

Drilling Down

**Turning Customer Data into Profits
with a Spreadsheet**

Note: This is the sample version of the Drilling Down book. The chapters after Chapter 4 have been eliminated and the customer profiling software application is not included, as it is with the full PDF or hardcopy book. To order the complete book with customer profiling application, visit MarketingSherpa at:

<http://sherpastore.com/store/page.cfm/2115>

For more information on the software application, see:

<http://www.jimnovo.com/software.htm>

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Jim Novo

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Acknowledgement

Without the support and input of my wife Barbara, you would not be reading this book, and there would be no Drilling Down software. ‘Nuff said.

I’d also like to thank Alex Romanov and Wade Downs, two friends who helped to develop these techniques and along with my wife, edited my ramblings into something readable and understandable.

Thanks to Richard Hoy and Angela Adair-Hoy, for starting this whole book thing in the first place and making it come true through Booklocker. Visit them at <http://www.booklocker.com>.

Bud Paxson and Roy Speer, the founders of the Home Shopping Network, deserve more credit than they have ever received for pioneering 24 x 7 interactive retailing, business operations, and customer service. Despite the limitations of technology at the time, they provided customers real-time interaction, community, and the first taste of being “in charge”, all in one service. Thanks to them for believing we could find the marketing and customer service answers, and seeing past our failures.

And thanks to my Mom and Dad, for helping to shape my life.

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Preface

Drowning in data but have no information? Confused by ROI, LTV, RFM and all the rest of the alphabet soup involved in using customer data to increase profits? You know you should be “Drilling Down” and creating “customer profiles”, but how is it done? Drill how deep, and look for what?

Drilling Down pulls back the curtain on the “how” of Data-Driven marketing and service concepts, the enabling knowledge behind CRM, database marketing, frequency marketing, loyalty marketing, relationship marketing, 1-to-1 marketing, permission marketing, and so forth. Learn the basic techniques of Data-Driven marketing / service and you will know how to use your data to attack any of these approaches, while customizing them for your business.

You will learn the hands-on fundamentals of teasing out and evolving the essentials of highly profitable marketing and service programs using customer data, without using fancy hardware or software. Do it yourself with a spreadsheet! Drilling Down is not another “consultant fluff book”, where the promise to deliver actionable ideas is not kept. You will get the whole “how do I actually do it” story in this book.

The book puts forth an easy to follow real world framework for designing your own marketing and service programs using customer data. The core ideas are based on a process and techniques proven under circumstances where there was no previous history to follow for guidance, and require no specialized skills other than knowledge of your business. This framework allows those with little customer data experience to create a structure for marketing and service decision-making. Instead of going about business in a haphazard way, always wondering, “**Who** should I pay attention to? **When** should I pay attention to them? **How** should I design the program?” the reader will be able to make these marketing and service decisions based on the customer data they have on hand.

If you work in a larger company trying to figure out the mysteries of CRM (to CRM, or not – that is the question) following the Drilling Down method “Pre-CRM” will allow you to uncover the potential benefits and ROI traps in your customer data **before installing CRM**. Learn how your customer base responds to database marketing and service techniques and use this experience to evaluate the features of CRM analytical packages and their potential ROI.

Drilling Down explains why Data-Driven marketing and service programs work, and shows you how to do it step by step. You can learn at your own pace and implement simple techniques right away, then graduate to increasingly complex approaches as you experience the results. To top it all off, the book provides descriptions of advanced testing ideas discovered only through years of research in database marketing and customer behavior, with a special focus on interactive customers and their special quirks.

INTRODUCTION

I spend a lot of time in marketing and service-oriented discussion lists. If you do, you probably also sense the incredible frustration of people who keep asking about using their customer data to retain customers and increase profits. Everybody knows they should be doing it, but can't find out **how** to do it.

Consultants and agencies make this process sound like some kind of “black magic”, something you can't possibly do yourself. I disagree. I think the average business owner can do a perfectly decent job creating profiles and using them to retain customers and drive profits. That is why I wrote the book.

This book is about the down-and-dirty, nitty-gritty art of taking chunks of data generated by your customers and making sense of it, getting it to speak to you, creating insight into what types of marketing or general business actions you can take to make your business more profitable.

We'll be talking about “action-oriented” ideas you can generate on your own to drive sales and profits, ideas that will reveal themselves by analyzing your own customer data, using only a spreadsheet.

We have all heard how important it is to collect customer data, to “know” your customer. What I don't hear much about is what exactly you DO with all that data once you have collected it. How is it used? What exactly is Drilling Down into the data supposed to tell me, and what am I looking for when I get there? For that matter, what data should I be collecting and how will I use it when I have it? And can it be done without breaking the bank?

The following outlines what you will learn and be able to do after reading the Drilling Down book:

What data is important to collect about a customer and what data is not

How to create action oriented customer profiles with an Excel spreadsheet and use these profiles to create marketing and service programs that retain and increase the value of customers.

How to use these profiles to define the future value of your customers

How to use these profiles to measure the general health of your business now and in the future

How to use these profiles to encourage customers to do what you want

How to increase your profits while decreasing your marketing and service costs

How to design high ROI (Return on Investment) marketing / service programs

How to predict when a customer is about to defect and leave you

How to blow away investors with accurate predictions of the future profitability of your business

Before we get going, let me make some suggestions. Take it easy. Read the book slowly. Make sure you understand each section before you move on to the next, because each section builds on the concepts of the previous section. Important concepts are in **boldface** type. There are plenty of examples provided; please take the time to understand them.

Once you internalize these concepts, you won't believe how profitable your marketing and service programs will be when you do some Drilling Down. This book covers five decades worth of Data-Driven thinking, detailing valuable techniques from the beginnings of catalog marketing up through state-of-the-art techniques used in interactive retailing. It's a lot of serious material and no fluff; so take your time reading it.

And if you like the book, tell your friends about it.

Jim Novo

ABOUT JIM NOVO

Jim Novo is an interactive customer retention, defection, and loyalty expert with over 15 years of experience generating exceptional returns on marketing program investments.

His professional career has been focused on introducing Data-Driven marketing to new industries. In the 80's, cable television was the target and his groundbreaking programs were widely accepted throughout the business. In the 90's, Jim revolutionized the TV Shopping industry by focusing resources on the customer instead of the products. And for the 00's, the Internet lies squarely in Jim's sights.



At The Home Shopping Network, Jim Novo witnessed the entire business cycle of a hyper-growth interactive retailer. After the land-grab customer acquisition phase, he directed the critical transition to customer retention and credit marketing activities across the television, catalog, and Internet divisions. As Vice President of Programming & Marketing during the slowdown to the mature phase, Jim handled the integration of customer communications and marketing across all the distribution channels, creating a “cradle-to-grave” customer path from Television to Internet to Catalog.

These lessons are proving valuable in understanding Internet retailing, as the consumer behavior is similar, though more exaggerated.

Jim is an MBA Graduate of Babson College, a school known for a focus on entrepreneurial activity. He majored in Economics and Psychology as an undergraduate at Dartmouth College. Jim is currently working with software

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and marketing companies to improve their products and practices in database marketing and on the Internet.

