bars

Demographics: Male, single, salary \$200K+

Life-stage: New professional, focused business man

Needs: Financial advisor, mutual funds, IRA

Behaviors / purchase patterns: Purchases expensive work clothing, travels frequently for business and pleasure, spends discretionary money on fine dining and wine

Demographics: Male, married, child under age one, salary \$300K+

Life-stage: Newly married, new home owner, new father

Needs: Mortgage, home equity line, education savings plan

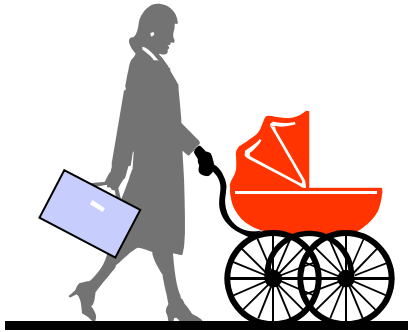
Behaviors / purchase patterns: Frequently purchases home goods, spends significant amount of money on home improvement, spends discretionary money on products for wife and baby

Source: IBM Institute for Business Value analysis, 2003.

Companies also need to understand which segmentation characteristics differentiate customers; customers that look alike don't necessarily act alike

Some customers that have similar Life-stages and Demographics, may have very different Needs and Attitudes

View from the Eyes of a Grocery Store

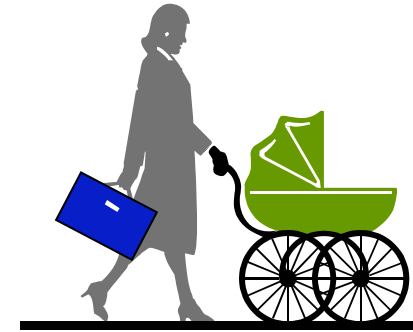


Demographics: Woman, early 40's, married, house-hold income of \$200K

Life-stage: Two kids, working mom

Needs: Menu planning advice (low-fat and value oriented), cooking club

Attitudes: Value shopper, prefers low-fat products, enjoys cooking



Demographics: Woman, early 40's, married, house-hold income of \$200K

Life-stage: Two kids, working mom

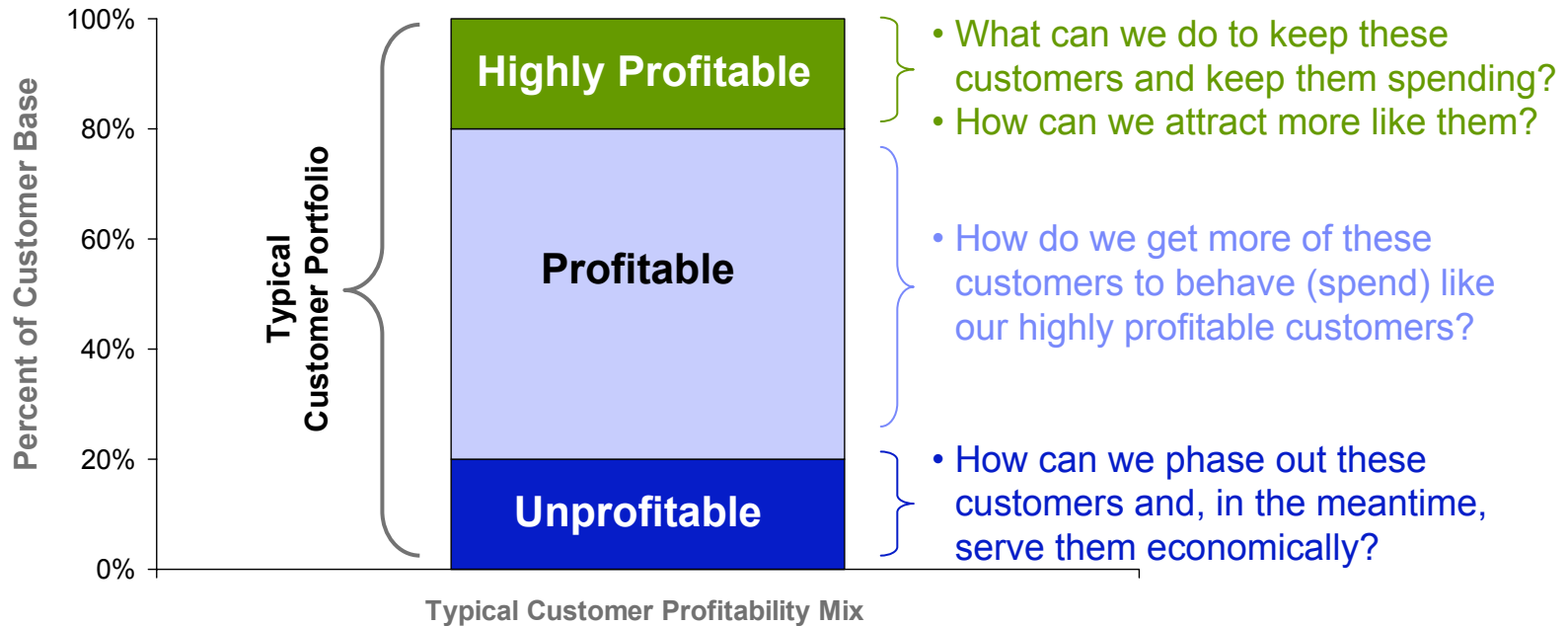
Needs: Ready-to-eat products, pre-cooked entrées, home grocery delivery services

Attitudes: Convenience shopper, prefers organic foods, does not like to cook

Segmentation is the vehicle by which companies know and manage their portfolio of customers; it directly links to profitability

A Company's Portfolio of Customers

Customer Segmentation Informs and Directs



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“The customer portfolio needs to become the basis for how companies get organized, measured, and managed.”¹

Note: ¹ “Will This Customer Sink Your Stock?” Fortune Magazine, September 15, 2002.

Source: Institute for Business Value analysis, 2003; “Will This Customer Sink Your Stock?” Fortune Magazine, Larry Selden, September 2002.

A few clarifying definitions, for purposes of communicating the results of our study

Segmentation Definitions

Segmentation Types

WHO

- Demographics
- Lifestyles

WHAT

- Needs
- Preferences
- Purchase behaviors

WHEN

- Life-stage
- Occasion
- Purchase behaviors

WHY

- Attitudes

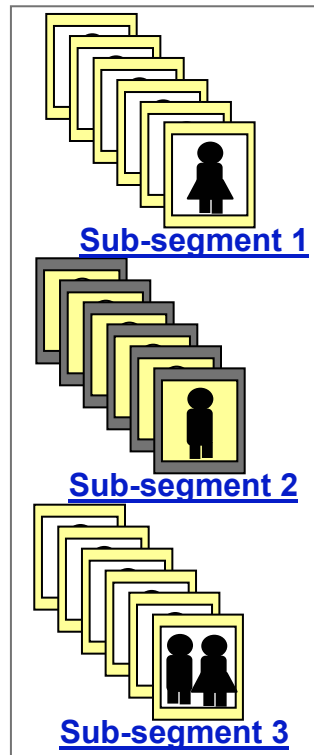
Customer Profile



Characteristics

- Male
- \$200K salary
- Buys books on taxes
- Has 2 kids in college
- Just bought a new home

