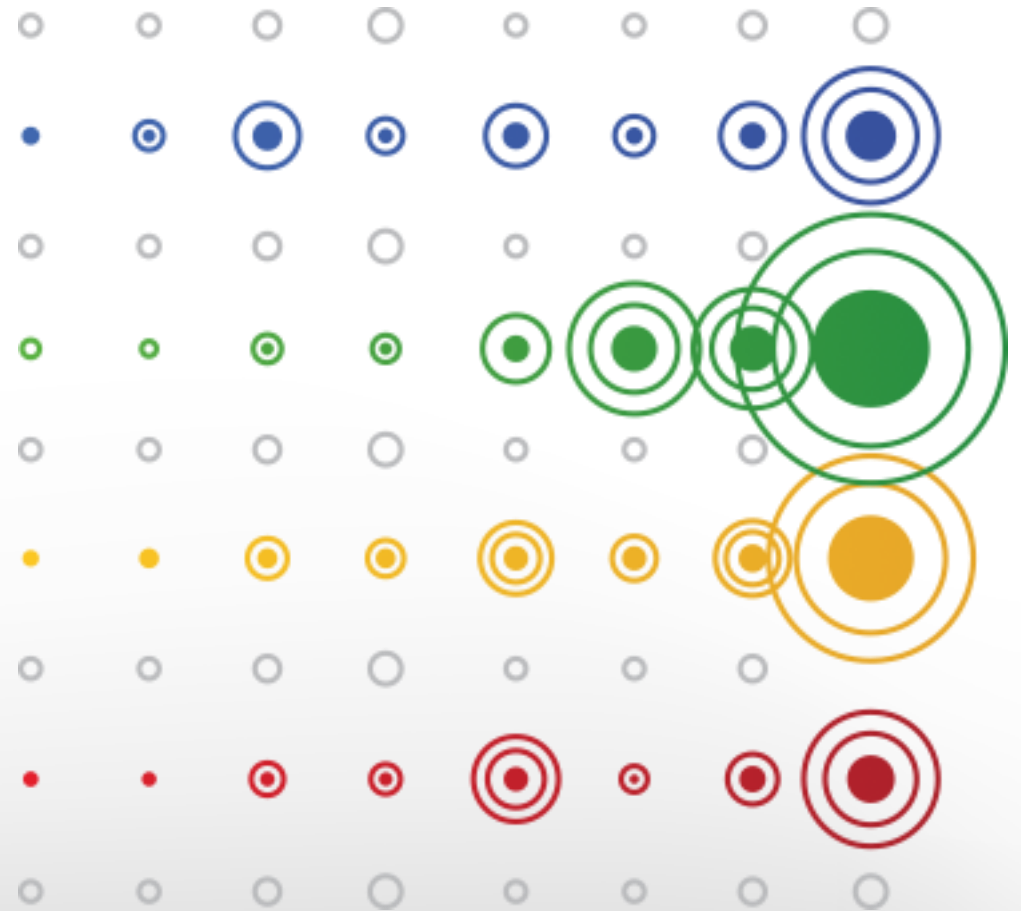




Valuable Connections:
Reaching the Right Customer -
Segment, Experiment, and Optimize

