The Five Keys to Organic Growth

How to Drive Profitable Relationships with Predictive Analytics

SPSS

Peppers & Rogers Group
a division of Carlson Marketing

The Five Keys to Organic Growth

How to Drive Profitable Relationships with Predictive Analytics

Executive Overview

When it comes to organic growth, is your organization acting like a true predictive enterprise? Are you driving better decisions through the widespread use of insights gathered from data? Do the actions you take today directly achieve your organization's goals tomorrow? Increasingly, organizations in virtually every industry around the globe, are realizing the benefits of using data to modify their interactions across customer touch points to better align with future objectives. By incorporating predictive analytics, these organizations have harnessed the power of data-driven insights to make improved decisions, so that they can successfully meet their business goals.

In a landscape that demands growth, the issue becomes predicting how and where it will be achieved. Growth, at its most basic level, comes from customers, and organic growth is defined by Investopedia as "the growth rate that a company can achieve by increasing output and enhancing sales" (this excludes any profits or growth required from takeovers, acquisitions, and mergers). Collecting the best data available and then incorporating that data using a predictive analytic strategy will add to understanding how customers behave and where profits can be best earned.

Which of these initiatives should you choose?

	Initiative A	Initiative B
Customer Investment	$10	$20
Profit	$5	$6
ROI	50%	30%

Source: *Peppers & Rogers Group*

Here you have two possible marketing initiatives: A and B. You spend $10 per customer on Initiative A, and you generate a $5 profit per customer, plus the $10 back, so your ROI is 50 percent. Initiative B, on the other hand, requires you to invest $20 per customer and you get a $6 profit, netting only a 30 percent ROI (see table above).

The question is, which of these initiatives

In Brief

Written for senior executives, this white paper:

- Makes the case for using predictive analytics to drive organic growth
- Describes five ways to achieve organic growth
- Explains two different methods for measuring financial return

should you choose? If you follow the ROI strategy, obviously Initiative A generates more return on your investment. But what if you only have one customer? What if your whole business operates on a single customer? Then Initiative B generates a $6 profit, whereas Initiative A only generates a $5 profit. So you'll make more money with Initiative B.

Consider this: Would your answer be different if you only had a million customers? No. Your answer would be the same. You'd still choose Initiative B as long as your ROI is sufficient to cover the cost of borrowing. "In most cases, you want to choose the initiative that actually creates the most organic growth for your business," Don Peppers, founding partner, Peppers & Rogers Group, says," and you can only create organic growth from customers."

Predictive analytics plays a vital part in growing your business. By focusing on data and predicting the behavior of individual customers, companies can close the gap between the expectations placed on customer value growth and the tactics needed to achieve it. The key is to use data to drive better decision-making, to maximize those customer experiences that will influence the customers to generate greater value for your organization.

By using advanced predictive analytics, companies are able to use information on past events and present circumstances to project future actions. They're capitalizing on a combination of attitudinal and behavioral information gathered from both structured and unstructured data for a complete view of their customers, employees, patients, students or citizens. Then they're using that insight to direct, optimize and automate their decision making. The result is successful achievement of specific organizational goals, whether it's an increase in cross-sell revenue generation, a decrease in marketing costs, a reduction in fraudulent behavior or an increase in promotional campaign response rates.

Predictive analytics enables an enterprise to leverage the organizational data that you currently have at your disposal and the data that you might want to collect in the future. "It uncovers the patterns that interrelate between all that customer data, using both predictive and descriptive techniques, and then it ultimately uses the results of those analyses and insight to really drive improvement in organizational performance," says Richard Hren, director of product marketing for SPSS.

"The Pareto principle, or the 80/20 rule, has long established that roughly 20 percent of your customers may be generating 80 percent of your profit or value. "

– Richard Hren, *Director of Product Marketing*, SPSS

The Five Keys to Organic Growth

1. Classification: Classification defines the core approach to map the ways and means that customers are generating value by identifying where those profitable customers come from and what drives them.

What makes a profitable customer at the end of the day? The Pareto principle, or the 80/20 rule, has long established that roughly 20 percent of your customers may be generating 80 percent of your profit or value. The idea is to take advantage of this fundamental business fact and to then understand what drives those profitable relationships. A company needs to understand why some customers are more profitable than others—do they buy more, more often, through less expensive channels, return less? Predictive analytics that measure things like recency, frequency and monetary value, can help you answer these important classification questions.

Additionally, in the current marketplace, multi-channel and multi-category activities are strong indicators of customer value and can be used within a predictive analytics sense to quantify and to classify those customers into various discrete segments. Measuring other behaviors that impact incremental value, such as referrals and cross purchasing as well as product returns and bargain coupon hunting, can enrich the mix of understanding and highlighting how customer value is created and what its major drivers are.

For example, a large financial firm that focuses on high-value and loyal customers decided to split the two dimensions of longevity (tenure) and revenue (spend) that are typically rolled together into the calculation of lifetime value of its customers. The goal was to concentrate on driving customers to buy more through cross-selling efforts while retaining them longer and cutting off possible defectors before they happen. The company used predictive analytics to provide a better understanding of its customers by segmenting its base along the dimensions of both loyalty and profit. At the end of the day, the firm achieved incredible savings of over 50 percent by reducing the number of marketing campaigns, making them more effective, and improving lead conversion and loyalty overall.