Segment A



- **Segmentation Type:** Collection of descriptive information (characteristics) about customers
- **Characteristic:** Descriptive information or traits about customers, sub-segments, or segments (the same characteristics are used to describe customer profiles, segments, and sub-segments)
- **Customer Profile:** Portrait of a customer painted by compiling applicable characteristics from across segmentation types
- **Segment:** Groupings of like customer profiles (in some companies, groupings of similar sub-segments)
- **Sub-segment:** Sub-groupings of most similar customer profiles within a single segment



“You want to grab as much relevant information as you can for analysis, then cut it many different ways to glean insights.” - Leading Retailer

What effective segmentation looks like

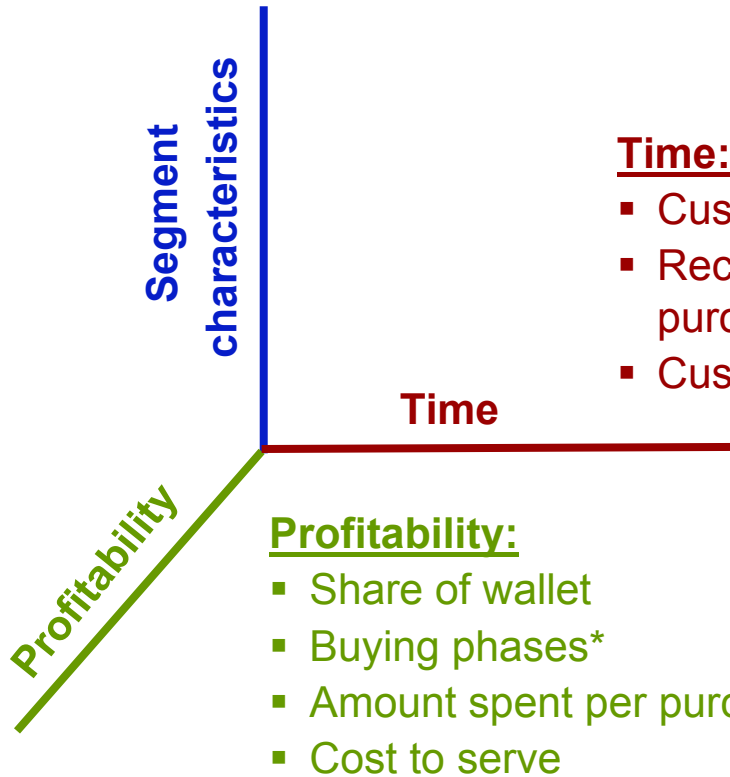
To make full use of customer segmentation’s potential, companies should look at the dynamic interaction of three key variables



Three Building Blocks of Effective Segmentation

Segment Characteristics

- Multi-dimensional view
 - Who are they
 - What do they look like
 - What do they need
 - How do they act
 - What do they buy
 - When do they need it
 - Why do they want it



Time:

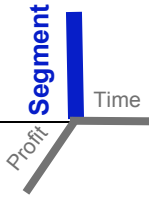
- Customer lifecycle view
- Recency and frequency of purchasing
- Customer life-stage

Profitability:

- Share of wallet
- Buying phases*
- Amount spent per purchase
- Cost to serve

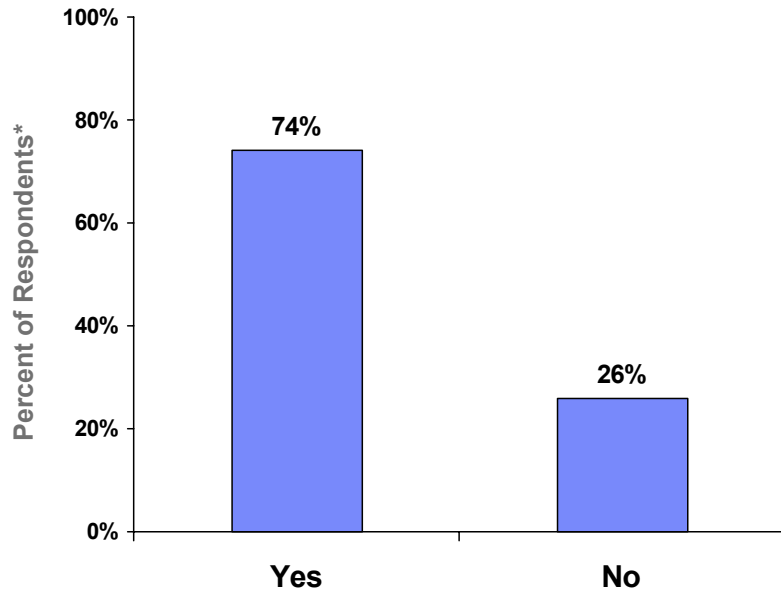
Note: *Buying phases: customer purchases tend to be cyclical; e.g., a period of time when purchases are made frequently followed by a period of time where purchases are less frequent.
 Source: IBM Institute for Business Value analysis, 2003.

Almost three-quarters of the companies we surveyed, and 100% of those we interviewed, rely on a multidimensional view of the customer



Multidimensional Use of Segmentation Characteristics

Use of Multi-Dimensional Segmentation



Executive Quotes About Value of Multi-Dimensional

- “One dimensional segmentations continually resulted in segments that were not that differentiated. Multi-dimensional studies enable us to maximize differentiation and make segmentations more actionable.” - Top Tier International Hospitality Company
- “We primarily use value segmentation and append it with demographic and behavioral data to further differentiate segments. You cannot use only one type of segmentation because that will direct you to the least common denominator.” - Top Five US Asset Manager
- “Segmenting customers by using just internal customer data is limiting because it only shows your view of the world.” - Top Ten Insurance Organization



Together, demographics and behaviors only account for about half of what customers buy. The rest of the purchasing equation is propelled by the buyer's attitudes and motivations

Note: *IBM quantitative online survey, number of responses = 122

Source: IBM Institute for Business Value interviews, survey, and analysis, 2003; “Segmentation: Key to Efficient CRM,” Doran Levy, DM Review, September 2001.

What effective segmentation looks like

Multi-dimensional segmentation looks different for different industries, companies, and purposes

