

Customer Relationship
Management

**CUSTOMER
PROFITABILITY INFORMATION
JUST ISN'T ENOUGH**

Michael Meltzer

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AMT
ACTIVE MANAGEMENT TECHNIQUES

CUSTOMER PROFITABILITY JUST ISN'T ENOUGH

Customer relationship management demands that you understand which customers create profits and those that destroy it. However this is just not enough if you want stay in business in the long term.

This paper explores how customer management solutions based on a scaleable data warehouse and a strategy to couple profitability measurements with predictive modelling can create sustained competitive advantage.

Historic profitability measures just don't measure profitability - financial accounting systems fail the test. You need something to replace them that can actually support the business and the business decisions that must be made.

About The Author

Michael Meltzer is a managing partner of AMT consulting that specialises in advising organisations on the use and abuse of information to support relationship management in all its forms. He is a hands on partner who has experience spanning financial services, telecommunications, education and retailing. He has specialised in uses of information to support customer relationship management, e-business, customer knowledge and building organisations where innovation and experience can flourish. He is a respected author, sought after speaker, educator, consultant and experienced business manager.

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**CUSTOMER RELATIONSHIP MANAGEMENT and
e-BUSINESS PAPERS BY MICHAEL MELTZER:**

- ⇒ Getting Started Building A Customer Information Infrastructure
- ⇒ Business Case Blues (Building A Business Case)
- ⇒ Discovering the Value of Customer Information
- ⇒ Are your Customers Profitable (What About ABC)
- ⇒ Effective Channel Management
- ⇒ Customer Retention, Development and Acquisition for Financial Services
- ⇒ Customer Retention, Development and Acquisition For
Telecommunications
- ⇒ Understanding What Do Consumers Value?
- ⇒ Segment Your Customers Based On Profitability
- ⇒ **Customer Profitability just isn't enough**
- ⇒ Integrating the Call Centre with the Data Warehouse
- ⇒ Data Mining Dispelling The Myths
- ⇒ ALM With A Customer Focus Forms A Virtuous and Profitable Cycle
- ⇒ How to Recreate Customer Intimacy for Profit
- ⇒ Channel Management the Dilemma Remains
- ⇒ Driving Customer Retention, Development and Acquisition in the
Insurance Industry (with Chris Saunders)
- ⇒ Survive and Prosper by using Customer Information - an Insurance
Perspective
- ⇒ Customer Profitability Just Isn't Enough
- ⇒ e-Mining Myth & Magic
- ⇒ e-Insurance a CRM Perspective
- ⇒ e-Demand the consumer connection
- ⇒ CRM Realising the Benefits Part 1

Every Financial Services Provider (FSP) and for that matter any organisation wants to know if they are profitable or not and their financial reporting systems 'normally' tells them this. But they also want to know who and what makes that so and here the financial accounting systems fail them. What also makes sense is to know who are the customers are that create and destroy your profits so you can identify who you don't want to keep or those you really want to attract. So the question many organisations are asking is just what makes up individual customer profitability. Initially managers have asked simple questions that reflect simple needs as who are those customers? Simple because few managers have been able to do very much with highly aggregated and untrustworthy profitability information even when they could actually tease it out of their financial accounting systems. Yet the question of customer profitability is one of the most important questions that any company can ask. Now they are beginning to ask the more important questions: If I know who the customers are, can someone tell me why they are profitable, can then identify or profile others that could become profitable and then tell me how I can do all this?

*Just what makes
customers
profitable and
what makes them
unprofitable?*

Information is an asset

This article continues my theme regarding the need to manage information as a valuable asset and the application of currently available technologies to improve customer relationships and the real litmus test, actual profitability! The first part will describe some of the difficulties and history of getting at customer profitability whilst in the second part I will discuss how to apply and extend its use. In other articles I have argued the case for using customer profitability information as a means of segmenting your customer base and choosing the customers to serve, these arguments are still valid. However I will extend these views with some insights into the need for behavioural information added to profitability measures to make any real solutions actionable.

Customer Relationship Management (CRM)

Today the term Customer Relationship Management (CRM) is banded about by consultants and the press as if the mere chanting of the term can change the way organisations have done business for decades. The term is mis-used for sales purposes by those marketing call centres, sales automation software, Enterprise Resource Planning systems (ERP's) and other systems that will change the way business is to be carried out "tomorrow" - yes well!? Claims made by vendors, sales people and consultants are sometimes true but the success of CRM rests on both technology and organisational change. This change should start with understanding the profitability of each customer at a granular level and then actions can be planned to make use of the other wondrous technologies and change management practices available. CRM is a vision founded upon customer profitability as its centrepiece. By taking

*The customers actions
and transactions
drives the business -
no customer no
business*



an enterprise-wide focus CRM identifies the customer as the driver of all the FSP's business.