What's the Difference Between Product-Centric and Customer-Centric?

Profits come from customers. For some companies, increasing output means just manufacturing more goods, but that's not relevant to organic growth. Who is going to buy the increased goods that you manufacture? Customers.

"Traditional marketing is focused on products, and a product addresses a single need," says Don Peppers, founding partner, Peppers & Rogers Group, "and you try to sell that product to as many customers a possible… Instead of focusing on one product and trying to sell it to as many customers as you can, you could focus on one customer and try to sell them as many products and meet as many needs as you can, which maximizes the value created by each customer."

Indeed, customers and their increasing value are the relevant output. Decrease the strength of your relationships and you might grow profits in the short term, but not in the long term. Grow the strength of your relationships, and profits will follow.

Product-Centric	Customer-Centric
Maximize the value created by each product	Maximize the value created by each customer

2. Segmentation: Once you've identified how those profit drivers occur, how can you segment and find sub-segments of customer groups that somehow have similar value and require similar treatments, but are different from another subgroup? This is where you use predictive analytics to identify interrelationships among data to understand those unique value contributions from each customer group. You can then isolate groups that behave differently require specific differential treatments from a very simple profiling using generic geo-demographic or household-level systems, or by using a proprietary customized approach that is expressly designed and built to fit into your business.

The idea here is to ultimately link those core segments to your profit classification. Just creating segments in and of themselves gives you some material you can use for marketing and targeting purposes, but linking them to the profit classification is that next step in the evolution of really creating huge increases in customer value.

For each of these identified subgroups, you then can establish independent investment strategies for each group determined by your estimated return—you can read, monitor, and track those segment dynamics and watch their migration and growth. You can use analytics to cluster similar customers into discrete marketable units and then apply technologies, techniques, campaigns, and tactics against each of them to optimize each customer touch point to maximize that segment's total unique value.

One leading online software and hardware retailer, for example, was able to triple its profitability by simply understanding that their customer base differed considerably in terms of their relative sophistication. By using this spohistication assessment along with some additional data, the company effectively segmented its customer base into subgroups, where they were treated differently in terms of the recommended next-best product that would appeal to them. This resulted in a huge improvement in page views, close to a 70 percent increase, and overall, a tripling in the profitability of the company's online operations just by understanding and using predictive analytics to form differential segments of customers that had different needs and wants.

3. Targeting: This is a relatively new idea: to develop segment-relevant marketing plans that optimize the message, channel, product, and press promotion, while aligning those with the classifications and segments that you've already developed. It's about getting the most out of your customers and making sure the actions you're going to take against them will be the most appropriate—the tried-and-true right product/right place/right promotion.

Traditionally, with a product-centric focus, you would do some analysis to find the customers who are most responsive or most closely aligned to that product and then chase those targets out into the marketplace. But with predictive analytics, and the current focus of maximizing customer value across the landscape, you start with customers, their segments and needs as you're given, and fit the products, offerings and promotions to suit them, not the other way around. (A sideline benefit of this is, on occasion, you'll see that there may not be any appropriate products in your portfolio, thereby identifying gaps in how you're covering the needs of the marketplace, and guiding you in the action needed to correct that gap.)

An example of the effectiveness of this targeting based upon a customer-centric focus is a large bank that aligned its product offering with its customer types to improve the cross-selling of financial products. The company did both the strong alignment and some predictive modeling behind the scenes. Executives achieved a seven-fold improvement in the response rates across the board and almost an 80 percent reduction in marketing spend by eventually eliminating the duplication of efforts that came from the practice of, no longer chasing the same customers with the same products that occurs so frequently under a product-centric focus.

Why is analytically based insight critical to business decisions?

	Before Analytics	After Analytics
Banner ad click through rates	0.3%	21%
Mail response rates	0.5%	18%
Merchandising response rates	0.2%	12%
Conversion rates (post response)	0.9%	10%
Buyer repeat rates	2.0%	60%

Compiled Research: Forrester, Jupiter, Amazon.com and Ovum (DM Review, 2/11/05)

4. Prediction: Can you use the customer data you have to predict, forecast, and estimate what that next likely behavior is going to be—and optimize all of the various interactions that might occur with a new customer? With predictive analytics, the answer is yes.

You can start to combine some of those operational optimizations even within discrete segments so that even within the segment you've defined by value earlier, you can still create some likelihood-to-buy model or optimize frequency of contact. The goal is to focus on the total draw from that customer in terms of the lifetime value and to really concentrate on the margin—finding the profit that that customer is delivering back to you, rather than just optimizing response rate for any given campaign.

For example, a major insurer effectively deployed an array of optimized models across multiple channels in which it combined predictive analytics technologies across many environments and many customer touch points—extracting the most value out of all the customers across the stream.