You can schedule workshops, seminars, and speaking engagements based on the techniques and methodology described in this book. Jim will teach your marketing and / or IT staff the Drilling Down method using your own data - see <http://www.jimnovo.com/Customer-Consulting.htm> for more information.

Chapter 1

Customer Profile or Customer Model?

Many people think using your customer data is about creating a customer “profile”. It’s a hot topic. Everybody wants to do it. But what is a customer profile? Here are 2 kinds of customer profiles:

- Customer is married, has children, lives in an upscale neighborhood, and reads Time magazine
- Customer visited the site every day for 2 months, but has not visited the site at all in the past 2 weeks

The first profile is demographic, a set of characteristics. The second profile is behavior-based, involving what the customer is actually doing. **It’s about customer activity.**

Which seems more important to you?

They’re both important in their own ways. For someone selling advertising, or deciding on content for a website, the first profile is usually important, because it defines the market for ad sales and provides clues to editorial direction. These are important considerations in attracting customers and generating revenue in the first stages of an online project.

The second profile is about action, behavior, and for anybody concerned about what their customers are **doing**, is more important than the first. Will they visit again? Will they buy again? These are the questions answered by looking at behavior. Customer behavior is a much stronger predictor of your future relationship with a customer than demographic information ever will be. You have to look at the data, the record of their behavior, and it will tell you things. It will tell you “I’m not satisfied”. It will tell you “I want to buy more, give me a push.” It will tell you “I think your service is awful”.

I’d argue the second type of profile is more important longer term, because if the customer stops buying from or visiting the site, you’re not going to have much of a chance to serve up the customized pages or ads based on any “profile” given to you. You could customize the heck out of the site based on

demographics or self-reported survey data but customers would never see the results if they never come back. So for the long haul, if you had to choose the more important profile, the profile based on action and behavior would be more critical to you than a demographic one. **Customer behavior profiling is critical to a company interested in retaining customers.**

Marketers who use data often talk about “customer modeling”, instead of customer profiling. Modeling is kind of like profiling, but it is action oriented. Models are not about a static state, like “Customer is 50 years old”. Models are about action over time, like “If this customer does not make a purchase in the next 30 days, they are unlikely to come back and make any further purchases”.

It sounds so mystical, and it is. To see a mathematical model predict customer behavior is astonishing, to say the least. The model says, “Do this to these people and they will likely do this”. The marketer or service provider goes out and does what the model says, and like magic, a good bunch of the customers do exactly what the model said they would. It works like a charm – usually.

Building real models is expensive, because it requires an awesome amount of talent and experience. There are many mathematical techniques used to build models, each with their own pitfalls and gotchas. Success depends a lot on the type of business, the kinds of data available, and the experience of the modeler / analyst in building models for a particular business.

What is a model? Simply, it looks at customers who are engaging in a certain behavior and tries to find a commonality in them. The marketer might say to the modeler, “Here’s a list of our very best customers, and here’s a list of our former best customers. Is there any behavioral signal a best customer gives before they stop being a customer? What does the data say to you?”

So here’s what’s in it for you, what this book is about. You can do your own “models”, based on the years of experience of what works for Data-Driven marketers and service providers. And while they won’t be as good as the “real” models done by Ph.D. analysts, they’ll be pretty darn good. Plus, they will help you increase profits while cutting marketing and service costs. This book will show you how to do it, with a spreadsheet. Ph.D. not required.

Then you can use your models to answer some basic marketing and service questions about your customer base. Questions you no doubt have asked many times yourself, such as the following:

- Who do I provide marketing or service programs to? When? How often?
- Should I contact some customers more often than others? (Yes, you definitely should.)
- How much and what kind of incentives should I provide to get a customer to do something I want them to? Can I predict which customers will be responsive to the program? (Yes, you can)
- How can I tell when I'm losing a customer or when service has failed?
- How can I put a value on my different customers and the business as a whole now, and project this value into the future?
- Is my business strong and healthy, or becoming weaker?
- What can I expect in future sales from my existing customers?

And you can also use these behavioral models in combination with demographics and characteristics to produce an even richer picture of the customer. Which of the following seems more useful to you?

- Customer is married, has children, lives in an upscale neighborhood, and reads Time magazine
- Customers who are married, have children, live in upscale neighborhoods, and read Time magazine appear to be disappointed with our site, because a high proportion of them haven't visited the site in the last 30 days

The combination of behavior and characteristics can be very powerful indeed. But without the behavior, demographic characteristics don't tell you much. You will learn how to use both in building your models. First we'll talk about customer behavior, and then add customer characteristics later on.

Chapter 2

Data-Driven Marketing and Service Models: Customer Value Management Basics

I came up with the phrase “Data-Driven” because I needed one name for the process happening in the background of all the marketing and business optimization approaches where customer data is used. As soon as you say “Relationship Marketing” or “Loyalty Marketing” or “1-to-1 Marketing” or “Permission Marketing” or “CRM”, all kinds of extra ideas creep in, obscuring what’s really going on in the background of all these concepts.

These approaches differ in how they are positioned to the customer, and how they are communicated. But back in the pits where the data analysts are, where customer profiling and modeling take place, they’re much the same.

Good marketers and service providers have two objectives with any kind of customer value management, which is what the above approaches are all about:

1. Hold on to the most valuable customers
2. Try to make less valuable customers more valuable

So whether it’s relationship marketing, a loyalty program, permission based, or 1-to-1, you still have to accomplish these goals, and to do it, you have to create marketing or service programs and execute them. This means you have to know the value of your customers and their likelihood to respond to a program, whether the program is customized based on books already purchased, uses loyalty points, or is service-oriented.

The above marketing and service approaches are all “wrappers” around what is really going on — you want the customer to do something, or perhaps not do something. This means you have to reach out to the customer and communicate your marketing and service programs. You need answers to 3 questions — WHO to communicate to, WHEN to communicate to them, and HOW you’re going to execute the communication. It doesn’t matter what you call your program, what “wrapper” you put it in to present to the customer — you always have to answer these 3 questions (and maybe a few more).

In addition, you probably care about how much you spend on these marketing and service programs. Ideally, instead of blasting out expensive stuff to every customer, you would want to spend money on the customers most likely to do whatever you want them to, and not waste money on those who are not.

You want customers to do something, to take action. You want them to visit your website, make a purchase, sign up for a newsletter, add new services. And once they do it for the first time, you usually want them to do it again, especially since you probably paid big money to get them to do this “something” the first time. You don’t want to pay big money the second time. The data can tell you how to accomplish this, no matter what kind of front-end marketing or service program you are running or how you “wrap it up” and present it to the customer. As long as you have the data, you can interpret it for clues as to what steps to take next, and how to save precious marketing dollars in the process.