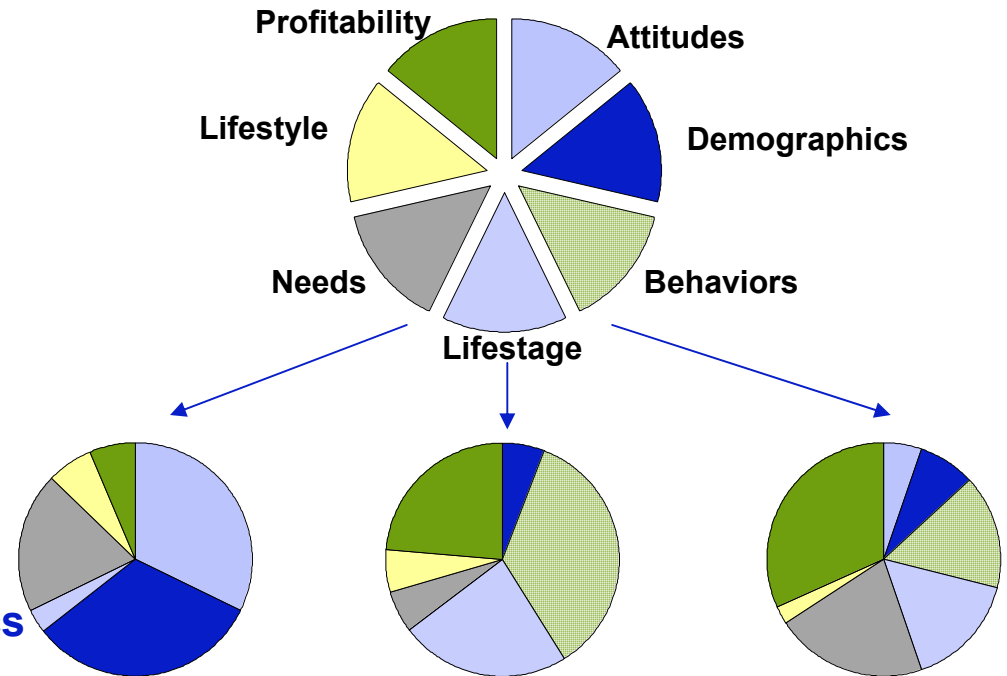


Relevant Segment Types for Your Company

Drivers of Differences

- Purposes
 - Strategic versus tactical
 - Companywide versus initiative based
 - One-on-one versus portfolio level
- Industry specific benefits
 - Individual customer profitability
- Company specific benefits
 - Attitudinal view, understanding motivations
- Product versus service
 - Portfolio level versus one-on-one

Importance of Each Segmentation Type



CPG Company:
Segmenting to develop corporate level strategy for promoting brand

Hospitality Company:
Targeting frequent flyers with specific initiatives to increase number of flights

FSI Company:
Segmenting customers one-by-one to target relevant services

Steps to Determine Relevant Characteristics

- Trial and error
- Factor analysis

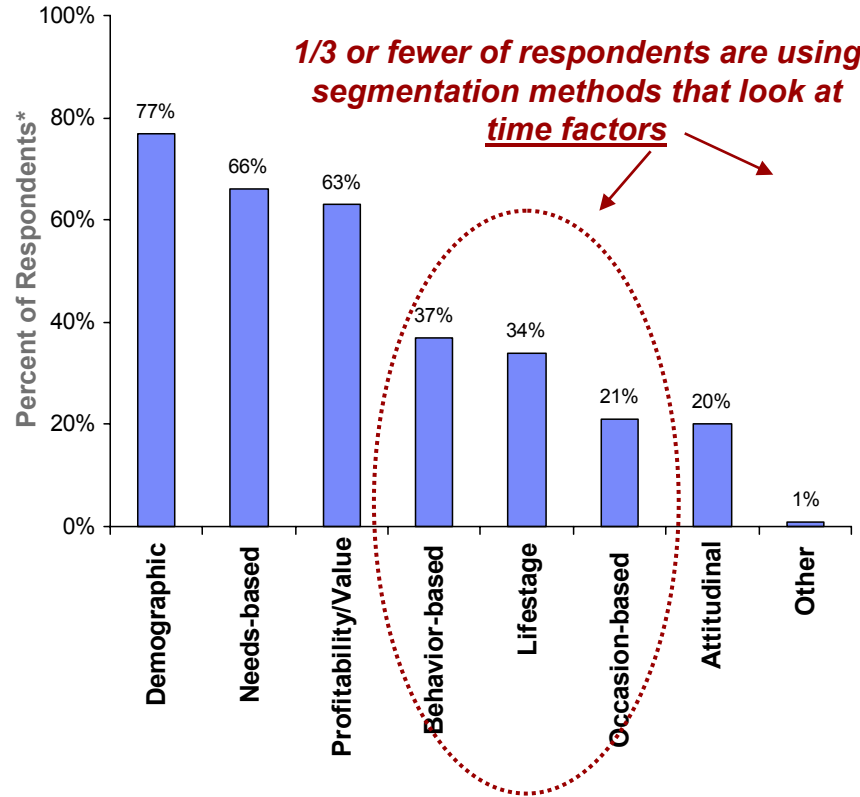
Source: IBM Institute for Business Value analysis, 2003.

What effective segmentation looks like

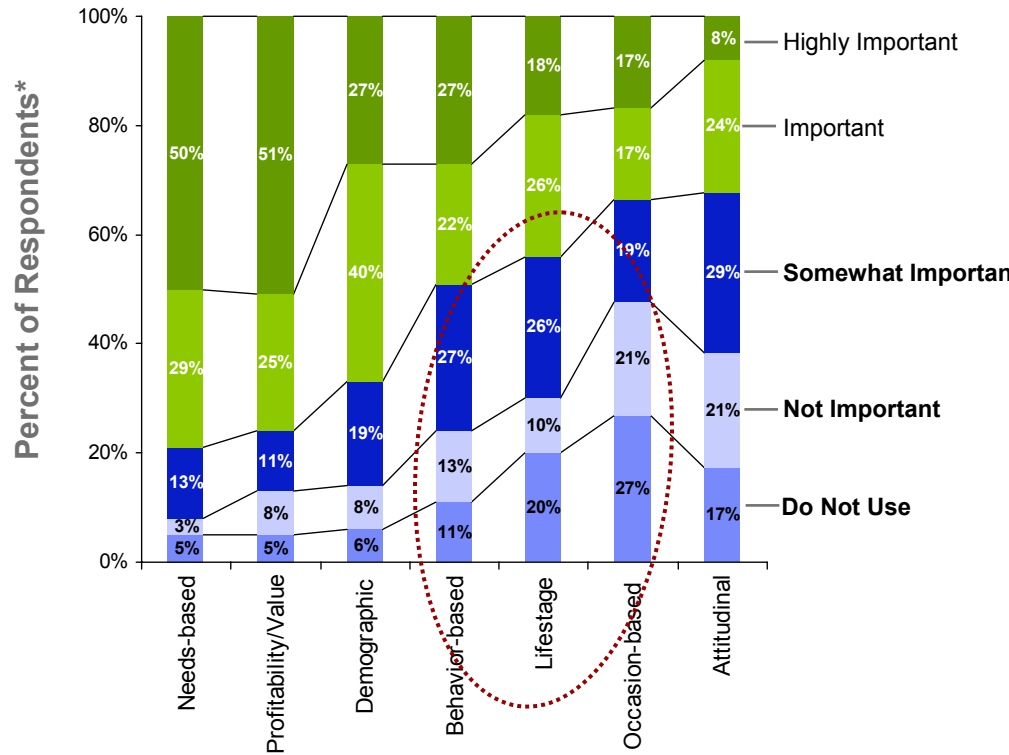
However, many companies deemphasize the time variables (reaching the right customer at the right time)



Use of Different Segmentation Type



Importance of Each Segmentation Type in Meeting Company's Needs and Expectations



More than half of respondents deem the segmentation methods that look at time factors to be less than important or do not use them at all.

Note: *IBM quantitative online survey, number of responses = 122
 Source: IBM Institute for Business Value survey and analysis, 2003.

