

Five Predictive Imperatives for Maximizing Customer Value



Applying predictive analytics to enhance customer relationship management

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Customers rule the economy

Whether you call solving the business problems related to customer profitability “customer relationship management” or just good business, you know that strengthening customer relationships is imperative for business success for one simple reason: customers drive profits.

In today’s increasingly global and competitive marketplace, customers have more options available to them than ever before. Many analysts and journalists, in fact, are calling this a “customer economy.” Attracting customers cost effectively and meeting their expectations for selection, price, quality, and service are essential to a customer value strategy. It is equally important, however, to identify and retain profitable customers, and increase their value over time. This requires the ability to anticipate customer needs and present attractive offers in the right way, at the right time. The companies who can do this will be the companies that thrive in the customer economy.

Many CRM initiatives fail to generate expected returns

Businesses in virtually every industry have implemented CRM strategies. Some have been massive initiatives, supported by significant investments in technology and designed to shift a company’s orientation from products to customers. Many of these initiatives, however, are failing to generate the expected returns and deliver significant value. This is partly due to the difficulty of pushing change through established cultures or processes. But another factor is that although operational CRM systems such as sales force automation or call center systems provide the necessary foundation for better customer relationships, they don’t do much to improve organizations’ ability to maximize customer lifetime value.



Highlights:

- Predict the most effective ways to win customers
 - Anticipate changes in customer attitudes and preferences
 - Develop more intimate customer relationships
 - Identify and retain customers who are likely to leave
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Summary:

Currently, most CRM systems rely on historical analytics that provide only a “rear-view mirror” of your customer relationships, offering little support for the decisions that shape the future. However, with predictive analytics you can meet your customers’ evolving needs with forward-looking insights that anticipate changes in customer attitudes, preferences, and actions. This white paper describes how following a set of best practices – five predictive imperatives – can ensure that your company maximizes the value of your customer relationships and sustains higher levels of revenues and profits.

The lifetime value of a customer is defined as the total profits generated during the time the customer does business with your company. The concept behind maximizing customer lifetime value is simple: Deliver value to customers cost effectively. When your organization delivers what customers need – what’s valuable to them – customers are more likely to remain open to future marketing efforts, buy more of your products and services and, as a result, become more valuable. This is a win-win relationship for both you and your customer. However, to achieve and maintain this type of relationship requires support from both operational and analytical CRM systems.

Analytics drives CRM returns

Until recently, analytics didn’t come up often in CRM conversations. Now, though, leading CRM experts are nearly unanimous, noting that analytics not only improves CRM efforts, but is essential to their success.

Companies typically start with historical analytics, using a combination of reporting tools, specialized data ware-houses, and online analytical processing (OLAP) solutions. As mentioned above, these solutions focus on understanding and measuring the outcome of past decisions and results, and can be useful in narrowing the scope of further investigations. But on their own, they can’t provide your organization with a clear picture of the future.

Evolution of analytical CRM

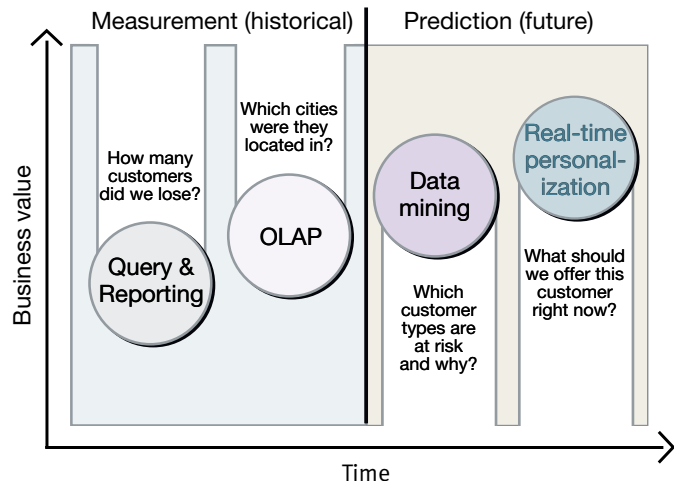


Figure 1: Every organization has data about its customers. Reporting and OLAP provide information about past customer interactions. Data mining and real-time personalization are forward-looking and can be used to guide future interactions. Over time, as companies move toward these predictive technologies, they increase the business value of their CRM information.