If you understand Data-Driven Marketing and Business Optimization, you will understand the basic driving forces in all of these customer retention-oriented programs. Here’s the basic philosophy of a Data-Driven program operator:

1. **Data-Driven programs are about allocating resources.** All businesses have limited resources, even the dot-coms (eventually). When you spend \$1.00 on a program, you are looking to make back more than \$1.00 in **PROFIT** (not sales). If you can’t make back \$1.00, the dollar is not worth spending. Given multiple places to spend the program dollar, if you can get back \$1.20 in one place and only \$.90 in another, wouldn’t you rather spend it where you get \$1.20 back? This approach is called **Return on Investment, or ROI, and is the reason why you want to do Data-Driven programs in the first place.** Data-Driven programs are among the very few approaches allowing you to accurately measure ROI.

It’s about knowing you will make a \$1.20 for every \$1.00 you spend. If you know this for sure, wouldn’t it be foolish not to spend every \$1.00 you had in the budget to get \$1.20 back? If you always migrate and reallocate program dollars towards higher ROI efforts, profits will grow even as the program budget stays flat. This idea is at the center of ROI thinking — reallocating capital with low return to higher return projects or programs, generating higher profits in the process.

ROI is often a difficult concept to understand because there are so many people using ROI in the wrong context and measuring it incorrectly. You will learn the correct way to calculate and use ROI later on in the book.

2. **Past and Current customer behavior is the best predictor of Future customer behavior.** Think about it. Any entity you can define as a customer – external, internal, distributors, manufacturers, suppliers – they all pursue certain routines, and changes in these routines often indicate an opportunity or challenge is ahead in your relationship with them. When it comes to action-oriented activities like interacting with a web site, this concept really takes on a very important role. You can predict future behavior based on an understanding of past behavior, and use this knowledge to improve marketing or service programs.

We are talking about actual behavior here, not implied behavior. Being a 35-year-old woman is not a behavior; it's a demographic characteristic. Take these two groups of potential buyers who surf around the 'Net:

- People who are a perfect demographic match for your site, but have never made a purchase online
- People who are outside the core demographics for your site, but have purchased repeatedly online

If you sent a 20% off promotion to each group, asking them to visit and make a first purchase, response would be higher from the buyers (second bullet above) than the demographically targeted group (first bullet above). This effect has been demonstrated for years with many different Data-Driven programs. **It works because actual behavior is better at predicting future behavior than demographic characteristics are.**

3. **Customers want to win at the customer game.** They like to feel they are in control and smart about choices they make, and they like to feel good about their behavior. Marketers and service providers take advantage of this attitude by offering programs of various kinds to get customers to engage in a certain behavior and feel good about doing it. Customers like to “win” through these programs, whether they are consumer customers taking a discount, B2B customers using a new service offering, distributors selecting your product over other products, or manufacturers working on

supply chain issues. Programs encourage behavior. If you want your customers to do something, you have to do something for them, and if it's something that makes them feel good (like they are winning the customer game) then they're more likely to do it.

This idea has always existed; on the Internet the behavior is much more traceable and obvious than before. Customers now leave evidence of this attitude all over the 'Net, in newsgroups, chat rooms, and so forth.

4. **Data-Driven marketing and service programs are all about Action – Reaction – Feedback – Repeat.** Marketing and service are conversations, as the ClueTrain Manifesto (<http://www.cluetrain.com>) and Permission Marketing (<http://www.permission.com>) have pointed out (if you haven't read these works, you are doing yourself a disfavor). At a high level, service is just another form of marketing – an extremely important one. Marketing and service provision using customer data is a highly evolved and valuable conversation, but it has to be back and forth between the program operator and the customer, and you have to LISTEN to what customers are saying.

That's why I will be talking about the data "speaking to you". The data is, in effect, speaking for the customer, telling you by its very existence (or non-existence) there has been an action, and it's waiting for a reaction. **An action or inaction is a raising of the hand by the customer, and the Data-Driven marketer or service provider not only sees the raised hand, but also reacts to it, then looks for the hand to be raised again by the customer.**

For example, if a customer visits your site every day and then just stops, something has happened. They are unhappy with the content or service, or they have found an alternative source. Or perhaps they're just plain not interested in you anymore. This inaction on their part is the raising of the hand, the flag telling you something has happened to change the way this customer thinks about your site. You should react to this and then look for feedback from the customer. If you improve the content, e-mail them a notice, and the customer starts visiting again, the feedback has been given. The cycle is complete until the next time the data indicates a change in behavior, and you need to react to the change.

Let's say this same customer then makes a first purchase. This is an enormously important piece of data, because it indicates a very significant change in behavior. You have a new relationship now, a deeper one. You should react and look for feedback. You send a welcome message, thank the customer for the trust they have displayed in your site, and provide a 2nd purchase discount. Then you await feedback from the customer, in the form of a second purchase, or increased visits. Perhaps you get negative feedback, a return of the first purchase. React to this new feedback and repeat the process over again.

The Data-Driven model of marketing / service provision is 2-way, as opposed to the 1-way approach of media advertising or "data-blind" service. It is give and take, an exchange; a communication process. Using a lot of customer communications can be costly in the offline world. But communication costs are generally low on the Internet, so the Data-Driven model is ideally suited for use there.

How is this exchange accomplished? Can the data really "speak"? It can and does, but you need to know its language and learn how to listen. It's not very hard, and I'm going to teach you how to do it. But first, we need more background on customer behavior.

Latency Metric Toolkit

Chapter 3 Trip Wire Marketing

No question about it, the constant drumbeat of the CRM machine over the past several years has confused the heck out of people. I've been doing this stuff for almost 20 years now, and I can tell you it is not as difficult as it is often portrayed. Sure, you can make it very, very complicated if you want to. But if you don't start with the basics, you're going to end up wasting a ton of money. Let's start simple, shall we?

In this chapter I'm going to explain in a more general sense how customer metrics are used, and in particular, address some of the misconceptions people have regarding customer value-based and relationship marketing techniques. Much of CRM is based on these fundamental ideas. Remember, CRM is an approach to managing a business, not a technology. You do not need to live on the bleeding edge of technology to take advantage of a customer-based management philosophy.

Generally, CRM or Relationship Marketing attempts to define customer behavior and then looks for variances in behavior. When you hear people talk about "predictive modeling" or looking for "patterns" using data mining, they are essentially taking a behavioral approach using the latest tools. Once you know how "normal" customers behave, you can do two things with your business approach:

- Formally document normal customer behavior and internalize it systemically, leveraging what you know to improve business functionality and profitability.
- Set up early warning systems, triggering events, or "trip wires" to alert you to customer behavior outside the norm. This variance in behavior generally signals an opportunity to take action with the customer and increase their value - online or offline.

What is most important to measure in CRM is change. People spend way too much time worrying about "absolute" numbers, like LifeTime Value. What they should really be looking at is "relative" numbers - change over time. It's not nearly as important to know the absolute value of a customer as it is to know whether this value is rising or falling - called the customer LifeCycle. **Knowing and understanding the customer LifeCycle is the most powerful marketing tool you can have.** I will show you how to track the customer LifeCycle and use it to increase the ROI of customer marketing later on in the book.