November 10, 2011

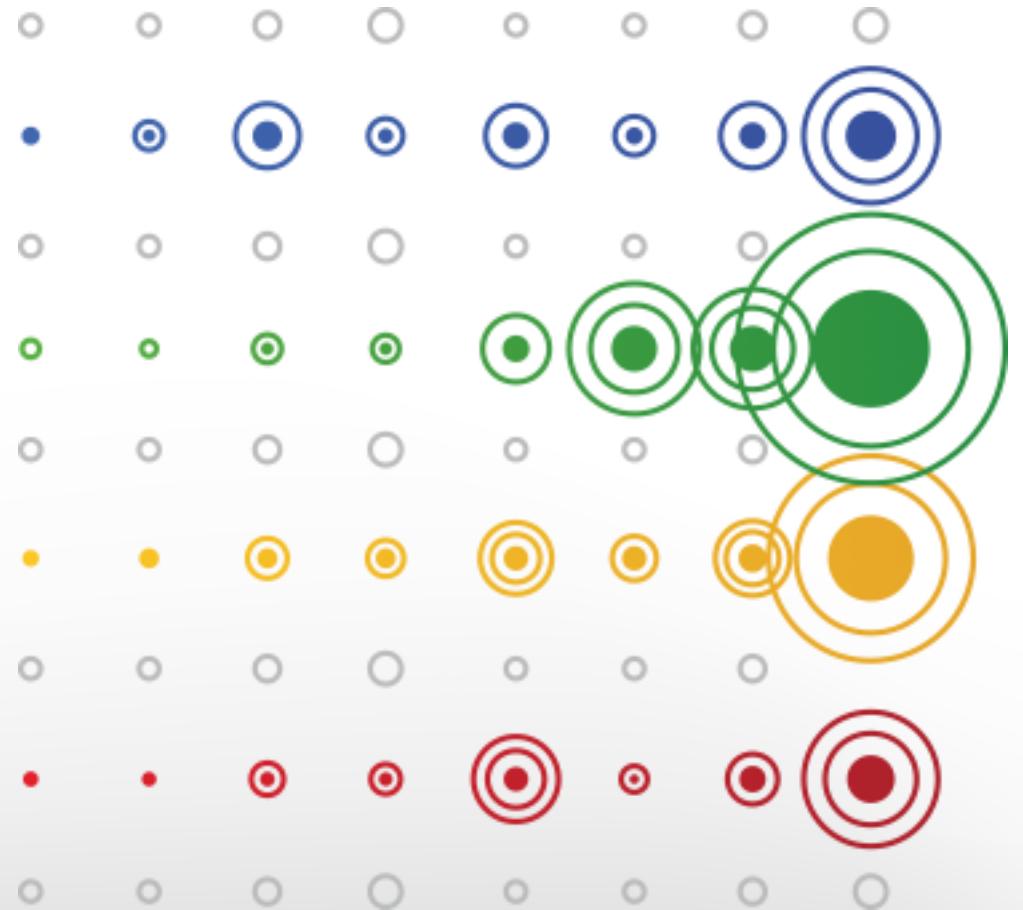


How Can Customer Centricity Be Profitable?

November 10, 2011

Professor Peter Fader
The Wharton School, University of Pennsylvania
Co-director, Wharton Customer Analytics Initiative

@faderp



Customer centricity

What it is, what it isn't, and why it matters

- The traditional product-centric business model is showing some cracks
 - Commoditization, well-informed customers, globalization, etc.
- Customer centricity is a promising alternative but is not clearly understood
 - Many firms that are touted to be customer centric really aren't, e.g., Nordstrom, Wal-Mart, Apple, Costco, and Starbucks



What is customer centricity?

Customer centricity is a strategy that aligns a company's *development/delivery* of its *products/services* around the *current and future needs* of a *select set of customers* in order to *maximize their long-term financial value* to the firm.

Customer centricity

What it is, what it isn't, and why it matters

- The traditional product-centric business model is showing some cracks
 - Commoditization, well-informed customers, globalization, etc.
- Customer centricity is a promising alternative but is not clearly understood
 - Many firms that are touted to be customer centric really aren't, e.g., Nordstrom, Wal-Mart, Apple, Costco, and Starbucks
- **There are huge organizational challenges to becoming customer centric**
 - You must start thinking/acting like a direct marketer...

Thinking like a direct marketer...



- ✓ Identify individual customers and track their behavior(s)
- ✓ Aim to drive marketing communications based on behavioral patterns
- ✓ Constantly experiment to see what works (and for whom)
- ✓ Constantly determine (and leverage) individual customer value

Customer centricity

What it is, what it isn't, and why it matters

- The traditional product-centric business model is showing some cracks
 - Commoditization, well-informed customers, globalization, etc.

• Customer centricity is a promising alternative but is not clearly understood

And if/when we accomplish this, what is the upside? (e.g., Nordstrom,

Walmart, Apple, Costco, and Starbucks)

• That's our focus this afternoon...

– You must start thinking/acting like a direct marketer...

Living in a customer-centric world

- The goal of the firm is to **maximize shareholder value**
- Celebrate **customer heterogeneity**:
Distinguish the profitable customers from the less profitable ones
- Focus on expected **future profitability** (aka customer lifetime value) instead of past profitability
- The competitive advantage – “**relationship expertise**” with each customer
- Customer-centric **organizational structure**



COMING SOON: HIGHLIGHTS FROM THE 2011 ESSENCE® MUSIC FESTIVAL*

Stay tuned to our site to be among the first to see highlights from one of the hottest music festivals in the country!

Learn More

FACEBOOK*

My Black is Beautiful: Feel free to whip your hair back and forth after you've used Pantene North America Relaxed & Natural Collection. Now tell us - which famous celebrity haircut would you love to rock the most?