Time variables are critical because they highlight how customers and their buying phases change over time



Customer Value Changes Over Time

What's not enough to ask:

- Which customers should be targeted? →
- Which characteristics will create distinctive segments? →
- How much will a customer buy? →

- What needs does a customer have? →
- Which customers have high profit and value potential? →

To be effective, segmentation must answer:

- Which customers should be targeted **when?**
- Which characteristics will create distinctive segment **at a given point in time?**
- How much will a customer buy and:
 - **How often will a customer buy?**
 - **For how long will a customer buy?**
 - **With what recency will a customer buy?**
 - **Where is XYZ customer in its buying phase?**
 - **What is its predicted purchase propensity?**
- What needs does a customer have **today, tomorrow, the next day, the next year?**
- Which customers have high profit potential **now, a day from now, a week from now, next year?**

❖ Companies should use CRM and its customer analytics capabilities to track customers as they grow and change.

What effective segmentation looks like

Companies should take advantage of relevant information about customers as it comes available



Customer Lifecycle



Segmentation Types and Approaches

- Demographics
- Mapping of attractive current customers to external data
- Estimated profitability

Acquisition

- Needs-based
- Preferences
- Life-stage
- Profitability

Retention

- Behavioral
- Preferences
- Profitability and customer lifetime value

Benefits of Segmenting

Begin to get to know the customer; start learning what they are like

Target customers with relevant offerings that will increase number and amounts of purchases

Track usage and purchase behavior over time; personalizes to increase share of wallet and loyalty

❖ *“Identifying segments and knowing a little about them is not enough; you have to know a lot about them.” – Leading Diversified Retailer*

Source: IBM Institute for Business Value interviews and analysis, 2003.

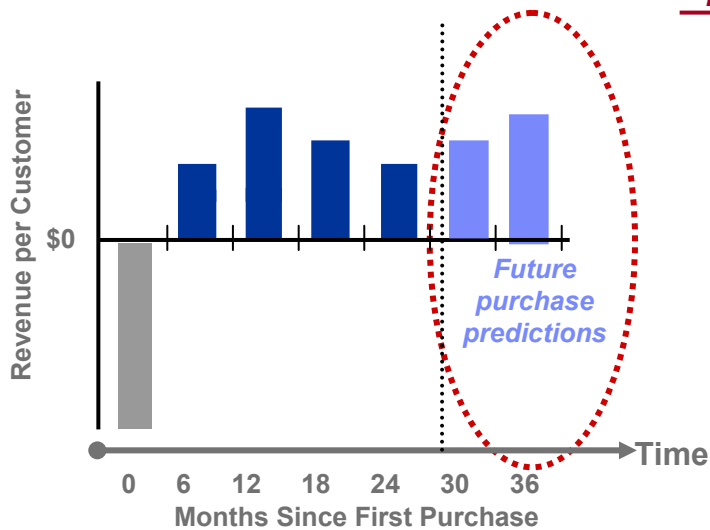
What effective segmentation looks like

Looking at profitability variables enables companies to identify profitable and high potential customers and target them effectively



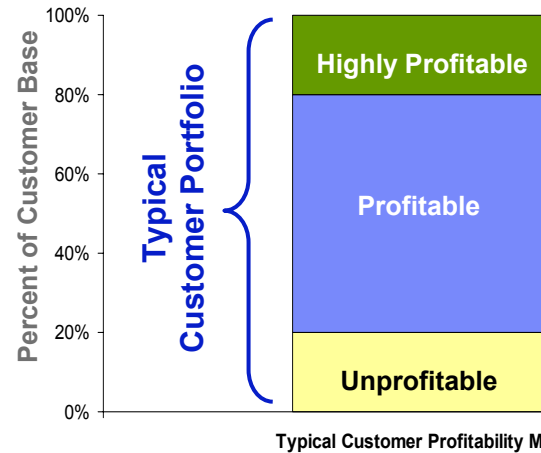
Segmentation and Profitability

Customer Lifetime Value (by customer, sub-segment, segment)



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Goal for Company: Optimizing Portfolio Profitability



What can we do to keep these customers AND keep them spending?
How can we attract more like them?

How do we get more of these customers to behave (spend) like our highly profitable customers?

How can we phase out these customers and, in the meantime, serve them economically?

Acquisition Cost
Realized Revenue
Predicted Future Revenue
Retention spending not shown for simplicity

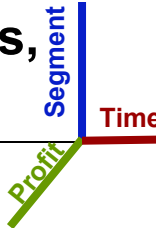


Effective segmentation lets companies view a complete picture of profitable customers at different levels: individuals, sub-segments, segments, and total customer portfolio.

Source: IBM Institute for Business Value analysis, 2003.

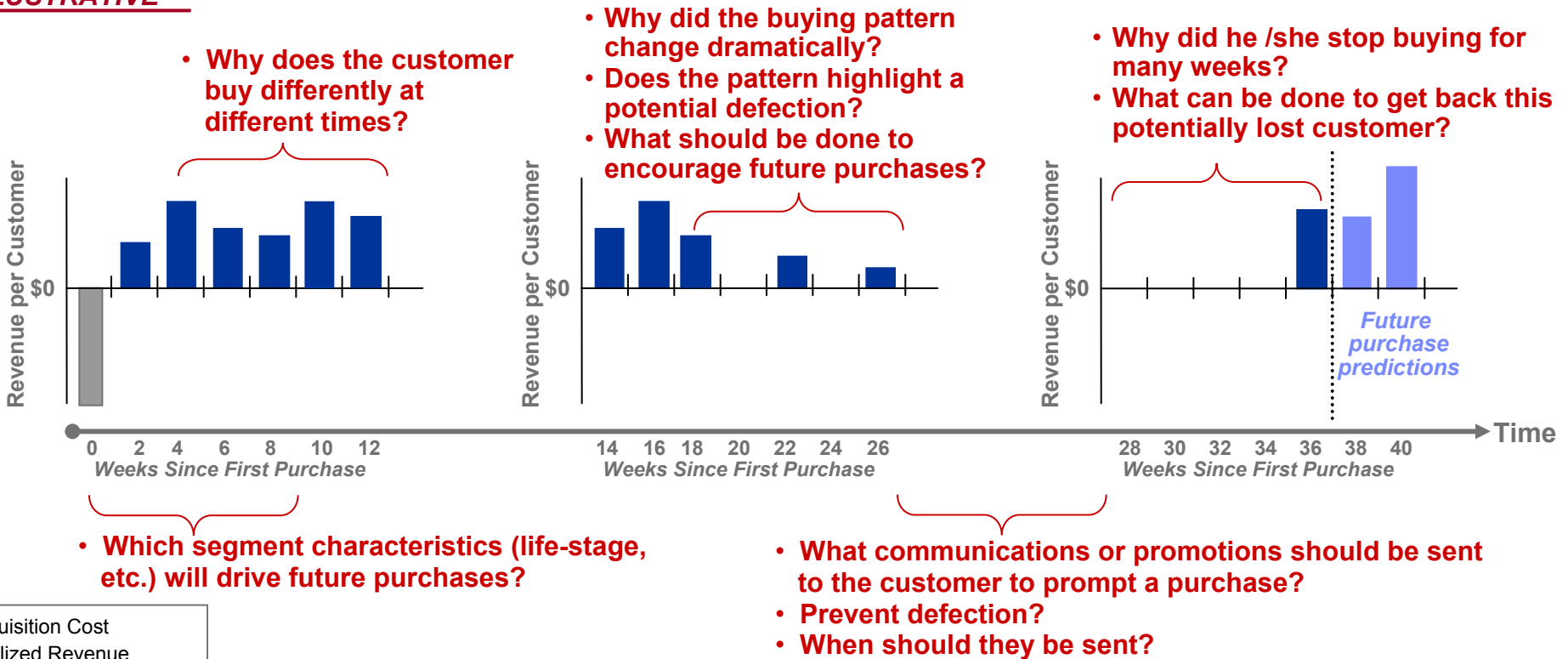
What effective segmentation looks like

On-going value comes from capitalizing on customers' changing patterns, defined by interaction of the three segmentation building blocks



Changing Patterns: Company Analysis and Interpretation

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Acquisition Cost
 Realized Revenue
 Predicted, Future Revenue
Attention spending not shown for simplicity

Changing patterns analysis follows predictive modeling; changing patterns applies a business interpretation to explain why; the lynchpin is timely action by the company.