Industry leaders, however, are evolving their analytical capabilities by adding data mining and other predictive capabilities to their operational CRM systems. Data mining is the process of discovering meaningful and previously unknown correlations, patterns, and trends in large amounts of data. To make these discoveries, data mining relies on pattern recognition technologies, and statistical and mathematical techniques. Because it is forward-looking, data mining enables your organization to measure the potential of your customer relationships and develop plans to maximize that potential.

The most evolved analytical CRM solutions continuously apply predictive analytics technologies and deploy the results enterprise-wide, so that whether customers interact with your organization online, by phone, or face-to-face, they receive the kind of treatment that meets their present needs and anticipates new ones. This increases their tendency to remain loyal and make additional purchases, increasing their lifetime value – and your organization’s profits.

For example, one of the world’s largest airlines relies on predictive analytics to optimize revenue for each flight, improve service for its best customers and increase customer loyalty. By using IBM® SPSS® Modeler for predictive modeling, its agents and flight staff were able to identify high-value customers and ensure that their needs were met. The resulting increase in customer satisfaction boosted annual revenues – an average of \$200 each for its “valuable” customers and \$800 each for its “most profitable” customers. Total revenues for the year after implementation increased by \$40 million. Over the same period, the airline saved \$31 million in operational costs.

The five predictive imperatives

Based on more than 40 years of experience working with a wide range of organizations, SPSS, an IBM Company, has identified the following “predictive imperatives” – best practices used by leading organizations to maximize customer value with predictive analytics.

1. Base your customer strategy on predictive profiles
2. Predict the best way to win the right customers
3. Predict the best way to grow customer relationships
4. Predict the best way to keep the right customers longer
5. Use predictive intelligence at every customer touch-point

1: Base your customer strategy on predictive profiles

Detailed, accurate predictive profiles are the essential foundation of any customer strategy and CRM initiative. To understand your customers better, use analytical tools to create customer segments, and then create predictive profiles of each segment. These profiles, when deployed enterprise-wide, enable your entire organization to focus on activities that are most likely to generate the highest returns.

Identify key customer segments

You can define customer segments based on behavioral information drawn from operational systems and on attitudinal information obtained through market research. The two approaches complement each other, enabling you to gain a more accurate customer understanding and develop more effective strategies for each customer segment.

You can segment customers and prospective customers according to a number of different criteria. For example, you can analyze customers by the amount they spend with you, by their payment pattern, by the length of the relationship, and many other factors. You can split customer segments into smaller sub-segments, even reaching the ultimate one-to-one relationship, in which you understand each individual's needs and preferences. By understanding which customers are most likely to purchase certain products or services, you can focus your marketing programs to obtain the highest possible response on your marketing investment. You can segment customers by value, behavior, demographics and even by attitude.

- Segmentation by value builds an understanding of who your most valuable customers are
- Segmentation by behavior helps you know who is most likely to purchase your products or services, so you can use marketing funds more effectively
- Segmentation by demographic and other supplemental data provides additional information that can be used in predicting customer behavior
- Segmentation by attitude adds another dimension to your customer understanding. One of the best ways to understand customers' attitudes is to ask them through survey research.

Create predictive profiles of each segment

Once you've identified the segments of customers who use and value your products and services, the next step is to understand what products or services customers in each segment are likely to want next. Adding this predictive element makes your customer relationship significantly more productive and profitable.