My Black is Beautiful: What's the #1 topic of discussion when you get together with your girlfriends?

LIKE US ON FACEBOOK



DISCOVER MY LIFE, MY STYLE

Bring out your true beauty in everything you do! Do things your way with our new feature, designed to give you expert advice and useful tools to fit you, your life and your style!

Learn More



My Home Made Beautiful

Get tips, ideas and inspiration to make your home a comfort zone. Discover My Home Made Beautiful, and get more out of life at home.

Learn More



"BLAQUE" BEAUTY ROCKS!

Discover the power of your beauty from this month's True Beauty Story. Let Stylic B.'s poem bring out the best in you!

Read Her Poem

Living in a customer-centric world

- The goal of the firm is to **maximize shareholder value**
- Celebrate **customer heterogeneity**:
Distinguish the profitable customers from the less profitable ones

But we still haven't answered the big question:

how are profits improved as a result?

- Customer-centric **organizational structure**

Show me the money!

- Customer centricity can lead to improved profitability through greater effectiveness/efficiency in:
 - **Customer acquisition**
 - **Customer retention**
 - **Customer development**



You can't expect to be world-class on all three dimensions, but doing very well at even one of these could be highly lucrative for the company as a whole.

But mastering each of these critical functions is a lot trickier than you think...

Customer acquisition



What metric is used by most firms to gauge and guide their acquisition activities?

- ~~CPA (cost per acquisition)~~
- Big mistake!



Would you use that for other assets? How about for your personal assets (e.g., clothes/shoes)?

- ✓ – VPA (value per acquisition)

Measuring the Lifetime Value of Customers Acquired from Google Search Advertising

Tat Y. Chan, Chunhua Wu, Ying Xie

Olin Business School, Washington University in St. Louis, St. Louis, Missouri 63130

“Customers acquired from **Google** on average have a higher lifetime value (**mean CLV at \$1,002**) than customers acquired from other channels (mean CLV at \$808). The difference is even larger for those whose **first-time purchase was off-line** (**mean CLV at \$1,226** versus \$959, respectively)...”

former. After accounting for future purchases and sales spillover to offline channels, the calculated profit from new customers is much higher than that when we use the conventional method. The approach used in our study therefore provides a practical framework for firms to evaluate the long term profit impact of their search advertising investment in a multichannel setting.

Key words: Customer Lifetime Value, Multiple-Channel Shopping, Customer Acquisition, Sponsored Search Advertising