Customers in the aggregate tend to follow similar behavioral patterns, and when any single customer deviates from the norm, this can be a sign of trouble (or opportunity) ahead. For example, if the average new cellular customer calls customer service 60 days after they start, and an individual customer calls customer service 5 days after they start, this customer is exhibiting behavior far outside the norm. Is there a potential problem, or opportunity? Does the customer having difficulty understanding how to use advanced services on the phone? Or is the customer happily inquiring about adding on more services? In either case, there is an opportunity to increase the value of the customer, if you have the ability to recognize the opportunity and react to it in a timely way.

Understand, there is no "average customer", and a business will have many different customer groups, each exhibiting their own kind of "normal" behavior. The tools available to identify and differentiate customer segments using behavioral metrics are discussed at length in this book. For example, the type of media or offer used to attract the customer can have a dramatic effect on long term behavior, and customers who come into the business on the same media and offer will tend to behave in similar ways over time.

In the cell phone case above, the measurement of Latency (number of days until customer service call) serves as the "trip wire", a raising of the hand by the customer, to say to the marketer "I'm different. Pay attention to me." It is then up to the marketing behaviorist to determine the next course of action. Metrics like Latency provide the framework for setting up the capability to recognize the opportunity for increasing customer value.

This raising of the hand by customers, and the reaction by marketers, is the feedback loop at the center of Relationship or LifeCycle-based marketing. It's a repeating Action - Reaction - Feedback cycle. The customer raises the hand, the marketer Reacts. The customer provides Feedback through Action - perhaps they cancel service, or perhaps they add service. The marketer reacts to this

Action, perhaps with a win-back campaign, or with a thank you note. It's a constant (and mostly non-verbal) conversation, an ongoing relationship with the customer requiring interaction to sustain. It is not a relationship in the "buddy-buddy" sense. Customers don't want to be friends with a company, they want the company to be responsive to their needs - even if they never come out and state them openly to the company.

This relationship continues to cycle over and over as long as there is value in the relationship for both the customer and the marketer. If the customer takes an Action and there is no Reaction from the marketer, value begins to disappear for the customer, and they may defect. When value disappears for the marketer (the customer stops taking Action / providing Feedback), marketers should stop spending incremental money on the customer.

Notice I did not say "fire the customer" or any of the related drivel thrown around in some of the CRM venues. All customers deserve (and pay for) a certain level of support. The real question is this: for each **incremental**, or additional dollar spent on marketing to the customer, is there a Return On the Investment? If I have the ability to choose between spending \$1 on a customer returning \$1.10, and \$1 on another customer returning \$3, I would be nuts not to choose the customer returning \$3. I have not "fired" the customer returning only \$1.10; I have just **chosen not to spend incremental money** doing any special marketing to them.

Do you see the difference?

In fact, much of the profitability typical of high ROI Customer Marketing techniques comes from knowing who **not to spend on**. Most of the decreased profitability in any marketing program is a result of over-spending on unsuitable targets with lowered returns. But because marketers tend to look at results in the aggregate, or they are looking at demographically-based segments to measure a behaviorally-based outcome like purchases, they miss important details. For example, certain segments may return \$5 for each \$1 spent while others may lose \$5 for every \$1 spent, even though the campaign as a whole may return \$1.10 for each \$1 spent.

When you are trying to encourage a customer to buy something, you are looking for a behavior to occur. To measure the results of such a marketing campaign using only demographic segmentation without any behavior-based metrics (like Latency) is misleading at best, and lazy otherwise - it's apples and oranges. If

you are trying to create behavior, use behavior as your measurement yardstick to define success.

Why is all of this important to understand?

Customers who are in the process of changing their behavior - either accelerating their relationship with you, or terminating their relationship with you - are the highest potential return customers from a marketing perspective. They represent the opportunity to use leverage, to make the highest possible impact with your marketing dollar. You may make money marketing to customers who are just cruising along the LifeCycle, acting like an "average customer". But when you can predict the likelihood of an average customer to turn into a best customer, and you successfully encourage this behavior, or you can reverse a customer defection before it happens, then there are tremendously profitable longer-term implications for the bottom line. You will discover these opportunities by understanding behavior and setting up **trip wires** to alert you to deviations from normal behavior by a customer.

What about all the rest of the customers, those who are not either accelerating or terminating the relationship? Leave 'em alone. Whatever background marketing you are doing (advertising, branding, service campaigns, etc.) is serving them just fine. **High ROI data-driven marketing techniques are best used (and create the highest returns) when they are used to surgically strike at a trend in behavior, not when customers are comfortably plodding along.** However, there are not as many comfortable plodders as you think; in fact, from 40% to 60% of your customer base is either in the process of accelerating or terminating their relationship with you right now. The question is this: how do you take advantage of the situation?

Latency, Recency, and all the other metrics described in the Drilling Down book are simply tools for recognizing the opportunity to take an Action in Reaction to the customer raising their hand. If you don't have some kind of system to recognize customers in the process of changing their behavior, you will miss out on most of the highest ROI customer marketing opportunities you have. And don't count on the customer to e-mail you when they're thinking of changing their behavior - we both know that is not going to happen. A more likely scenario: they will just stop taking Action and providing Feedback. And by then, it's too late for you to do anything profitable about it. Set up your trip wires and predict the behavior, folks. It's the only way to sense when an average

customer is ready to become a best customer. And reacting to a customer defection after the fact is a truly sub-optimal way to "manage" a relationship.

Based on a national survey, 50% of marketing managers do not know their customer defection rate, and the other 50% underestimate the true defection rate. After reading this shocking statistic, I figured it was time write the book on customer LifeCycles, which can be used both to track customer defection and define high ROI opportunities to retain customers before they defect. If you understand the customer LifeCycle, you can predict the primary defection points and react to them before customers leave you. This is the highest ROI marketing you can possibly do; it's cheaper than "win-back" (after the customer defects, response is much lower) and preserves the investment and profits you have in the customer.

So we're going to take a little tour though LifeCycle-based marketing land first, and take a look at one of the simplest customer LifeCycle metrics - Latency. Latency is one of the easiest "trip wire" metrics to implement, and you can use it to make more money marketing to customers whether you are using a CRM suite or a spreadsheet to run your business.

At the core of a LifeCycle-based marketing approach is customer behavior. Customers tend to behave in certain ways unique to your business and products, and if you can discover these patterns, you can use them to predict customer behavior. **If you can predict customer behavior, you can make a ton of money marketing to your customers, because you can anticipate their behavior and take appropriate steps to try and modify it.** Many approaches to customer marketing rely on customer behavior "trip wires". For example, a win-back program is triggered when the customer defects. Have you switched long distance or cellular providers lately? Did you get inundated with win-back calls begging you to reconsider? "Jim, we just wanted you to know we have lowered our rates". Yeah, well, thanks for telling me after over-charging me for the past six months! But could they have known I was about to switch?

Sure. If they had looked at the calling patterns of defected customers like me, they would have seen a common thread in the behavior. These patterns create the "trip wires" for initiating high ROI marketing campaigns before the defection. The proper profit maximizing approach is to wait until I look like I'm going to defect, and then call me and offer a lower rate before I defect. I would humbly submit marketing to the customer after they defect is a sub-optimal approach; the decision has already been made. If you can market to them when

they appear likely to defect, you optimize your marketing resources by not applying them too soon or too late in the customer LifeCycle.