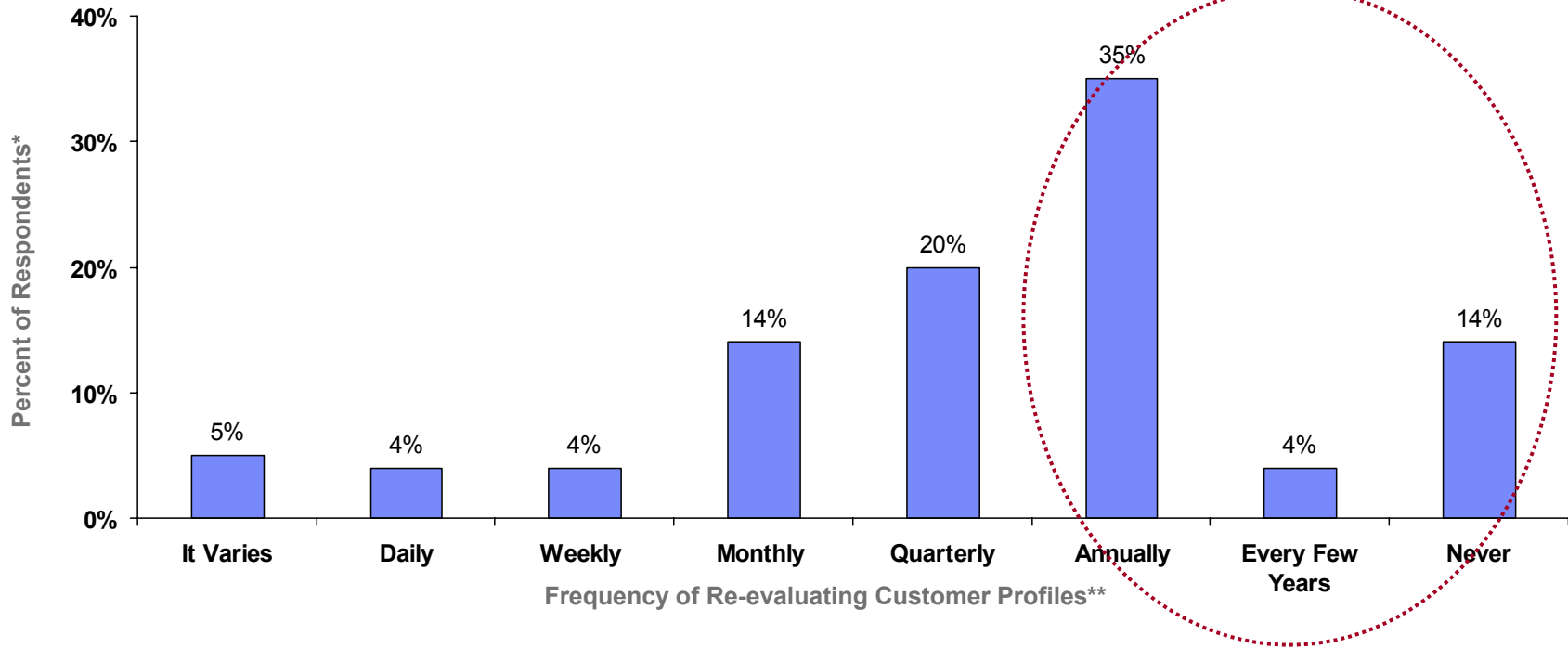
Source: IBM Institute for Business Value analysis, 2003.

What effective segmentation looks like

Act first. Today, few companies are expeditious about tracking movement of customers; this equates to missed opportunities



Frequency of Tracking and Re-evaluating Customer Profiles
(To Identify if Customers have Migrated Between Segments)



Not paying attention to changing patterns could result in a company wasting months and dollars targeting a customer who is no longer (or was never) profitable.

Notes: *IBM Quantitative online survey, number of responses = 122; ** "It Varies" and "Every Few Years" were added to graph responses from respondents who selected "Other, please explain".
Source: IBM Institute for Business Value survey and analysis, 2003.

What effective segmentation looks like

Optimal rate of tracking customers varies based on industry, purpose of segmentation, and nature of customer interaction

Segment
Time
Profit

Tracking Customer Movement


	Nearly Real-time (Daily - Monthly)	Regularly and Often (Monthly - Quarterly)	Less Often (Quarterly - Annually)
Industry / Interviewed Company	<ul style="list-style-type: none"> Financial Services Top Five US Asset Manager 	<ul style="list-style-type: none"> Distribution/Retailer International Leader in Pharmacy Products and Services 	<ul style="list-style-type: none"> Distribution/CPG Leading CPG Company
Purpose of Segmentation	<ul style="list-style-type: none"> Increasing customer share of wallet Migrating customers to higher value 	<ul style="list-style-type: none"> Identifying attractive new offerings Customer retention Migrating customers to higher value 	<ul style="list-style-type: none"> Determining optimal positioning Identifying new offerings for different segments Increasing share of wallet within growth segments
Nature of Customer Interaction	<ul style="list-style-type: none"> Through the necessary, regular and frequent interaction customers have across multiple touch points (branch, online, ATM) 	<ul style="list-style-type: none"> Through in-store and online shopping for products that are both necessary and nice-to-haves 	<ul style="list-style-type: none"> Through focus groups and customer surveys
Type of Data Collected	<ul style="list-style-type: none"> Individual customer data collected at each customer interaction Demographic data purchased from a third party 	<ul style="list-style-type: none"> Individual customer data collected with loyalty cards Data about customers as a whole collected from sales data Demographic data purchased from a third party 	<ul style="list-style-type: none"> Customer data collected in focus groups and customer surveys Data about customers collected from sales data Demographic data purchased from a third party



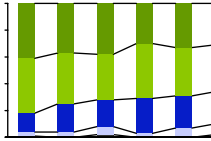
Companies, regardless of industry, should move away from annual and never updates of customer movement.

Source: IBM Institute for Business Value interviews and analysis, 2003.