One of the world's leading financial services companies initiated a customer loyalty program using IBM SPSS Modeler. The data mining solution enabled the firm to analyze its data warehouse of 2.5 million customers according to 400 different attributes. By defining a number of different customer segments, the company could focus its marketing campaigns on the one percent who are not only "extremely likely" to purchase a product or service, but also have the credit rating to do so. It recouped its investment in the project within two years.

Customer Lifetime Value

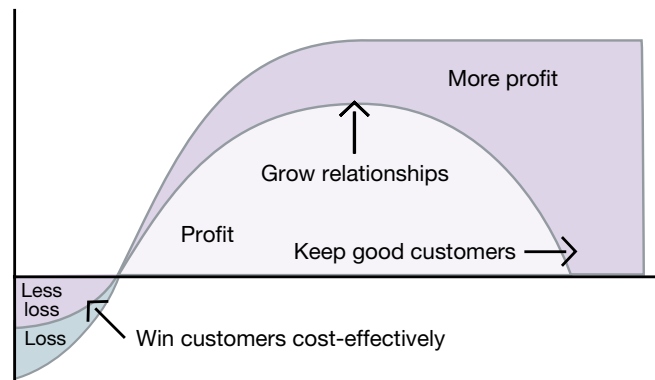


Figure 2: Predictive analytics improves customer profitability from the very beginning by allowing companies to acquire customers more cost effectively, as this graphic shows. Then, throughout the customer life cycle, predictive analytics helps companies design more attractive offers and conduct more effective marketing campaigns, leading to increased sales. Predictive analytics also helps companies retain customers, increasing the revenues and profits they obtain from these relationships.

2: Predict the best way to win the right customers

Acquiring customers is costly but necessary. Paying too high a price to attract customers, however, or acquiring the wrong types of customers, can have a significant negative impact on your profits.

Using inefficient methods to attract customers will result in higher costs and profits that are lower than they should be. Attracting the wrong customers impacts profits, too. For example, if you attract customers who are likely to leave or “churn,” you may incur the acquisition cost without ever seeing a profit from the customer relationship. Other customers may be loyal, but cost so much to serve that they are only marginally profitable.

With predictive analytics, your organization can minimize costs by directing programs toward the people most likely to respond. You can further boost profits by focusing on the types of prospects most likely to become profitable customers.

Create a prediction-based customer attraction strategy

Use predictive profiles to determine what types of customers you want to attract. Then create a cost-effective attraction strategy that includes separate plans for each customer segment.

Most companies will want to focus their attraction efforts on winning over prospects that fit the profile of their most profitable customers. But other, less-profitable customer segments may have more room to grow over the long term, or may be more cost-effective to attract – so marketing to these segments may be an attractive option when marketing budgets are tight.

Optimize your customer attraction strategy with response modeling

Fine-tune your customer attraction plans by using response modeling to predict which marketing programs will generate the highest response. This benefits your organization in two ways: you attain the results you want, while avoiding the high costs associated with unproductive marketing efforts. In this way, you see higher profits for the money you invest.

A large Belgium-based insurance company's saw its profit margin narrowed and its growth strategy threatened because the cost of adding new customers exceeded revenues from first-year premiums by almost 50 percent. Using predictive analytics and decision management technologies, the firm was able to first identify groups most likely to respond to a campaign, and then perform a sophisticated profit-cost analysis. Using this information the company reduced its direct marketing costs by 30 percent and made acquisition campaigns profitable in the first year. In addition, long-term customer profitability increased by 20 percent.

Improve conversion rates with prospect surveys

Market research can be used to improve customer acquisition both before and after your campaigns. Beforehand, surveys of groups identified as likely prospects can clarify their reasons for buying your products or services, enabling you to refine your campaign offers. Afterwards, by surveying prospects that did convert and those that did not, you can learn what worked, and what you need to change, to earn prospects' business in the future. By using this type of predictive intelligence to guide your customer attraction strategy, you can improve the conversion rate for your best prospects.