An easy to implement and proven powerful LifeCycle trip wire is called Latency. Latency refers to the average time between customer activity events, for example, making a purchase, calling the help desk, or visiting a web site. All you have to do is calculate the average time elapsed (Latency) between the two events, and use this metric as a guide for anti-defection campaigns. Many small business people naturally use Latency in an intuitive way, for example: "Gee, it has been a while since Mary Lou had her hair styled". What the stylist really means is this: Mary Lou is taking longer than the average customer to schedule a "refresh" on her hair. In database marketing terms, her Latency is exceeding the norm. So the stylist calls Mary Lou and finds either a customer who "forgot" and appreciates the reminder, or a customer who has defected to another stylist.

In database marketing, we don't rely on "remembering" the habits of thousands of customers; we measure the behavior and react based on these measurements. When you see a particular customer's behavior diverge from the average customer behavior you have calculated above, you get a trip wire event. Since the calculation of Latency is very simple, and the diverging behavior is easy to spot, this type of anti-defection campaign is an ideal candidate for "lights-out" or automated rules-based customer retention campaigns.

As an example, let's take purchase behavior in a retail scenario. If you examine your customers and find the average time between the second and third purchase is 2 months, you have found "third purchase Latency". Any customer who goes more than 2 months after the second purchase without making a third purchase is diverging from the norm, and a likely defection candidate. It's simple logic. If the average customer makes a third purchase within 2 months of the second purchase, and a particular customer breaks this pattern, they are not acting like the average customer. Something has changed. This particular customer's LifeCycle has become out of synch with the average customer LifeCycle, and this condition is a trip wire for a high ROI Customer Marketing event.

On average, if you divert marketing resources away from customers who have made a 3rd purchase within 2 months after the second purchase, and apply these resources to customers who are "crossing over" the 2 month LifeCycle trip wire without making a third purchase, you will end up spending less money and generating higher profits for any given marketing budget. You are applying

your limited resources right at the time in the customer LifeCycle when they create the most powerful impact - at the point of likely customer defection.

Now, will all these customers respond? No, of course not. But the ones that do become active, loyal customers again, and those that don't are probably not going to be good customers in the future. The behavior of the rest of your customers tells you so. These non-responding customers may not be worth spending money on to "win-back", and in fact, will have much lower response rates to a win-back campaign. They have already demonstrated their lack of interest with their behavior, and you could be better off financially by just letting them go and focusing on more responsive, more profitable customers.

The above example is a relatively crude approach to Latency. As you might suspect, different customer segments will have different Latency characteristics, and the more you fine-tune a Latency campaign, the more profitable it will become. For example, let's say you execute the Latency campaign described above, and succeed in retaining 30% of the defecting customers, making a tidy profit. But you really have two major product lines, software and hardware, each 50% of sales. Could the Latency be different between software and hardware customers? You betcha. Upon further analysis, you find third purchase Latency for software is really one month, and for hardware it's three months. The average 3rd purchase Latency of all customers is 2 months, but the Latency by product line is specific to each line. So you bust the two groups apart, and run separate Latency-based campaigns, one for each product line.

In your original third purchase Latency campaign, you promoted to customers who did not make a third purchase within 2 months of the second purchase. This means you were "late" for software (because the average Latency is really 1 month) and early for hardware (because the average Latency is really 3 months). When you realign the timing based on the line of merchandise, you find instead of retaining 30% of customers, you retain 50% of the customers, because you have synched-up the marketing effort with the true customer LifeCycle.

And that, folks, is what LifeCycle-based marketing is all about - using your own customer's behavior to telegraph to you the most important (and profitable) time to market to them. The customer, through their behavior, raises a hand and asks you to take action. If you synch up your marketing efforts with the natural customer LifeCycle, you can't help but being more successful.

What if you were to look at an entire series of Latencies? The average number of days between the first and second purchases, the average number of days between the second and third purchases, third and fourth, fourth and fifth, etc. You don't have to use purchases, you could use contacts with customer service, visits to a web site, any behavior important to your business. What would that look like, and more importantly, what can it do for you?

It would look like a snapshot of the customer LifeCycle. And what it can do for you is start you on the path to predicting customer behavior and increasing the value of your customer base. Any type of event can be used – purchases, downloads, visits to a web site – but the event must be one that repeats or have an established “sequence” of actions to it.

Let's say you look at average behavior across all customers, and end up with a "Latency Sequence" that looks something like following:

Time between 1st - 2nd event: 90 days
Time between 2nd - 3rd event: 60 days
Time between 3rd - 4th event: 30 days
Time between 4th - 5th event: 60 days
Time between 5th - 6th event: 90 days
Time between 6th - 7th event: 120 days
Time between 7th - 8th event: 150 days

What does this pattern say to you? Think about it.

I'll tell you what it says to me. First, as you probably realized, you are now starting to see something that looks like a "cycle", as in LifeCycle of the customer. It's a series of events you can graph with a line and make charts of. If you can measure it, you can try to affect it in a positive way, and determine the results of your efforts. Second, you now have a series of seven "trip wires" you can use as described above to more finely sift and screen behavior looking for deviations from the norm. If the average number of days between events for any single customer starts to exceed the average for all customers, a trip wire call for action is triggered on that customer. And third, somewhere around the 3rd or 4th event, something significant happens to change customer behavior in a very noticeable way. The customer accelerates into the 4th event (the time between events gets shorter and shorter), then begins to decelerate in terms of behavior (the time between events gets longer and longer). Depending on your business, this may be positive or negative.

How to use this information?

Regarding the Lifecycle and the trip wires, you could have a series of seven actions ready to take at any point in this LifeCycle where the customer deviates from average behavior. As long as the customer stays on track, save the money and take no action. But as soon as the customer misses or "rolls over" past one of these LifeCycle milestones, you know to pull the trigger on your action. If you follow this model, you will end up maximizing every cent of your budget and driving higher profits, because **you don't spend unless you have to, and when you spend, it creates maximum impact**. This is the recipe for high ROI customer management and marketing. Act only when you have to and always at the point of maximum impact.

Regarding the behavior change, if I was a retailer, this looks negative since the "ramp" in buying behavior reversed and went in the other direction. If I was running a pure service center, this may be a very desirable pattern; perhaps meaning the customer has "learned" the product and no longer needs as much service. It could be negative though, since opportunities to up-sell or cross-sell the customer are decreasing over time. It depends on your business. The important thing to recognize is this: there was a change in behavior, and you should try and determine how you might affect this change in a positive way. Reversals in the direction of a behavior like this are almost always significant turning points in the relationship with the customer.

Human behavior dynamics often take on seemingly "physical" properties. Inertia is one such property - an object in motion tends to remain in motion unless acted on by an outside force. This reversal in the direction of the customer "momentum" after the 4th event indicates there is something about your business - a process (or lack of a process), a product (or lack of a product), something - which causes the average customer to "slow down" and reverse their contact momentum. Your mission (should you decide to accept it) is to find out what it is and try to influence this "something" positively.