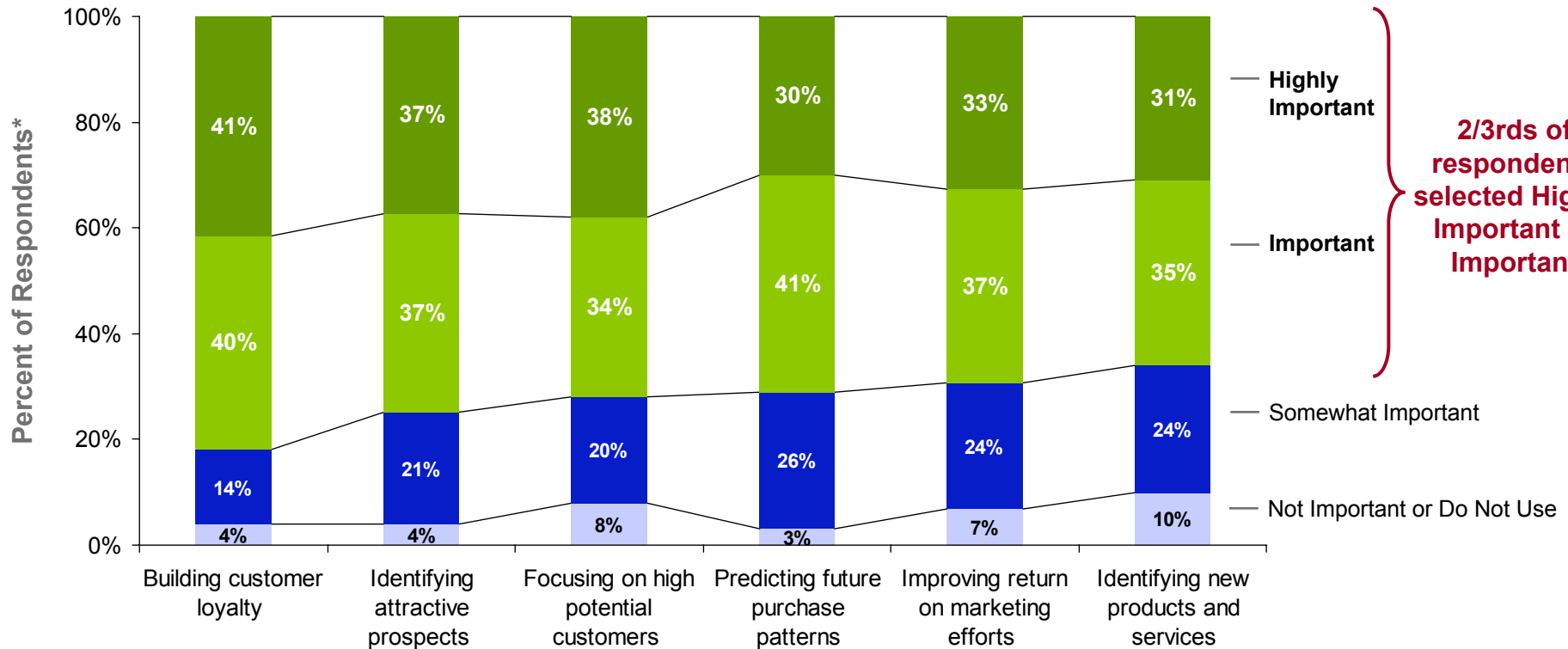
Contents

- What effective segmentation looks like
-  Using segmentation findings to reach profitable customers
- Weaving segmentation into the fabric of organizations

Companies pursue segmentation to appeal to old customers in new ways and to attract potential customers in innovative ways



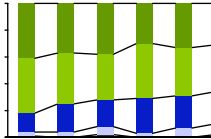
Importance of Customer Segmentation in Reaching Profitable Customers



Note: *IBM quantitative online survey, number of responses = 122
 Source: IBM Institute for Business Value survey and analysis, 2003.

How can companies make traditional segmentation techniques even better?

Even if your company uses segmentation in each of these marketing activities, there are opportunities to improve



1. Competitive Advantage
2. Why buy
3. Quantify Segmentation

Opportunities to Improve Traditional Uses of Segmentation

Competitive Advantage:
Identify New Sources of Competitive advantage

- Capitalize on changing patterns of loyal customers; keep a close eye on customer's, then, cater to their changing needs **before competitors do**
 - Only 20-35% of companies surveyed do this today
 - Pay attention to time-based elements to know how and when customers change and cater to their changing needs

Why Buy:
Understand Motivations Behind Why Customers Buy

- Incorporate the attitudinal view to understand **why** (motivations) customers buy; link to other segment characteristics to make actionable
 - Only 20% of companies surveyed do this today

Quantify Segmentation:
Establish Clear Links to Customer Profitability and Track Performance

- Strengthen link of customer profitability to segmentation; use segmentation to optimize profitability of total customer portfolio
 - *"Many executives haven't the least idea just how profitable (or unprofitable) individual customers or customer segments are."* - Fortune, September 2002



The opportunities we explored in the previous section improve performance across all segmentation efforts.

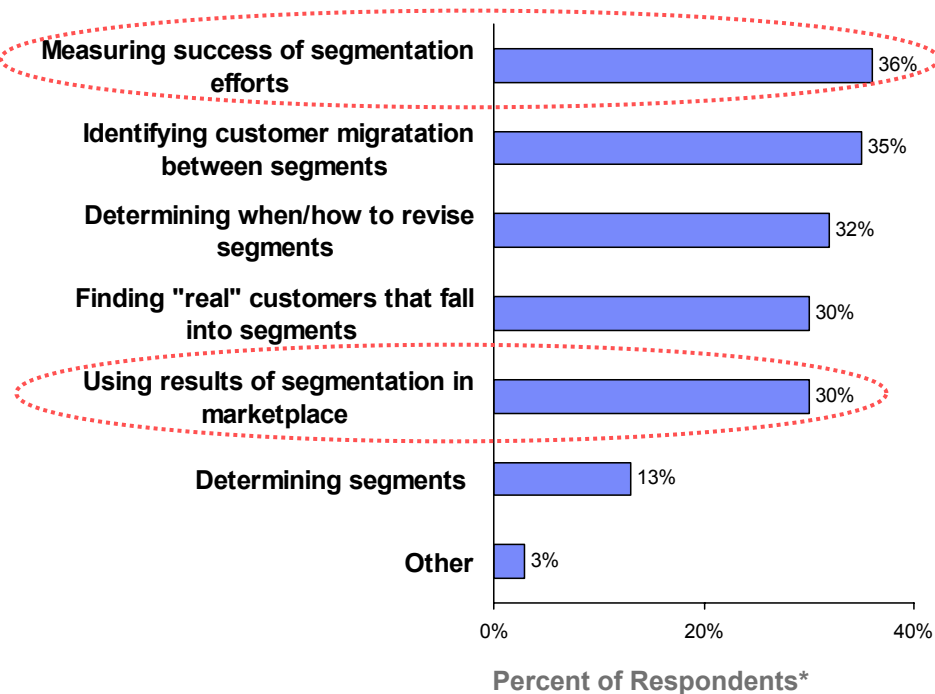
Source: ¹ "Will This Customer Sink Your Stock?" Fortune Magazine, September 15, 2002.
Source: IBM Institute for Business Value analysis, 2003.