CRM is Holistic

The power of the CRM vision is that it pervades the whole of the enterprise and is founded on the concept of a strategic information repository a scaleable data warehouse (SDW). Information soft and hard is captured from all points of contact: phone, branch, retail counter, call-centre, Internet, personal adviser, ATM and kiosk. This information is assimilated into "one version of the truth" that enables decision makers and customer service representatives to make the right decisions and take the right actions that build relationships and enhance profits. One of the major reasons for this drive to undertake the CRM journey is that it is good for profits and survival. In other articles I have stressed the benefits to be derived from the move from simplistic data-base marketing to critical event driven marketing as a move from FSP push tactics to a customer pull strategy. The foundation however of any strategy is an understanding of what drives customer profitability and as an exercise in addition what actually drives an FSP's overall profitability.

Can you use the Profitability System?

There is also a problem facing many institutions in how to actually use the profitability system once implemented. It is not just a financial or management accounting system it is an input for creating a more profitable business. And as such must be planned for across business units with a clear vision that it has a multiplicity of uses. It will be a FSP wide solution that supports many business units and this in itself will require a plan for change management that will be supported by senior management. Profitability solutions must be implemented that incorporate multi-dimensional views that see the profits of the organisation as a whole, it's products, channel, business groups, and specifically customers.

**A good
profitability
system is more
than
a tool
for measuring**

The History of Measuring Profitability

Historically the ways of finding out customer profitability have been very difficult the task often hindered by the very accountants (who are there to help?) that were supposed to understand how to derive the magic numbers! This has much to do with the history of accounting practices and the lack of acceptable number crunching technologies that were understandable and trustworthy. From about 1825 to 1925 huge and successful industrial conglomerates emerged and there were a host of innovative management accounting practices. Many of the largest companies were unlikely to have survived without those robust management accounting systems that could provide insights into the efficiency and effectiveness of their decentralized operations. However between 1925 and 1985 there was little innovation in management accounting techniques and practices. Criticism of management

**The history of
accounting is full of
innovation and risk
taking.....
Oh really ???**



accounting techniques came to a head in the 1980's. Robert Kaplan in a number of Harvard Business Review articles questioned the relevance of the then current management accounting practices. He then co-authored a book with Thomas Johnson called "Relevance Lost: The Rise And Fall of Management Accounting." This seminal work created a watershed in the development of management accounting leading to a number of new techniques and application of new technologies.

Criticisms of Management Accounting

The principal criticisms of management accounting could be summed up:

1. Current management accounting practices do not meet the needs of today's industries, manufacturing or service!
2. Product costing systems provide misleading information that can lead to the wrong decisions being taken!
3. Financial accounting requirements make management accounting subservient to external reporting needs!
4. There is too much focus on internal activities with little attention given to the what exists externally and effects the way a firm operates!

Proxies instead of Actual Costs

With the above as a backdrop to attempts by FSP's trying to understand customer profitability it is easy to see why many have attempted to use proxies instead of untrustworthy "actual" costs as a basis. These proxies were often based on personal bias and inadequate information:

- Account balances: The higher the account balance the more valuable the customer is. There is a need however to measure the customers usage of other FSP services to really see whether they are profitable or not. This also goes for those customers that have large loans outstanding.
- Multiple account and product relationships: The more accounts the customer has and or the more products the customer has means they are more profitable than those with few accounts and products. More accounts and products does not lead automatically to increased profits if they're the wrong products and the accounts incur high costs.
- Particular products used: the belief is that if the customer uses specific high value services such as private banking or investment facilities then by default they must be valuable customers. Once again it all depends on the overall cost incurred in servicing the relationship.
- Socio-demographics: Where the customer lives, occupation, income, and so on are used as predictors of potential or actual customer profitability. However it all depends on the customers' cost to serve and the way the customer makes use of the FSPs services obvious and hidden. The obvious costs relate to actual chargeable services used whilst the hidden are often the soft services not recorded like branch

PROXIES

- Account balances
- Multiple account and product relationships
- Particular products used
- Socio-demographics
- Use of facilities

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visits or telephone queries direct to a bank branch or insurance broker.