Customer Retention

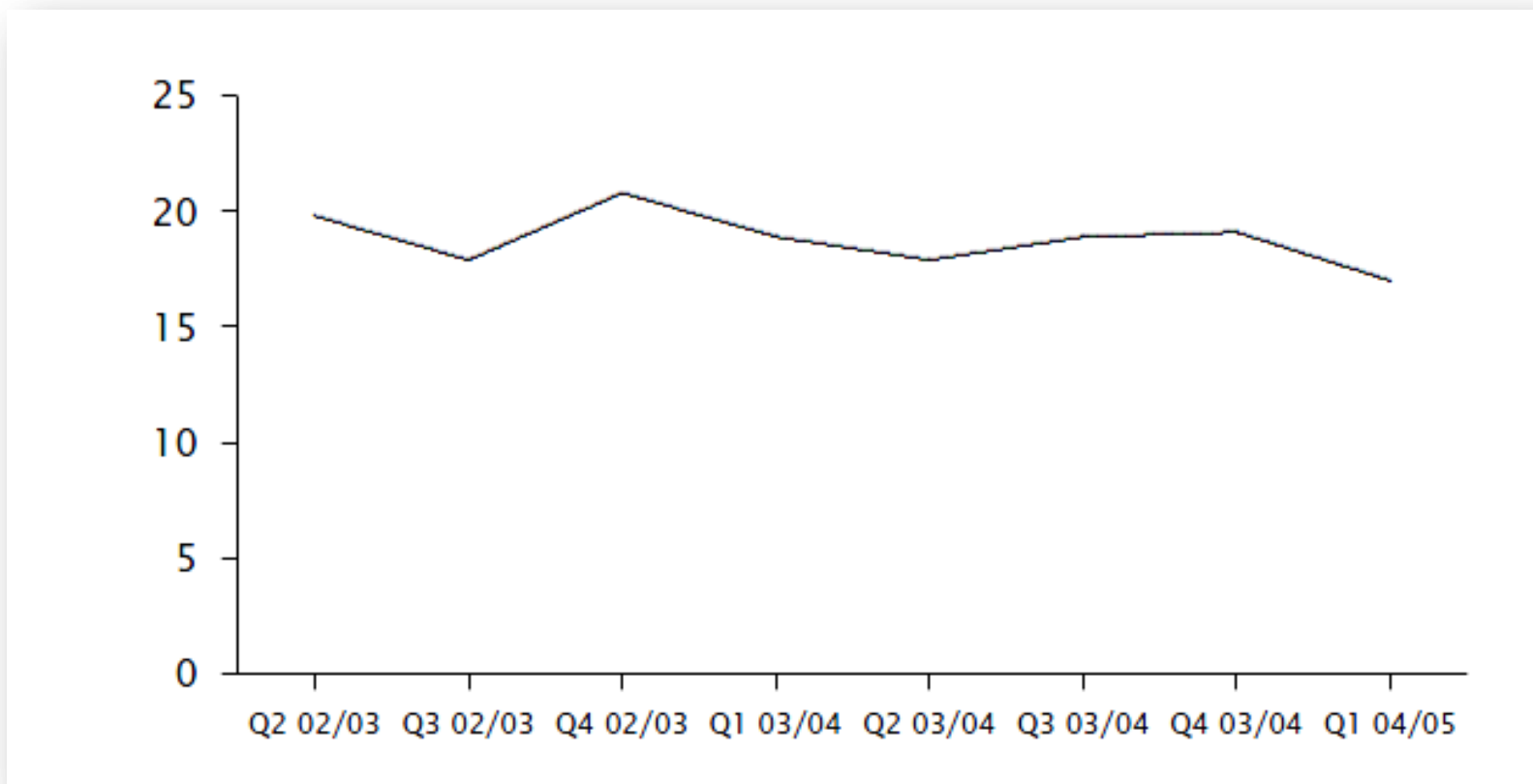


What metric is used by most firms to gauge and guide their retention activities

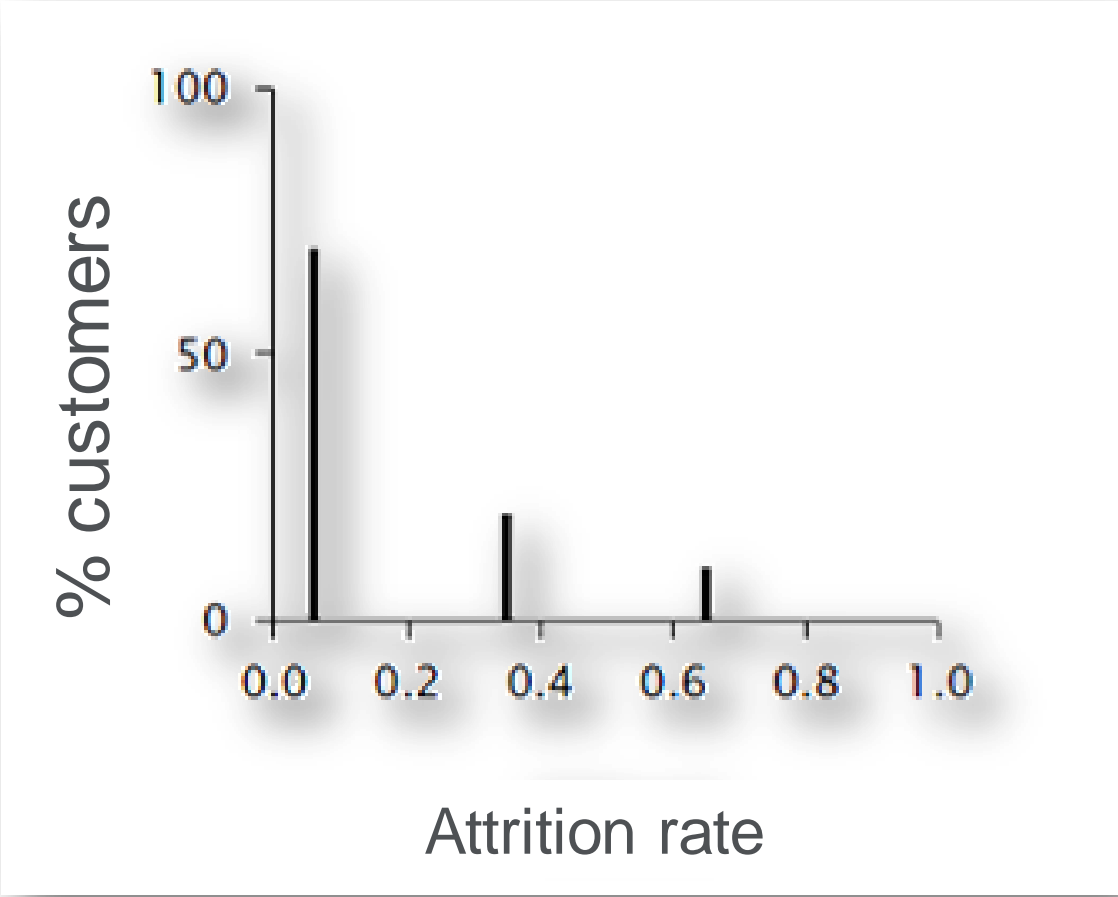
- Churn/attrition rate (or retention rate)
- This is a good metric, but you need to examine it at the right level...