Customer value analytical architecture

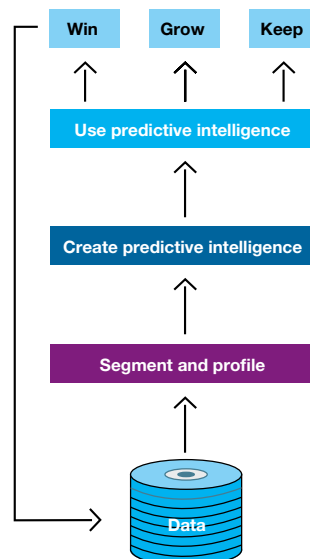


Figure 3: Build predictive analytics into your customer relationships and learn from the data generated by every interaction. Use your data to know customers better, create predictive intelligence on each customer segment and use that intelligence to improve customer interactions and maximize customer lifetime value.

3: Predict the best way to grow customer relationships

To maximize customer growth and increase customer lifetime value, your organization needs to know not only what customers are most likely to want, but also when and how they will want it delivered. With predictive analytics, you can achieve this level of customer knowledge.

Create a prediction-based customer growth strategy

By using predictive profiles, product-affinity models, segment-migration models, response models, and even survey research, you can generate predictive intelligence about your customers. As a result, your customers will be more satisfied with your service, and reinforce their decision to buy from you again.

Discover product affinities

Customers often purchase products and services together, or in certain sequences. By analyzing their “market baskets” – products and services purchased at the same time – you can offer customers appropriate additional products at just the right time. Understanding what products your customers buy together can lead to improved product placement in retail stores, attractive “bundling” of products in both direct marketing and online offers, and more timely offers. Not only does this increase revenues, it generally improves customer satisfaction and contributes to maximizing customer lifetime value.

A leading computer retailer in Japan, used IBM SPSS Modeler to build a recommendation engine that suggests products to visitors to its Web site. Recommendations are based on customer profiles and information about prior purchases contained in the company’s database. The first year it was implemented, the recommendation engine resulted in a sales increase of 18 percent, and a profit increase of 200 percent.

Predict segment migration

Applying data mining techniques to your historical sales data shows you who buys what. By combining this information with other data, you can also make other kinds of predictions, such as which customer segments will become more valuable and which less valuable, and by what amount.

Predictive segmentation modeling shows you which characteristics are linked to migration between customer value segments. Adding this kind of predictive intelligence to your customer growth strategy enables you to realistically plan growth for each segment.

Models useful in analytical CRM:

- Response models predict which customers are likely to respond to a new offer
 - Product-affinity models predict which sets of products customers are likely to purchase together
 - Segment-migration models predict which groups of customers are likely to become more or less valuable
 - Attrition models predict which customers are likely to leave
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Optimize your customer growth strategy with response modeling

Fine-tune your customer growth plans by using response modeling to predict which types of marketing programs will generate the highest response.

A firm that operates 15 vacation parks initiated a growth strategy that included improving its occupancy rate and cross-selling more sports and leisure activities to guests. Using predictive analytics and decision management technologies, the company added smaller, more targeted mailings to its marketing strategy. This reduced direct marketing costs by close to \$1.5 million in a single year, while increasing revenues by \$1.65 million.

Grow relationships by asking customers what they want

Using the data you already have to predict customer needs is a powerful way to improve interactions and lifetime value. But it is also important to systematically ask customers what they want. Surveying your customers and gaining a better understanding of their needs, and why they buy from you, enables your organization to improve your customer growth strategy and maximize customer lifetime value.

4: Predict the best way to keep the right customers longer

Studies have shown that customer acquisition can cost five to 12 times more than retention, and that improving its customer retention rate by just five percent can increase an organization's profitability by from 25 to 100 percent. Obviously, improving customer retention can have a big impact on profits.

Customer attrition is particularly challenging for online retailers and companies in financial services, telecommunications, and other industries where customers can change vendors relatively easily.