- Use of facilities (channel usage and transaction volumes): the more the staff of an FSP has contact with the customer or they carry out numerous transactions implies that they must be more valuable than the customer that is invisible. The reverse is often the case. The cost of face-to-face interaction is high and their high transaction volumes may in fact be destroying profits.

The above then are not satisfactory measures or predictors of customer profitability. What those proxies state clearly is that the FSP's just didn't have the right data to turn into useful information or metrics in evaluating one customer from another. What is needed is a set of principles that will enable a consistent approach to profitability measurement. For many this means finding ways of allocating costs to individual customers that are both realistic and cost effective in application.

The Road to Customer Profitability

On the road to customer profitability many institutions began by attempting to carry out product profitability. Initially we could see this attempt at product profitability and hence better costing as a manifestation of FSP's fixation on being product driven as opposed to customer focused. However even this approach was difficult to implement as a product's profitability was often managed only vertically, from development through sales, with no measurement of costs borne horizontally through an institution's administrative and back-office expenses. Manufacturing had overcome this problem but the FSP's found it difficult because of the many attributes their products had. A television may have many working parts but it performs one function and does not have a range of service or risk elements attached to it. A current account actually has many functions acquiring and dispenses many costs and charges along the way. The fixation by many FSP's on being product driven created product aligned organisations. Systems were developed for the needs of particular products that could not communicate with systems from other parts of the organisation. The other considerations centre on the concepts of cost allocation and cost attribution.

Existing Costing Systems

To determine customer profitability you would normally look to your existing costing systems. These systems which are invariably based on the standard accounting rules which only look at profits for the current year. These accounting systems take no account of the potential profits or losses attached to individuals, customer segments or the range of products they take. Revenue is normally the one thing you can get at. There are mechanisms to track charges made for services and products used. This revenue is collated at many levels of aggregation but rarely is there enough detail to clearly see the total revenue and cost picture for the individual

*Consistent business
rules to deal with
allocations and
apportionment*

**One Per Cent
Of All Charges
Are Never
Actually
Posted**



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customer. It is worth remembering that in most FSP's their tend to be failure to charge at least one per cent of the time. This is often referred to as "leakage." Charges for providing the services and products internally are normally passed down to the actual group providing the service to the customer by simple allocation methodologies. Often traditional top-down methods of measuring customer profit, product profit data was simply allocated using few customer characteristics such as balance, rates and product types and is most often applied to customer segments (e.g., small business, private banking, etc). Yet the charges and revenue captured must be built up from actual charges made and there is this problem of leakage! Few FSP's talk about this however.

Attributing Costs

Cost attribution is focused on cost/profit centre profit and loss that eventually rolls up to the institutions overall profit and loss statement. The accounting system is not focused on customers or FSP performance but on cost allocation. In age of steam it was easy material costs and direct labour were the largest proportion of total costs in a manufacturer's world and the rest was overhead. In the new world of service-dominated economies the old accounting methods distort profitability. Almost every activity can be seen as undifferentiated overhead. The whole process is top down as there was no granularity to the actual customer transactions. In the past the technology was just not available to enable an FSP to see the trees for the wood!

Well there is Direct Cost and everything else is Overhead - well isn't it?

The General Ledger

Many FSB's initially believed that the numbers shown in the General Ledger (GL) were a true reflection of reality. But it soon became apparent that something was missing. While the general ledger system contained the FSP's financial accounting data, it carried very little transaction or volume related information. FSPs needed volume information from FSP application systems (account based systems, savings systems, payments systems, ATM's, loan systems, etc.) to calculate percentages and to drive the cost-allocation process. Staff had to collect the missing information manually and then input it into memo accounts on the general ledger.

Aggregation is not the answer

Activity Based Costing (ABC)

To overcome this we must view another allocation methodology called Activity Based Costing (ABC), the use of funds transfer pricing and capital allocation methodologies to really reflect the reality of the financial services organisations. To actually benefit from the accounting activities an FSP must also build a transaction based system to get at granular level detail (a SDW), implement predictive modelling and use customer lifetime value as key ingredients in any CRM solution. The bottom line to this is that allocation of shared costs among business units, products, customer accounts and channels of distribution is required to make good profitability decisions.

ABC is just another allocation methodology - it may even be a good one?