Vodafone attrition rate

Quarterly annualized %

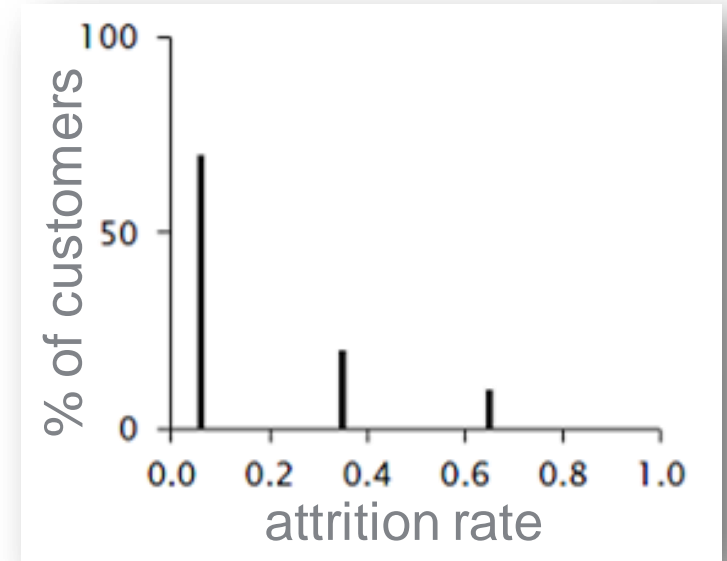


How about heterogeneity?



Translation to Customer Lifetime Value

cluster	attrition rate	% of customers	expected lifetime
low risk	0.06	70	16.7 years
medium risk	0.35	20	2.9 years
high risk	0.65	10	1.5 years



Average attrition rate: **0.177** ($0.06 \times 0.70 + 0.35 \times 0.20 + 0.65 \times 0.10 = 0.177$)

Expected lifetime using this average attrition rate: **5.6** years

Correct average lifetime: **12.4** years ($16.7 \times 0.70 + 2.9 \times 0.20 + 1.5 \times 0.10 = 12.4$)

Customer Development



What metric is used by most firms to gauge and guide their development activities

- Share of wallet
- This is a decent metric, but it doesn't tell the whole story...