Create a prediction-based customer retention strategy

Keep your best customers longer by creating attrition models, and then use these models to determine which customers are at risk of defecting. You can enrich these models through survey research that adds valuable attitudinal information.

Create predictive attrition models

Understand which customers are most likely to leave for competitors and, more importantly, why. By applying data mining techniques to data about your customers, you can develop profiles of customers who are valuable and customers who have previously defected. Then you can develop strategies to keep your valuable customers from leaving.

A multinational European bank with more than one millions customers successfully reduced customer attrition with data mining. Using IBM SPSS Modeler, it identified key behaviors of customers likely to leave the bank, so it could do what was needed to keep them. By focusing retention efforts on its most valuable customers, the bank reduced attrition by 15 to 20 percent and increased profits by 10 to 20 percent.

A European telecommunications company also uses IBM SPSS Modeler to identify customers likely to leave or “churn.” By discovering what types of customers were likely to leave, the company was able to make targeted offers that reduced churn by 20 percent, compared to a similar group that did not receive the offer.

A U.S.-based telecommunications company used IBM SPSS text analytics and data mining technologies to predict and prevent churn. It increased the effectiveness of its attrition model by 10 percent, saving hundreds of thousands of dollars and putting itself in a stronger competitive position in its industry.

Conduct and analyze satisfaction surveys

Satisfaction surveys are invaluable in determining not just whether customers are satisfied, but why, and in uncovering issues that may affect their future loyalty in time to take corrective action. Even customers that you aren’t able to retain have potential value to your organization. By surveying customers that you failed to retain, you can better understand what you need to do to keep customers like them.

A Netherlands hospital that serves nearly 120,000 patients annually needed to comply with the requirements of national healthcare quality legislation. In addition to monitoring mandated quality standards, the hospital also wanted to monitor patients’ opinions and preferences. The hospital chose the IBM® SPSS® Data Collection survey research suite to collect and manage information and IBM® SPSS® Statistics software to analyze the data. Survey results pointed to several areas in need of improvement – for instance, a majority of patients indicated they were insufficiently informed about where they could turn for emotional support. The hospital used its findings to make improvements and is extending its evaluation process to its nursing and outpatient departments.

5: Use predictive intelligence to drive customer interactions at every touch-point

Monitor and manage customer value

Management gurus tell us that we cannot manage what we do not measure. This is certainly true of customer relationship management. Profitable customer relationship management requires precise, timely measurement of the factors that affect customer success, and your bottom line. This effort requires a combination of historical and predictive technologies: predictive analytics, to identify customer targets for acquisition, up-selling, or cross-selling; and historical analysis, to monitor the results of marketing campaigns and sales programs.

Power CRM systems with prediction

By deploying the results of predictive analytics to every customer touch-point from your branch offices to your call center to your Web site, you can achieve greater effectiveness and profitability. Build predictive results into your Web site, and visitors will be automatically presented with the offer most likely to result in a sale. Or build predictive results into your call center, so that sales representatives know what products or offers are most likely to suit a particular customer's needs. Every bit of data you have coming in from these systems becomes fuel for driving future customer interactions and realizing higher returns.