The company combined some very sophisticated models with business rules to be applied cross-campaign, cross-channel and cross-product. It significantly decreased its cost of servicing these customers in terms of the campaigns—a 35 percent decrease in mailing costs and a 40 percent decrease in the total of number of campaigns—and stopped abusing the communication privilege with customers as well. There was a huge increase in conversion rates, and at the same time, the company was better able to balance these campaigns and reduce the "spikiness" of its call center load, so there were additional benefits as the company got better at optimizing the cross-channel marketing. And because it's multi-channel, the company also increased its response rates on Web offers and, overall, increased almost 30 percent in aggregate outbound campaign profit, again focusing on value.

5. Action: This is where all the preparation and analysis becomes real. This phase requires you to do something in the marketplace and create programs that will maximize customer value.

The deployment capability of predictive analytics can be applied to drive better decision-making across most components of your company's communication landscape, via the Web, the call center, or risk management. Predictive analytics is channel and product independent; therefore, when you go down this path, you get a bigger bang for your buck—you may start small, with one campaign, and demonstrate real value quickly. But once you see the benefit of using predictive analytics to generate value through your customers, it begins to catch on and you migrate toward a more enterprise wide approach to using predictive analytics across many customer touch point channels, customer groups and product lines.

ROI vs. ROC℠

Traditionally, companies have measured success in terms of return on investment (ROI). According to Don Peppers, founding partner, Peppers & Rogers Group, return on investment makes the implicit assumption that money is the scarcest productive resource. "I'm going to argue that customers are a scarcer resource for most businesses than capital," he says.

"Think of your customers, whether they are consumers or businesses, as financial assets," says Peppers. "They're little financial assets with memories. They have memories, and that's an important point."

According to Peppers, a customer's lifetime value is the net present value of the future stream of cash flow expected from this customer. "Of course, anytime you're dealing with lifetime value, you're trying to predict the future, and we can change the future," he says. "The whole purpose of marketing is to change the customer's behavior, so he'll have more value and buy more things from you."

Ask yourself: How much might the customer be worth if he behaved in a completely optimal way for you? That's the potential value of the customer. The difference between a customer's potential value and his actual value is the unrealized potential. "If I come into your store and have a great experience and decide to come back again, my value as a financial asset to your business has gone up," Peppers says. "The experience I had in the store created value." Conversely, if a valuable customer calls you with a question and you don't do a very good job of answering the question, and he hangs up angry, that customer's value has decreased. "He's certainly a lot less likely to buy from you in the future now," Peppers explains. "So your discounted cash flow, the expected discounted cash flow you have from your business, has gone down slightly."

If a business truly wants to optimize the value that its customers create for it, it has to balance between long-term and short-term value. "We think a new metric is required, and we call that metric 'Return on Customer (ROC),'" Peppers says.

Conclusion: What's in it For Me?

Why is predictive analytics important to your organization?

According to IDC's Predictive Analytics and ROI: Lessons from IDC's Financial Impact Study, "The median ROI for the projects that incorporated predictive technologies was 145 percent, compared with a median ROI of 89 percent for those projects that did not."

Additionally, DM Review recently demonstrated that the approach and applications of predictive analytics technologies can impact considerably many of the avenues to which companies traditionally look to increase returns from customers, from banner ad clicks to direct mail responses and merchandising initiatives (see chart on page 7).

In short, customers bring the power to your company—they are the scarce commodity in the marketplace, and the ultimate source of all revenue. Predictive analytics tell companies much more than just how many customers it has; they help provide clues for ways to drive higher growth in customer value and guide a company on what to do next. And predictive analytics can help you unleash some of that untapped customer potential to help you segment, target and understand their wants, needs and concerns and thereby fit what you do to meet those needs and extract the greatest possible value. At the same time, those customers—your customers—are very pleased and happy, because their needs are being met. ■

"Customers bring the power to your company—they are the scarce commodity in the marketplace, and the ultimate source of all revenue."

– Richard Hren,
Director of Product Marketing, SPSS

SPSS

SPSS Inc. is a leading worldwide provider of predictive analytics software and solutions. Founded in 1968, today SPSS has more than 250,000 customers worldwide, served by more than 1,200 employees in 60 countries. You will find SPSS customers in virtually every industry, including telecommunications, banking, finance, insurance, healthcare, manufacturing, retail, consumer packaged goods, higher education, government, and market research. Our software helps organizations optimize interactions with their customers and ensure that the actions they are taking today will positively affect their ability to reach tomorrow's goals. More information is available at: www.SPSS.com

Peppers & Rogers Group

Peppers & Rogers Group is a management consulting firm, recognized as the world's leading authority on customer-based business strategy. Founded in 1993 by Don Peppers and Martha Rogers Ph.D., the firm is dedicated to helping companies grow the value of their business by growing the value of their customer base. Our goal is to develop and execute strategies that create immediate return on investment and long-term customer value. Peppers & Rogers Group maintains a significant voice in the marketplace with its 1to1 Media properties. Led by *1to1 Magazine*, these print, electronic and custom publications reach more than 250,000 decision-makers. Peppers & Rogers Group is a division of Carlson Marketing Worldwide, and is headquartered in Norwalk, Conn. More information is available at: www.1to1.com