Understanding the Behaviour of Costs

ABC emphasises the need to understand the behaviour of overhead costs and how they relate to products and services. ABC is a costing system that breaks down departmental costs into distinguishable activities. Activities (account openings, payments, system development and so on) in the FSP create the need for the services provided that cause costs and the products/services provided to customers create the demand for the activities. Activities are linked to products/services by the assignment of costs to those products/services based on their actual consumption or demand for those activities. The design of an ABC system for an FSP can involve the following steps:

1. Identifying the major activities that take place in the FSP;
2. Creating a cost pool/cost centre for each activity in the FSP;
3. Identifying the direct cost categories for the product;
4. Identifying the indirect cost pools and develop a rate to allocate these costs associated with the product;
5. Determining the cost driver for each major activity;
6. Assigning the cost activities to products/services according to the products/services demand for activities.

What if you could understand what drives your costs?

The use of ABC goes much further than enabling more accurate customer profitability profiles. There is an opportunity to begin to understand what drives costs and then be in a better position to make both macro and micro decisions. These can be related to cost to serve individual customer types. To the extent of identifying optimum staffing in a bank branch or brokers office dependant on the costs incurred and the profits to be made by handling customers in different ways. At the micro level, FSP management could consider alternative workflow processes for a given activity that would reduce the overall cost of that activity.

Funds Transfer Pricing

The financial services business is about borrowing money (from depositors) at one rate and lending it to others (borrowers) at a higher rate. The difference between the cost of borrowing and the interest income received from lending is the operating income of the FSP from which business expenses are paid and operating profits/losses created. The more competitive the market for deposits and loans, the less margin is available to the FSP.

The Treasury Function

The Treasury function inside the FSP conceptually “buys” the deposits from the deposit gatherers and “sells” those funds to the lenders (and they manage the “float” in between). In this way, the deposit taking function can be treated as a profit centre based upon the revenue it generates from the marked up sale of its funds to Treasury. The loans products are treated similarly.

The Treasury function inside the FSP conceptually “buys” the deposits from the deposit gatherers and “sells” those funds to the lenders

Techniques

Funds transfer pricing is a technique aimed at improving the way internal costs are determined and allocated across an FSP. The FSP creates the pretence that its deposits are sold in the open market at the going rate. In the same way, the FSP continues the pretence that the lending group is borrowing its funds at the price the FSP could get for those funds in the open market. In this way, the arbitrary allocation of costs for purposes of determining product and service profitability is replaced by a more rigorous pricing method based on the “pretence” that funds are placed in the open market. While the resultant profit is necessarily a book entry type of profit, the approach does provide management with a better methodology from which to approach product and service pricing in general.

For purposes of a modern profitability system, a robust funds transfer pricing capability allows individual product pricing to be determined for individual customers based upon that customer’s current and expected future behaviours. This leads us nicely into the topic of predictive behaviours that I will cover later in this article. Customers grouped upon behaviours which drive funds transfer pricing does not necessarily match up to how the FSP’s customer base is or will be segmented by other groups (e.g. marketing) within an FSP.

Capital Allocation/Risk Provisioning

The capital allocation methodology is to take the capital of the FSP and apportion it to the individual products and services as a function of the risk associated with them and the requirement for capital to be “held in reserve” in support of current and future risks. By then levying a charge for the capital (a rate of return - referred to as the “hurdle rate of return”) and deducting that charge (the “risk-adjusted cost of capital”) from the net income of the product or service they gets a truer picture of performance. Capital allocation theory allows FSP’s management to ask the question: What is the value of a service or product set after paying “rent” for the capital it requires? This approach allows for an equivalent comparison of performance across widely differing parts of the business.

What is the value of a service or product group after paying “rent” for the capital it requires?

Individual Customer Level

A more sophisticated and useful approach when getting at customer profitability is to repeat the above process down to the individual



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customer level for a given product or service. By understanding individual customer behaviour, a risk factor can be assigned to that customer, capital allocated as a function of that particular risk and a capital charge levied against the net income generated from that customer. The sum total of individual customer allocated capital equals the total amount of capital allocated to the products and services provided.