If I was a retailer with very limited resources, here is what I'd do. Given the seven possible promotional opportunities listed above, but looking for the **absolutely highest ROI on a single promotional event**, I would send a promotion to the customer immediately after the 4th purchase - and no sooner. I don't want to spend money on a promotion or by reducing my margin if I don't have to, so as long as the customer is accelerating, there is no reason to spend any money. But I would really like the ramp to continue past the 4th purchase,

and any way I can bring that 5th purchase in closer to the 4th is going to affect my bottom line, and perhaps lengthen the ramp into the 5th or 6th purchase and beyond. If I had more money to spend on promotions, I would test each of the seven trip wire opportunities, and pursue only those with the highest ROI, probably using a separate and unique discount approach for each of the seven trip wire opportunities.

If I was a service center, the fact it takes 4 calls to educate the customer might not be acceptable, and I would look for ways to decrease the length of time it takes. If I up-sell and cross-sell, I would look to weight more of this activity early in the process knowing I am not going to get as many chances as time goes on and the customer becomes more likely to defect. Success at either of these actions can create incremental profits with very little expense - you're not necessarily changing what you do, just when you do it, to match more closely with the customer LifeCycle.

Of course, you can begin to subdivide the customer base, just as we did in the hardware / software example above. The Latency Sequence may look quite different for hardware buyers relative to software buyers, and it will certainly be different by the type of campaign you used to attract the customer in the first place. Once you are able to compare and contrast different customer LifeCycles by product, campaign, customer source, or by any other data point meaningful to your business, you will begin to paint a more complete picture of what parameters positively or negatively affect customer behavior. Once you understand the behavior, you can learn to profit from it.

Chapter 4

The Hair Salon Example

There are three main phases to a successful High ROI Customer Marketing program: **Measure, Manage, and Maximize**. We'll tackle each of these components one at a time in this example.

Two hair salons operate in the same town, Salon A and Salon B. Both are equally competent one-person operations and charge similar prices for similar services and products. And both salons practice CRM.

There is a difference though - Salon A does not use customer data to track and manage the CRM effort, but Salon B does. Salon B's CRM toolset consists of a paper appointment book and a PC with a spreadsheet program. Salon A has only a paper appointment book, and doesn't really track anything.

One day the owner of Salon A is thinking:

Where has Mary Lou been? She's a high value customer who comes in to get the whole job done - hair, nails, massage, the works. Seems to me she hasn't been in the Salon for a while. She's tardy in scheduling her session. I should call her and find out when she is coming in.

The owner of Salon A is practicing CRM. High value customers have been identified, and a change in the behavior of one of these customers has been detected. This situation has been evaluated, and an action to take has been decided on.

But the owner of Salon A is very busy that day, and forgets to call Mary Lou. What's more, the owner has no system for classifying the fact Mary Lou has not been in "for a while". How long is a while? Part of why the owner forgets to call Mary Lou is there is no real urgency; she's just "tardy". But how tardy is tardy? When should the call be made? If there were a rule about "tardy", perhaps there would be more urgency to make the call. But there isn't, so it may seem like a waste of time. The owner thinks later on:

She'll come in sometime soon. I'm too tired to make the call tonight.

As we sit here gazing into Salon A, some other thoughts probably come to mind. How many Mary Lou customers are there? And how "tardy" will they get before the owner calls them? When you are making money cutting hair all day, it's probably hard to face calling Mary Lou customers, right? Time spent on the phone calling customers or sending them postcards is time not spent cutting hair, and the owner of Salon A can't afford to not cut hair. If the owner had only the time or energy to call just three Mary Lou customers, which three would it be?

If the owner has to give up time cutting hair to make calls, these calls better result in more business than was lost by not cutting hair to make calls. This potentially negative outcome is called "opportunity cost". If resources are allocated away from an income producing activity towards another activity, you better make sure these resources create more value than they did before re-allocation. If they do not, an opportunity cost has been created. The two fundamental rules of High ROI Customer Marketing are designed to avoid these opportunity costs:

1. Don't spend until you have to, and
2. When you spend, spend at the point of maximum impact

Over at Salon B, the owner has been thinking along the same lines as the owner of Salon A, about a High Value, tardy customer named Angela. The owner is cleaning up for the night, and thinks:

How many Angela customers do I have? If I keep forgetting to call my Angela customers, I may eventually lose them. But they always come back. Or do they? I'm going to start **Measuring** Angela customers. I'm going to start tracking "tardy" customers and find out exactly what this issue is about. If it's a real issue, I'll worry about it then. If it's not an issue, I can forget about it once and for all, and spend my time cutting hair.

So the owner of Salon B sits down with the paper appointment book, looks through the customer names, and enters all the "High Value" customer names into the spreadsheet, one to a line. The owner reasons the choice to track high value customers in this way:

If there is anything to this "tardy Angela" customer thing, I get hurt the most financially by losing High Value customers. If it's ever going to be worth spending time on this instead of cutting hair, then it will be most worth it to

spend the time marketing to high value customers. If it's not worth it for them, it won't be worth it for any customers and I can forget all about the whole thing.

Once the high value customers are entered into a spreadsheet (about 50% of the customers are considered high value), the owner of Salon B then enters all the appointment dates for each high value customer into the columns of the spreadsheet, next to each name. To keep this project manageable, the owner decides to enter only appointments for High Value customers for the past 6 months. The owner also creates columns to subtract the dates from each other for each customer and find the average number of days between visits for each customer. The spreadsheet (nothing special, off the shelf software) is smart enough to know these entries are dates and is able to easily subtract them and convert the result into days, so all these calculations are easy and take less than an hour to create.

The owner of Salon B is then astonished to discover these facts about customers: About 30% of high value customers have not had an appointment in 6 months. Since 50% of all customers are high value, this means $30\% \text{ of } 50\% = 15\%$ of all customers are already defected best customers. The average number of days between appointments is very similar across all the high value customers. It is, however, not the 30 days the owner expected, but 40 days.

The owner then assumes a high value, supposedly loyal customer who has not been to the salon in over 6 months is a lost customer - at least for the near future. The owner then calculates the value of the lost business for the 6-month period by multiplying the number of customers lost by the average sale of \$150 per trip at 40 days between trips. Needless to say, the resulting number is a very large, representing many days of total sales for Salon B:

Total Customers	200
Defected Best Customers @ 15 % of Total	30
Number Trips in 6 months @ 40 days between trips	4.5
Revenue per Trip	\$150
Lost Revenue: Defected Best Customers (4.5 x 30 x \$150)	\$20,250

The owner of Salon B then thinks:

I must be crazy for not looking at this before. I would make more money by not cutting hair for a couple of hours a week if I could get back even one of these high value customers. I'm going to do something about this right away - before I lose even more high value customers. Now that I have **Measured** this effect and know how much money it is costing me to not address the tardy Angela customers, I need to **Manage** the process somehow. How can I set up some kind of "system" that will help me figure out what to do with this data I have discovered? How can I turn the data into an action plan?