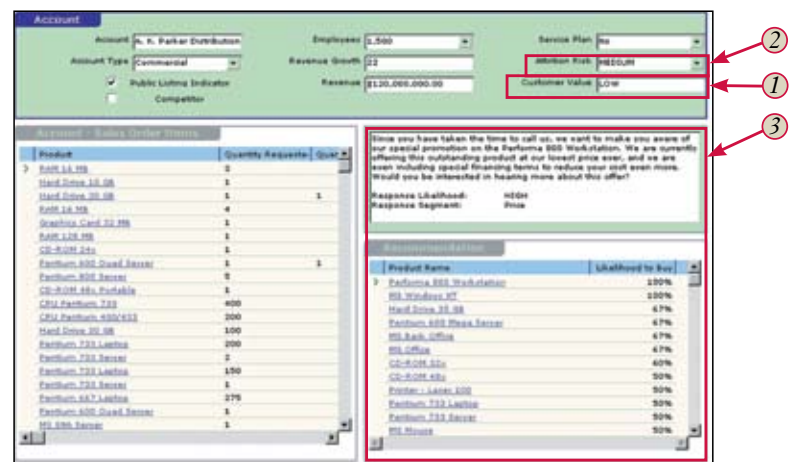


Figure 4: This is an example of predictive intelligence deployed to a call center application. The call center rep has information about the customer, including their lifetime value (1), risk of churning (2) and the recommendation most likely to satisfy them (3). That recommendation can even be refined in real time – while the rep is talking to the customer – by conducting a brief “needs assessment” survey. The survey results are fed into the call center application, which generates a new recommendation, based on the application’s predictive model.

IBM SPSS products and services for maximizing customer value

Interacting with customers profitably requires sophisticated analytical techniques and powerful deployment capabilities. SPSS Inc. offers such techniques and capabilities through a broad range of predictive analytics products and applications. These offerings provide your organization with the analytical capabilities needed to maximize customer lifetime value.

Deployment family:

IBM® SPSS® Decision Management for Customer Interactions –

Leverage all of your customer information including transactions, purchases, call histories and Web site visits to recommend the best actions your staff should take in real time.

IBM® SPSS® Decision Management for Claims – Quickly and easily determine how risk should be assessed, and automates many routine decisions while you retain full control of the claims handling process.

IBM® SPSS® Modeler Advantage – Enable non-technical users to incorporate their extensive knowledge of their customers, products and processes into the model creation process, affording them a larger role in operational decision-making.

Modeling family:

IBM® SPSS® AnswerTree® – Enable users to segment customers, create profiles and predict response rates using the widest range of decision-tree algorithms available.

IBM® SPSS® Modeler Professional – Solve any business challenge faster with more accurate results with this comprehensive data mining workbench and its powerful data preparation, visualization and predictive modeling capabilities.

IBM® SPSS® Modeler Premium – Apply a broad range of advanced data mining techniques to all of your structured data plus free-form text from documents, e-mails, call center notes, blogs, RSS feeds and other Web 2.0 sources.

Data Collection family:

IBM® SPSS® Data Collection – Improve the productivity and effectiveness of the entire survey research lifecycle, from survey authoring to data collection to reporting.

IBM® SPSS® Data Entry – Enable users to create professional surveys quickly and capture quality data efficiently, ensuring that you can start analysis and find the insight faster.

Statistics family:

IBM® SPSS® Statistics - Enable business users, analysts and statistical programmers to work together to support data-driven decision-making.

IBM® SPSS® Amos™ - Test and confirm the validity of claims such as “value drives loyalty” in minutes, not hours, with this powerful and easy-to-use structural equation modeling (SEM) software.

Consulting and training services:

SPSS, an IBM Company, has more than 40 years’ experience in delivering predictive analytics. Our expertise is available to extend your own in-house expertise and achieve the highest return on your investment. We also offer training, to transfer to your employees the knowledge and skills they need in order to use our analytical software most effectively for business problem solving.

About SPSS, an IBM Company

SPSS, an IBM Company, is a leading global provider of predictive analytics software and solutions. The company’s complete portfolio of products - data collection, statistics, modeling and deployment - captures people’s attitudes and opinions, predicts outcomes of future customer interactions, and then acts on these insights by embedding analytics into business processes. IBM SPSS solutions address interconnected business objectives across an entire organization by focusing on the convergence of analytics, IT architecture and business process. Commercial, government and academic customers worldwide rely on IBM SPSS technology as a competitive advantage in attracting, retaining and growing customers, while reducing fraud and mitigating risk. SPSS was acquired by IBM in October 2009. For further information, or to reach a representative, visit www.spss.com.



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