Using segmentation findings to reach profitable customers

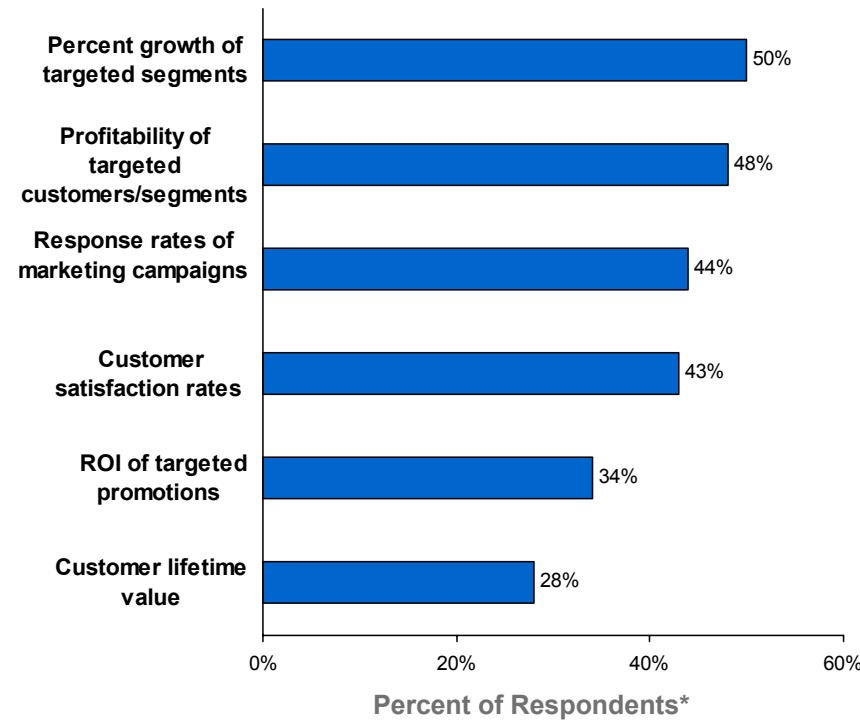
30% of companies surveyed cited making segmentation actionable as a major challenge; 36% said its tough to measure

Making Segmentation Actionable

Biggest Segmentation Challenges

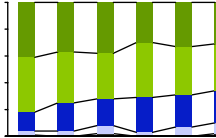


How Companies Measure the Effectiveness of Segmentation Efforts



The question is: what can be done to ensure actions taken yield positive results in the market place?

Note: *IBM quantitative online survey, number of responses = 122
Source: IBM Institute for Business Value survey and analysis, 2003.



1. Competitive Advantage
2. Why buy
3. Quantify Segmentation

This financial services company empowers customer services reps to deliver the appropriate service level based on customers' profitability

Customer Service Reps put Segmentation Knowledge into Action



Top Five US
Financial Services
Company

Segmentation Strategy

- Top Tier US bank uses data mining and activity based costing to tier customers into a pyramid based on profitability and assets
- Within each tier, customers with high growth potential are singled out

Migrating Customer Up

- Protocols for sales and service are set for each "High Potential" sub-segment; primary focus is retaining and migrating these customers up to next tier
- When a teller accesses a "High Potential" customer's record, a flag appears designating tier of service and specific offers to extend

Putting Segmentation Into Action, Examples:


- Special Pricing: Sales representatives know they can offer 50 basis points off a loan to a High Potential customer, but only 35 basis points off a loan to a customer in a mid level tier
- Phone Systems: Customers in higher tiers are routed to front of phone queues, to shorten their wait time and ensure they are served by experienced customer service representatives
- Sales Efforts: Sales representatives and customer service representatives know what sales actions and special offers to extend to each customer to try to migrate that customer up to the next level



Sales forces' incentive programs are linked and aligned with the company's goal of migrating customers tagged as "High Potential" up to the next tier of the pyramid.

Source: IBM Institute for Business Value interviews and analysis, 2003; "An Interview with Valarie Zeithaml," ITSMA, August 1999; "Segmentation: Building a Segmented CRM Database in an Emerging Market," Doran J. Levy, DMReview.com, July 2001, "Unequal treatment," Wall Street Journal, 1999.

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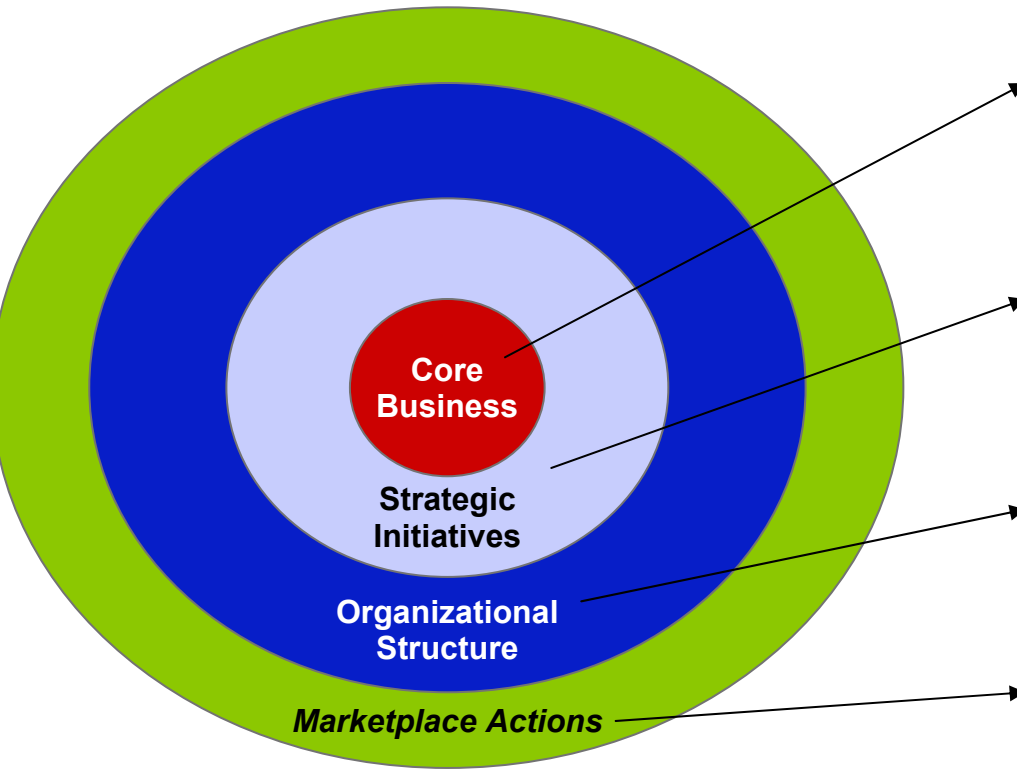
- What effective segmentation looks like
- Using segmentation findings to reach profitable customers
-  **Weaving segmentation into the fabric of organizations**



The most successful businesses make what they learn about customers integral to the organization