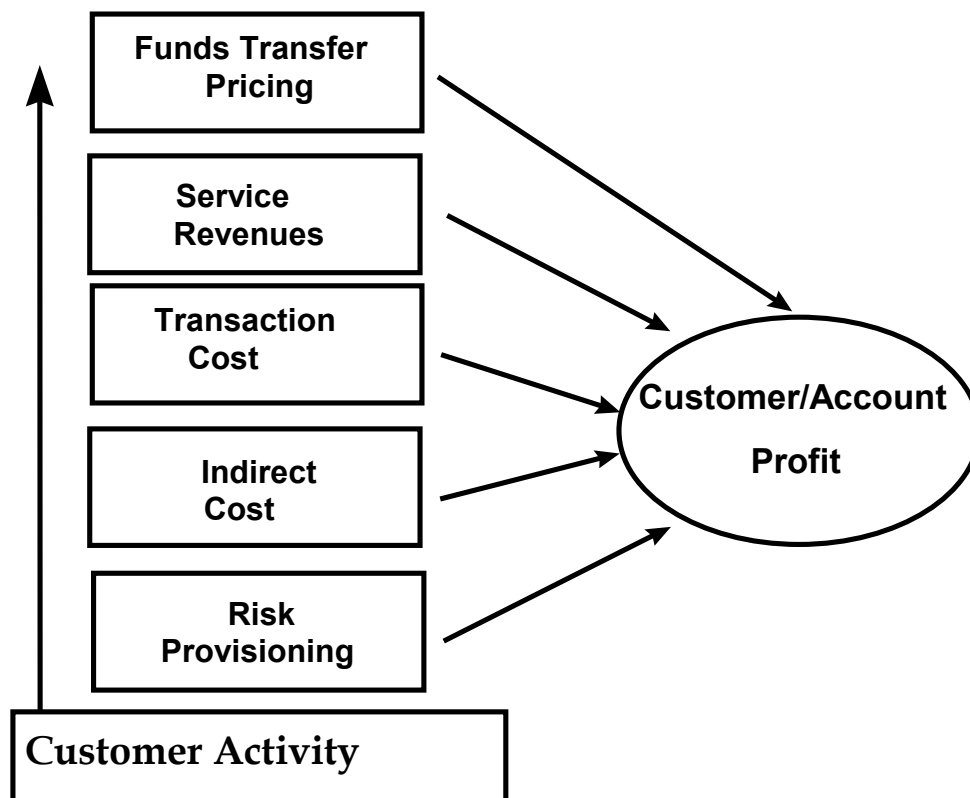


Figure 1 (NCR - VA)

In all there are five measures that make the difference (figure 1): Net interest revenue, Other revenue, direct expense and risk provision - the other element that is an input to the others is funds transfer pricing. To make a profitability system part of an overall CRM there is a need to approach the subject in a different way from the traditional methodologies that were forced to be top down. Systems of record were designed to carry aggregates to enable the financial reporting systems to function correctly in support of investors, creditors, regulators, and tax authorities.

Three Accounting Systems?

Today many FSP's have seen the need for multiple accounting systems as Robert Kaplan and Robin Cooper states in Cost and Effect:

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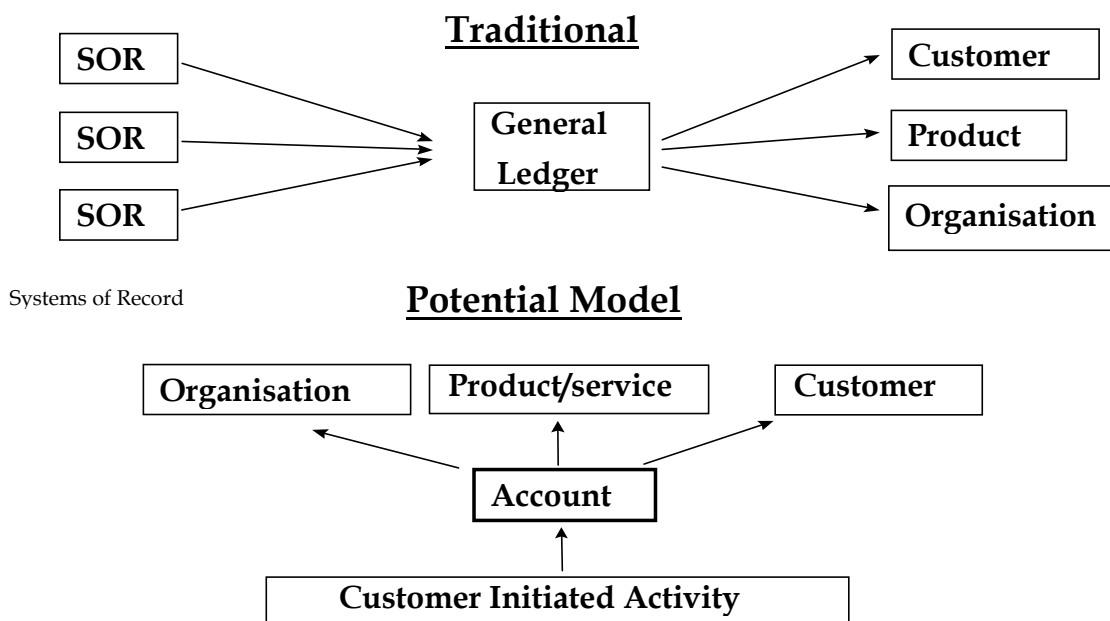
One Accounting System is not Enough