Over at Salon A, the owner knows the names of best customers who "have not been in for a while". But this owner has no system, no way to measure what the dynamics of the situation are. How long is "a while"? But at Salon B, the owner knows the average time between best customer visits is 40 days, and there are customers in this group who have not had an appointment in over 6 months. How can the owner get this business back? The owner thinks:

I'll just mail all these best customers who have not had an appointment in over 6 months a postcard offering them a discount. The postcards will say, "Since you are a best customer, you are entitled to a 15% discount if you come in for a visit within the next two weeks". They will come in and I will start a new relationship with them, and find out why they have not been in. The owner of Salon B prepares the targeted postcards, mails them out, and awaits appointments from these customers

The appointments never come.

A bunch of the postcards come back as "undeliverable", and the owner gets several phone calls from customers saying "I now go to Salon A, take me off your mailing list". Undaunted, the owner of Salon B reasons:

Clearly there is something wrong with this approach. Best customers who have not had an appointment for 6 months must already be "defected" customers. They obviously do not want to come back to me, and feel the relationship is broken already. They have moved on and established new relationships. I will try a new approach with the postcards, and will use the same offer. But this time, I will mail the postcards out as soon as the best customer has not been in for over 40 days. Since the average best customer comes in every 40 days, a best customer who fails to do so is not acting like a best customer. So each week I will use my spreadsheet to identify best customers who have not been in for 40 days, mail the discount postcard out to them, and track the results.

After a month of mailing the postcards to best customers who had not had an appointment in over 40 days, the owner of Salon B sat down to analyze the program. Of all the best customers mailed to, 1/3 had made new appointments, and 2/3 had not. But even with the discount, the additional profits from these customers paid for the postcard mailing many times over. High value Customer defection was being **Managed** by the program.

Despite this success, two things bothered the owner of Salon B. The first was what customers who responded said when making their discounted appointments. The second was the 2/3 of best customers who did not respond. The owner thinks:

Half the customers who responded said to me, "I'm so glad you mailed me a discount, I was planning on making an appointment in the next week and would have made one anyway, so it was great to get the discount". So I gave up margin and profits I did not need to give up. And how is it possible that so many of my best customers never responded to my offer? I wonder if there is a way to address these two issues? If I could reduce the number of "would have come in anyway" customers who got a discount, and get more customers to respond overall, I would be really making a ton of money on my best customer retention postcard program. I have **Measured** my best customer defection, and am **Managing** it with this program. I wonder if there is a way to **Maximize**, to make it even more profitable?

Well, fellow Driller, have you got an idea? You know Customer Retention is all about this process: Action - Reaction - Feedback - Repeat. The owner of Salon B has taken an action, and there has been a Reaction. How should the owner go about analyzing the Feedback? The owner of Salon B then has an idea:

What about this group of customers who said "they would have scheduled anyway without the postcard". Are they similar in any way? If there is a common reaction to the postcard among these customers, perhaps there is a commonality in the behavior or backgrounds of the customers. If I can find the key linking these customers together, perhaps I can understand why this is happening with them.

The owner of salon B goes back to the CRM software (a paper appointment book and the customer spreadsheet). The owner has entered "response date" in a spreadsheet column for each customer who responded to the postcard and any comments. The owner sorts the customers by the responders and looks at those

customers who said, "would have scheduled anyway without a postcard". For each customer who responded and said this, the owner looks the customer up in the appointment book to find more details.

"Long hair cuts!!!!" the owner exclaims. "They all have long hair cuts!" which the owner immediately realizes is the problem with the discount postcard mailing program. The owner thinks:

Best customers with long hair styles can come in much less often than every 40 days, even through the average of all best customers is a cut every 40 days. So customers with long cuts are getting the postcard too early - they're not really "defected", and schedule a planned appointment with a discount I did not have to offer. They should get a postcard possibly at 60 days, or even 90 days or longer after their last appointment. Since I have a lot of customers with long cuts, most are getting the postcard too early for the cut. This explains the low overall response rate. Best customers with short cuts however, are probably getting the postcard too late. By the time I get them in the mail and they reach the customers with short cuts, it could be too late, they may have already gone elsewhere for their short hair cut.

The owner of Salon B resolves to recalculate the average days between appointments separately for best customers with long cuts and best customers with short cuts. The owner divides the customer base in two - by length of cut, and finds the average time between trips of long cut customers is actually 75 days, and for short cut customers is actually 20 days. Rethinking the retention campaign, the owner resolves to track each group individually, and to do two types of mailings each week - one to long cut customers over 75 days since last visit, and one to short cut customers over 20 days since the last visit.

Using the advanced CRM system (a spreadsheet program with one customer per row), the owner creates a column for acceptable number of days since last visit - 75 days for long cut customers and 20 days for or short cut customers. Using the date of last appointment, the owner creates a simple equation that uses today's date and last appointment date to calculate days since last visit, and to subtract this number from the number in the "acceptable" column. The salon owner thinks:

I have created a "trip wire" system for the best customer retention postcard program. When the number in this column approaches zero or goes negative for a customer, it is time to mail the discount "where have you been" postcard.

Since each customer has an acceptable number of days since last visit based on hair cut length, the timing of the mailings should more closely reflect whether or not the customer has actually defected.

The salon owner tests the new campaign - and it works. Not only does the owner get many fewer customers saying "thanks for the discount, would have been in anyway", the response rate among targeted best customers increases by 30%. The program now is maximized for this level of detail - it makes even more money than it did before, and retains more customers while decreasing the cost of discounts given away. A beautiful thing, the owner thinks. But then another Eureka moment comes to the owner of Salon B:

If I use this system there is another benefit - I should be able to actually forecast what my volume should be months in advance based on customers likely to schedule an appointment. If I see a week coming up where visit volume looks to be low, I can promote to some customers and fill up empty slots, maybe give them a discount for scheduling on a specific day when my traffic is light. That way the customer is happy because they get a special one-time discount, and I am happy because I am maximizing my revenue per day by filling up light traffic days with happy customers!

Just then, the owner of Salon B hears someone walk in the door. A voice calls out, "Can we schedule appointments?" The owner recognizes the voice - it belongs to lost best customer Angela, the one who started this whole project by being tardy in scheduling an appointment. Angela is the reason the owner of Salon B first asked the question, "How many tardy best customers do I have?" But what does she mean "we"?

As the owner of Salon B comes around the corner, Angela smiles and says, "This is my friend Mary Lou. She was going to Salon A, but is dissatisfied with the results she is getting. She would like to try Salon B. And I need a cut too! I tried growing my hair out long, but I decided I like it better short".

The owner of Salon B thinks: I can't predict everything, but my new system is sure better than not predicting anything at all!