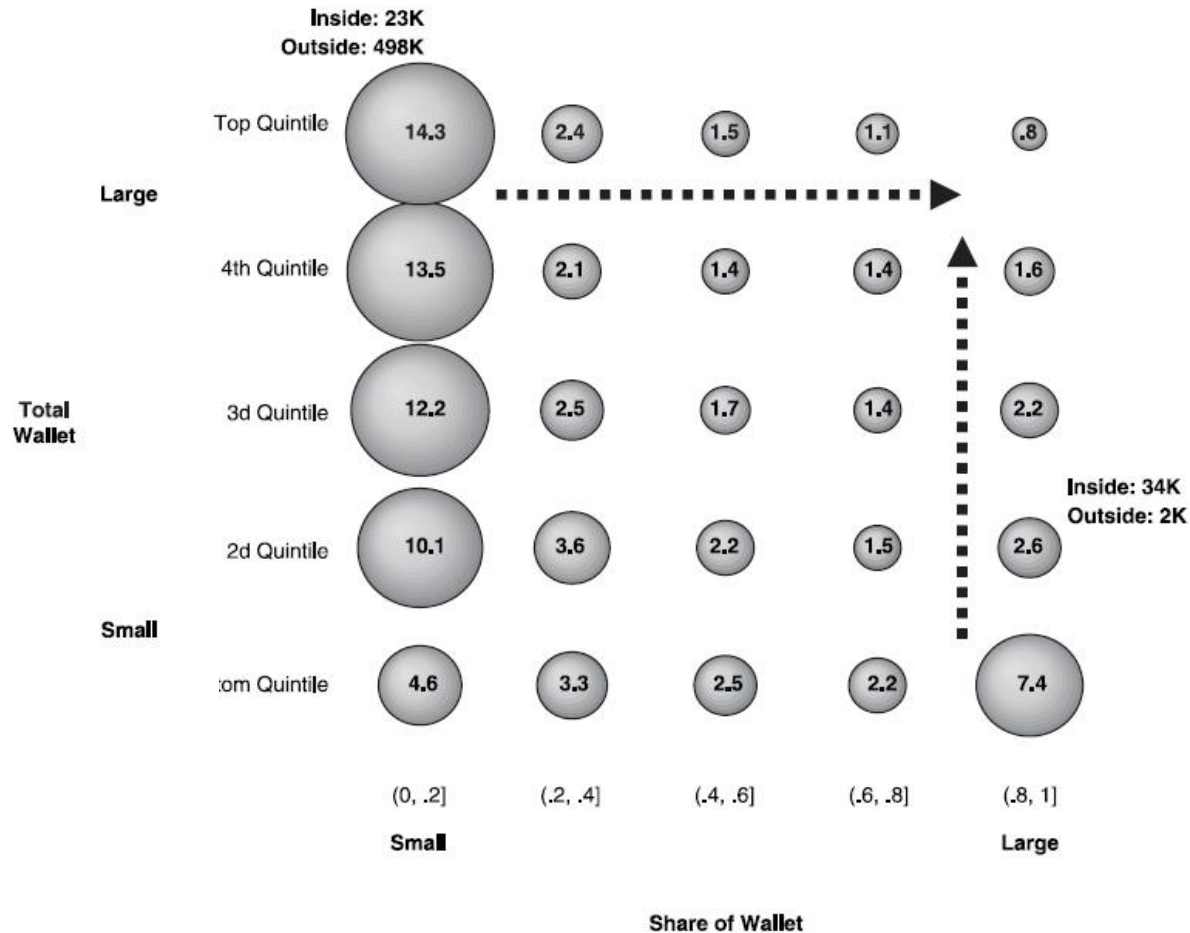
Customer development

Rex Yuxing Du, Wagner A. Kamakura, & Carl F. Mela

Size and Share of Customer Wallet

Many companies collect substantial information about their interactions with their customers. Yet information about their customers' transactions with competing firms is often sparse or nonexistent. As a result, firms are often compelled to manage customer relationships from an inward view of their customers. However, the empirical analysis in this study indicates that (1) the volume of customers' transactions within a firm has little correlation with the volume of their transactions with the firm's competitors and (2) a small percentage of customers account for a large portion of all the external transactions, suggesting the considerable potential to increase sales if these customers can be correctly identified and incentivized to switch. Thus, the authors argue for a more outward view in customer relationship management and develop a list augmentation–based approach to augment firms' internal records with insights into their customers' relationships with competing firms, including the size of each customer's wallet and the firm's share of it.

Analysis of a major U.S. bank



Share of wallet is largely independent of size of wallet

i.e., it doesn't vary systematically across large or small customers (except very small ones)

The good news & bad news about cross-selling

“Customers with high share in one category also tend to have high share in another category, indicating that **customers’ share decisions are positively correlated...**”

“A small percentage of customers account for a large portion of all the external transactions, suggesting the considerable **potential to increase sales if these customers can be correctly identified...**”

Balancing acquisition, retention, and development

Customer heterogeneity is a huge factor for each of these activities – you should never say “**the customer...**”.

If you had an extra dollar to spend, **which of these activities would you allocate it to?**

Not to minimize the importance of retention and development, but at the margin I **favor acquisition...**



Making customer centricity profitable

- ✓ Regularly calculate/update individual customer lifetime value
- ✓ Break customers into segments based on relevant characteristics (e.g., time/nature of acquisition)
- ✓ Allocate retention/development resources appropriately – create and target marketing communications based on segment characteristics
- ✓ Constantly experiment with these tactics (and analyze results at the customer/segment level)
- ✓ Use these “bottom up” perspectives to drive product-line decisions (and possible new service offerings)
- ✓ Identify which segments are the best “role models” for future acquisition activities



Lather. Rinse. Repeat.



Thank you
Q&A

Professor Peter Fader
The Wharton School, University of Pennsylvania
Co-director, Wharton Customer Analytics Initiative

@faderp