- A traditional, but well-functioning financial system that performs basic accounting and transactions-capturing functions, and prepares monthly or quarterly financial statements for external users, using conventional methods for allocating periodic production costs to cost-of-goods sold and inventory accounts.
- One or more activity-based cost systems that take data from the “official” financial system, as well as from other information and operating systems, to measure accurately the costs of activities, processes, products, services, customers, and organizational units
- Operational feedback systems that provide operators and all front-line employees with timely, accurate information, both financial and non financial, on the efficiency, quality, and cycle times of business processes.

There is an addition to this a system, a further wrinkle that enables an organisation to be able to look at the profitability of the customer that actually creates the future streams of profit. Accounting is more than reporting historical costs it is also about supporting the business in providing guidance for business decisions. A new approach is required that starts from the basics. The basics for an FSP is a customer transaction. From understanding what drives the costs and the revenues, the FSP can gain a clearer picture of multi-dimensional profitability in support of future revenue and profit generation. The implementation of a scaleable data warehouse based cost allocation system gives the flexibility to view the organisation in any way together with an ability to access detailed account level information.

Management Accounting should be about providing guidance for business decisions not simply bean counting!

Figure 2 (Adapted from NCR - VA)



Approach Profitability Bottom Up

By approaching the topic of customer profitability bottom up (see figure 2) we can measure in detail the components of income and expense at the account level, based on account characteristics such as transaction behaviour, term, risk probability, and fee revenue generated. The customer drives account profitability based on actual transaction activities that roll up to a total account profit or loss. From this base of data, any number of aggregations can be performed - across customer, channel, product and organisation. This approach means that profitability measurement and analysis could now be driven by customer behaviour not product averages. This ensures that the true cost and income drivers of the organisation can be understood at the most detailed level. By designing a flexible system a number of dimensions of profitability can be looked at: pricing relationship, distribution channel, individual account manager portfolio, customer segment, or geographical region and so on.

Event Driven Marginal Costs

Innovative and sound, this methodology focuses profit measures at the account level, using event driven marginal costing methods or other allocation methods that the FSP feels is right for them. The techniques used measure each account's profit contribution in five dimensions: net interest revenue, non-interest revenue, direct expense, indirect expense and risk provision. This approach is designed to reconcile with the General Ledger and allows for consistent analyses of customers, products and channels historical profitability. A revolutionary step for FSP's today.

*A Five Dimensional
Profitability
Measure*

However if you just use profitability information as it stands mistakes regarding the value of a customer over time can be made. Profitability is not static. A good summing up of just looking at current and historic information is summed up by Peter Carrol and Madhu Tadikonda of Oliver, Wyman & Co.

"In fact, three drawbacks undercut the utility of customer profitability data for operational decision-making:

- Descriptive, not predictive. Profitability figures broadly indicate which customers have been economically valuable over a given period. It may not suggest how that customer will behave in the future, especially in the context of the sales/service action under consideration.
- Myopic. Virtually all retail financial services products have a specific life cycle. With certain types of loans, for example, customers may have a negative profit contribution in the early years and become

Profitability does not stand still - who was profitable yesterday may or may not be profitable tomorrow

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more profitable later on. As a result, profitability recorded in a given performance period may incompletely describe the value of a particular relationship.

- Retrospective. Historical profit data is a lagging metric. It does not adequately reflect anticipated changes in customer holdings or changes in usage patterns. Furthermore, a retrospective metric may incorporate specific market conditions (e.g. interest rate environment, competitive intensity) which no longer exist.”

Consider Time

To bring customer profitability alive and to dovetail it into the CRM vision we need to consider the customer over time. Some major lifecycle events that affect customer's product needs and potential profitability include graduation from school, marriage, first home purchase, birth of a child, children leaving home, retirement and to finally prospective death. So we must also introduce other methodologies to predict customer behaviours. Once this information is integrated with predictive capabilities what was static although useful, becomes a valuable weapon in the FSP's armoury.

Lifetime/Long term Value (LTV)

The concept identifies that a customer normally has a relationship of sorts with the FFSP that spans a particular period of time. There isn't any customer relationship management if there is no relationship to speak of. By taking into consideration a customer's age, the anticipated length of his financial relationship with the FSP, his lifestyle stage, demographics and potential future financial holdings a set of cash flows are assumed to occur stretching into the future.