Segmentation Impacts Strategy and Structure

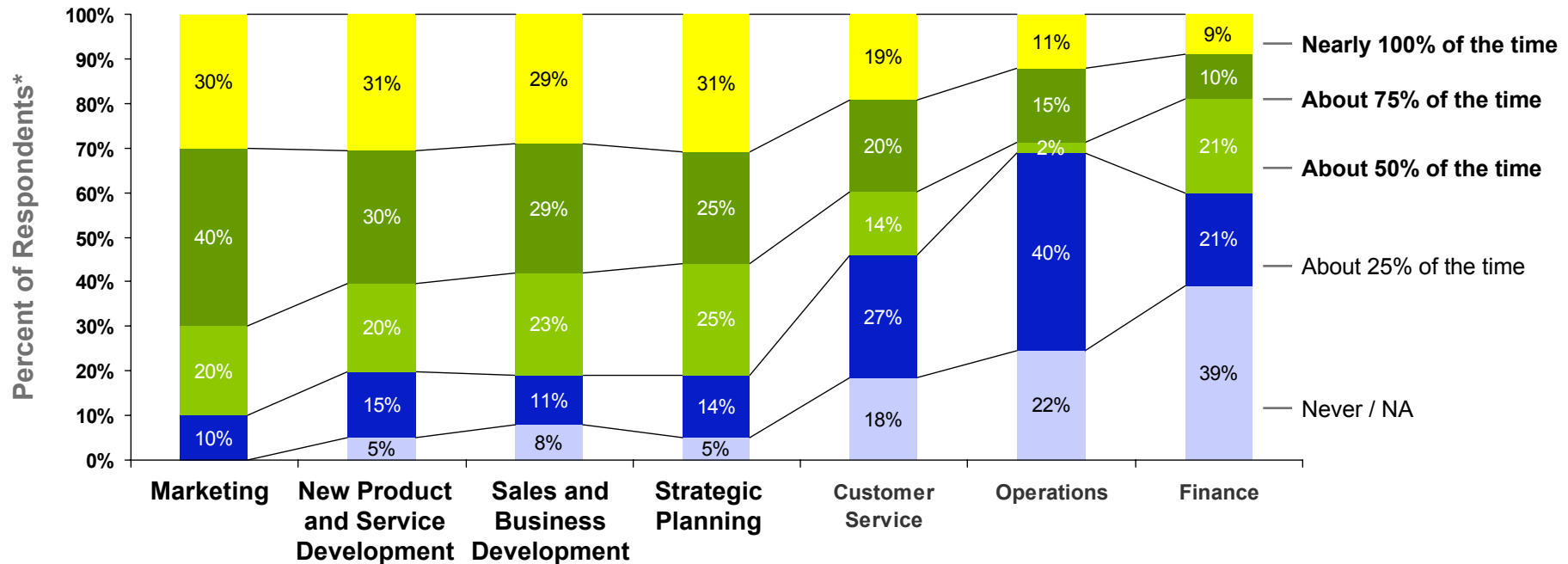
Applications of Segmentation



- **Core Business Strategy:** How segmentation is used in development of strategy, evaluating and revising value propositions, and creating competitive advantage
- **Strategic Initiatives:** How segmentation is used in financial planning, new product and service development, and analysis of individual initiatives
- **Organizational Structure:** How segmentation results and customer understanding can be used to improve and modify organizational structures in order to better serve customers
- **Marketplace Actions:** How segmentation is used to improve and focus customer acquisition and retention efforts (covered in previous section)

Today, companies are using segmentation across numerous functional areas

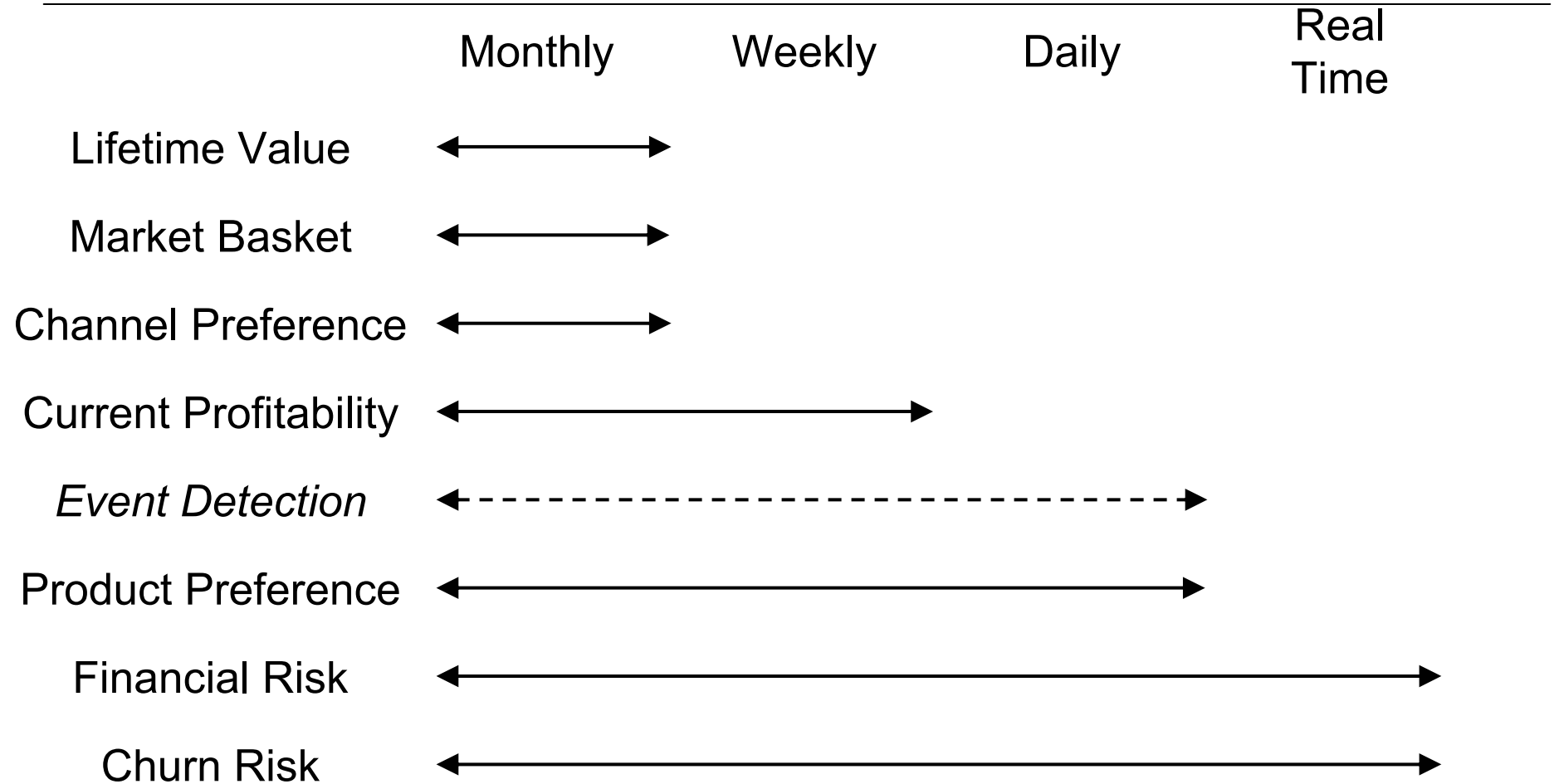
Functional Areas' Use of Customer Segmentation to Support Initiatives and Endeavors



Over three-quarters of respondents said marketing, product development, sales and business development, and strategic planning groups use segmentation in over 50% of their efforts.

Note: *IBM quantitative online survey, number of responses = 122
 Source: IBM Institute for Business Value survey and analysis, 2003.

How Real Time Do Decisions Need To Be?



Source: Gartner 2003

Advancements in the use of customer information is driving changes within Business Intelligence

- Significant increase in amount of data captured, stored and analyzed
- Drive to more frequent analysis up to and including real-time
- Data Warehouse must support multiple work streams (batch <-> transactions)
- Increased drive toward consolidated customer data for all products, channels and contacts
- Shorten window for development and deployment of analytic models
- Increased requirement for operational data mining

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