To bring the cash back to today a discounting techniques such as net present value (NPV) are used.

Assumptions

In order to calculate the future value of a customer's tenure, assumptions have to be made. Assumptions regarding the length of time a customer is likely to remain with you could include information relating to their age, their lifestyle, occupation, geographic location and income. From this information certain predictions have to be made regarding the types of products he is likely to purchase; the income that will be derived from those products; and the costs associated with marketing and providing those products. Based on analysis of existing customers using particular products predictions are made for similar looking customers. Current customer relationship characteristics, such as average length of the relationship, average account balances, and default or prepayment rates, are compared to other customer attributes representative of relationship behaviour, including age, income, education, credit history, and life stage. Based on this analysis, longevity predictions are made about

How much are you really worth to a retailer - what you spent last week or is it the potential spending you could have over the total life of the relationship you have with the retailer - your LIFE/LONG TERM VALUE



customers relationship tenure, account balances, payments tendency, and other inputs that will affect future profitability. A quote from Bottom Line Banking by McCoy, Frieder and Hedges puts it all in context: *"The ultimate competitive advantage does not lie with technology or economies of scale but with superior knowledge of the consumer, a corresponding business (profit) model and the ability to keep both up-to-date"*

Using the information

One of the first major benefits of looking at lifetime values as an added dimension to profitability and a customer's predicted behaviour is an FSP's ability to begin micro-segmenting its customer base based on value over time. The FSP can segment customers into tiers or by combining data use a multi-dimensional approach based on factors that are unique to the FSP and its customers.

In addition a start can be made in identifying for each customer, what actions or dynamics have the potential to change his or her value to the FSP. Product development and pricing strategies, including channel migration strategies, cross-sell activities, up-sell and fee structures, can positively or negatively impact the customer's value, as can customer service and retention treatments. Profitability measures coupled with LTV numbers enable an FSP to better profile their the potentially profitable customers and to identify look-alikes amongst its prospective customers. An FSP can use the information it has pulled together in its CRM system to enable it to retain customers, develop customers and to acquire new customers.

**Segmenting by
value and
propensities**

Retention

By identifying the customers that the FSP must retain because it has identified just how profitable these customers really are the FSP can undertake specific customer retention treatments. These customer groups can then receive special services, be given personal bankers and whatever else is required to keep their business. By knowing who your current and potentially profitable customers are enables the FSP to alter its treatments to the less profitable customers.

Cross sell, Up-Sell

To increase their share of the customer's wallet many FSP's believe that a depth of products taken means profit. As demonstrated above this may not be the case. However armed with profitability and LTV information an FSP can now cross-sell other products or up-sell more valuable services and products in the knowledge that they are contributing towards the bottom line. There is also the opportunity to move that marginally profitable customer into profit if understand the customer dynamics involved. For every decision or action, there is a likely pattern of behaviour, cash flow and risk outcomes that can be anticipated. Any cross-sell action includes estimates of all cash flows associated with the

Predict behaviour

actual marketing decision. Costs would include up-front acquisition expense, ongoing account maintenance and servicing, and potential risk weightings. Revenues would include potential LTV from fees and interest spreads. With an understanding what components make up a customer's profitability, banks can analyse the potential impact of various cross-sell initiatives on individuals, segments, and down to the segment of one profitability.

Data Mining

Using the predictive information that the FSP has gleaned from both it intuitive and machine based data mining, cross-selling can be far more effective. Customers with the likelihood to purchase will be targeted rather than those unlikely to respond. As a result, the cost of acquisition can be reduced while the profitability on each campaign increases.

When the FSP moves to a customer event driven capability campaigns as they are used now become less frequent. What takes over are micro-campaigns based on individual customer needs as predicted by the CRM system and valued by the bottom up profitability metrics.

Reduce cost of acquisition

Acquisition

An integrated SDW solution that incorporates the CRM vision enables an FSP to carry out numerous customer centric activities. Yet one of it's most powerful capabilities comes into play when an FSP wants to acquire new customers that look just like it's own already profitable customers. Given sufficient size and depth to it's historic base of data it can build predictive models that will identify the attributes of customers it would like to have within the universe prospective customers. Taking direct mailing as an initial example we could create a PVC score for the customers we intend to mail internally and externally. What we want to do is optimise our return on investment in the marketing campaigns we undertake. The algorithm uses each customer's propensity to purchase the product (P), the value of the purchase over time (V) and the cost of the contact (C). By its construction the score takes account of relevance (propensity) and profit (product value and communication cost), and the best type of contact for an individual. It means that the ones with the highest score per offer is contacted for that offer first. This goes against the grain of mass mailing but is just one of the effective new ways of marketing a well planned CRM solution offers when profitability metrics are an integral part.

Are you into PVC?

Customer Treatments

Because an FSP can work at the individual customer level although apply treatments at group level decisions can be made regarding customer charges. Customer service personnel can respond on a customer-by-customer basis to requests regarding special services, interest rates and fee waivers.

All customers are not created equal so an FSP must offer different treatments to match different customer needs and values - from an FSP's perspective and the customers



Armed with information on customers enables the FSP to differentiate according to value to the organisation. Some customers that are marginal may be guided towards facilities that are less costly and thereby improve that customer's profit margin. Some unprofitable customers could be guided to a competitor or a reduced level of service that matches their contribution.

Putting it all together

To build a CRM capability is not a simple task, see figure 3. It is a journey that starts with senior management sponsorship and commitment. For some FSP's total vision of CRM is far in the distance and simpler quickly implemented solutions to current problems must be considered. However with a good architectural plan and the right technology even speedy solutions can grow into a full-blown CRM system. A major question any organisation must ask when it invests in the future is: "if we invest in this, what does it do for us and will it value - when?" When making investment decisions, managers must consider their main options and then build customised analyses to support their deliberations. However in many cases you cannot prove to a disbelieving management that the figures you come up with are real. Therefore it is always good to have a senior champion in your corner. Some try to be very analytic in their approach to making decisions, as it seems the right thing to do. Yet today many FSP's have trod the path of implementing SDW and started

The Customer Relationship Management Vision

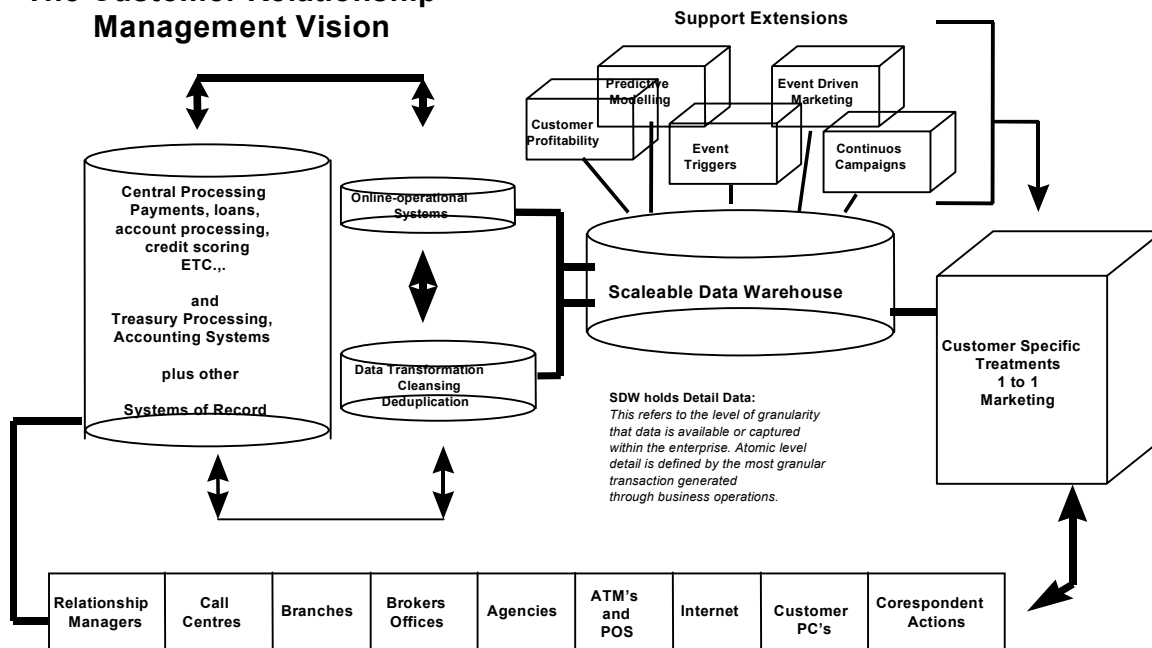


Figure 3 (MM)

on a CRM that the "truth is out there".

To effectively support your business you need to take the journey towards the customer relationship management vision. This leads to a companies differentiation and profit if implemented effectively and with insight into just why you are on this journey but this is another story.



If you liked this paper and want to read more then there is a list of papers on the second page of this paper.

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