You can e-mail Jim about the book: drillingdown@jimnovo.com
For FAQ, Support, Community, and Drilling Down Software Users:

<http://www.jimnovo.com>

The following are descriptions of the remaining chapters in the full PDF and hardcopy editions of the Drilling Down book:

LATENCY METRIC TOOLKIT

CHAPTER 5 - THE B2B SOFTWARE EXAMPLE

CHAPTER 6 - TURNING LATENCY DATA INTO PROFITS

Latency is the very simplest customer behavior model there is, and is very intuitive. If you know who some of your best customers are and have thought to yourself, "Gee, it has been a while since best customer X has been in" you are thinking about Latency. Your thought process is correct; but you have no method for determining when "been a while" means "they are not coming back", and you have no specific action plan to turn your thoughts into increased profits. The Latency toolkit shows you how to measure Latency and set up "trip wires" that will tell you how to increase the profitability of your marketing efforts - online or offline.

Latency is often the preferred model to use in service-oriented businesses where there is a monthly billing arrangement or other "built-in reason" for repeat activity such as with utilities, insurance, telecommunications, and personal services such as hair salons.

RECENCY METRIC TOOLKIT

CHAPTER 7 - CUSTOMER VALUE-BASED MARKETING

CHAPTER 8 - THE AD SPENDING EXAMPLE

CHAPTER 9 - TURNING RECENCY DATA INTO PROFITS

Recency is just a bit more complex than Latency, because it involves ranking customers against each other versus creating a simple "trip wire" for all of your customers. The Recency approach creates a more finely tuned model, allowing you to segment and target customers with more accuracy and drive profits even higher than you can with Latency. The Recency Toolkit builds on your knowledge of Latency and shows you how in some cases, using Latency and Recency together generates the highest increase in profits.

Recency is particularly effective in maximizing the margins of promotional programs, often making it the preferred model for retail oriented businesses, ad-supported web sites, and other businesses lacking "built-in reasons" for repeated customer activity over time.

RFM SCORING TOOLKIT

CHAPTER 10 - PREDICTIVE MARKETING

CHAPTER 11 - A TWEAK FOR INTERACTIVE CUSTOMERS

CHAPTER 12 - NO CUSTOMER DATABASE?

HOW TO SET UP A SPREADSHEET TO SCORE CUSTOMERS

CHAPTER 13 - HOW TO SCORE YOUR CUSTOMERS

CHAPTER 14 - THE COMMERCE AND CONTENT EXAMPLES:

TURNING SCORING DATA INTO PROFITS

Predictive marketing is proactive, meaning you predict the likelihood of future events based on customer models, where each customer is given a "score". These scores rank customers against each other for likelihood to respond, to defect from your business, to become a high value customer, and so forth. Don't get nervous about the word "model"; it's not some kind of black box thing you can't understand. If you can use a spreadsheet (or write some simple code), you can create these customer scores using a model called RFM. Why are scores important? Three reasons:

RFM Scores tell you which customers are drifting away, getting ready to leave you, and determine whether it will be profitable for you to act to try and keep the customer

RFM Scores tell you what best customers like and what they don't like

RFM Scores tell you how to make more money by allocating resources where you will drive the most profitable activity

ADVANCED DATA-DRIVEN MARKETING TOOLKIT

In Chapter 14, you learned how to use customer scores in the "snapshot" mode of traditional RF(M) scoring to dramatically boost response rates and compare the value of customer groups. But that approach just barely scratches the surface. Now that you have the scores, you can use them to drive very High ROI Customer Marketing Programs and Business Process Redesigns.

To generate maximum ROI, you don't just want to react to customer behavior; you want to *predict it*. You can even predict campaign ROI before a campaign is executed!

CHAPTER 15 USING CUSTOMER CHARACTERISTICS AND MULTIPLE SCORES

Now we go into "advanced snapshot mode". Customers can have scores for different behaviors (purchases and page views, for example) and using these scores in combination improves the predictability and profitability of campaigns. Additionally, you find out how to add other information you have (from surveys, for example) to start understanding which types of customers have high future value. You can profile customers for likelihood to respond and relative future value by any characteristic in your database - purchase categories, favorite pets, which magazines they read, ad source, anything - and determine the types of customers that are most profitable to you. Then you can reallocate your budgets and go get more like them!

CHAPTER 16 CUSTOMER LIFECYCLES: TRACKING SCORES OVER TIME

Picking up after the powerful "static" or snapshot future customer value profiling of RF(M) scoring, this chapter moves into the even more powerful "dynamic" customer scoring – the "snapshot" turns into a "movie". Customers change over time and so does their future value. By tracking customer LifeCycles, marketers can predict the "trigger points" in the customer relationship where the very highest ROI marketing takes place — customer anti-defection campaigns. If you can predict the defection, you take action before it takes place, and get a much higher response than in win-back campaigns, where the customer has already defected. You can react to the defection with win-back, or predict the defection by tracking customer LifeCycles – your choice.

CHAPTER 17 CUSTOMER SCORING GRIDS: HIGH PERFORMANCE LIEFECYCLE-BASED TRACKING

Not good enough for you? How about combining the Hurdle Rate techniques from the first section of the book with tracking the customer LifeCycle – the "advanced movie" mode? The result is Customer Scoring Grids, a visual map of customer retention and defection you can use as the "master plan" for managing your entire customer marketing efforts. Spot high ROI customer groups coming

up the value chain, and plan ahead for multi-step defection campaigns with accurate counts of customers in the various stages of defection. This tool was invented by Jim and has been used to manage the retention effort against massive multi-million customer databases. You have to know where customers are and where they're headed in the LifeCycle to make 200% and 300% ROI's in customer marketing. The Customer Scoring Grid is your master battle plan.

CHAPTER 18 STRAIGHT TALK ON LIFETIME VALUE

The promised land of LifeTime Value. If you could only tell what a customer was worth in the future, you would know how much you could spend on them and still make a profit. But how do you know what a LifeTime is? That's easy – you already figured out the LifeCycle, remember? You can now predict when a customer will defect, and if you know that, you know the LifeCycle (and Lifetime Value) are coming to an end. But the concept of LifeTime value is more than the LifeCycle, and in this chapter you will learn the ins and outs of calculating it, along with suggestions for integrating the concept into the rest of the corporate framework (if you have one, that is).

CHAPTER 19 PREDICTING CAMPAIGN ROI: SET UP

This chapter picks up after LifeCycles and Lifetime Value, demonstrating step by step how to set up the controlled test needed to determine the financial value of an RF score. After this test, you will be able to predict the profitability of a promotion before you even send it out! Includes instructions detailing the creation of control groups and random sampling methods.

CHAPTER 20 PREDICTING CAMPAIGN ROI: THE MODEL

In this chapter, you learn how to create ROI models with RF Scores, and learn one of the most important fundamental concepts in the Drilling Down method – how to control the issue of top-line sales versus bottom-line profits in a promotion. In an RF scored promotion, you can literally choose to maximum top-line sales at a reduced profit, or drive maximum bottom line profit in exchange for lower top-line sales – or any mix in between. The financial models show you how.

CHAPTER 21 PREDICTING CAMPAIGN ROI: FINE TUNING

Flexibility is the name of the game in the Drilling Down Method, and this chapter introduces modifications to the basic financial model from Chapter 13, allowing further financial flexibility in targeting customers by RF scores. See an impossible, money loser of a campaign turn into a winner right before your eyes using RF scores and the advanced ROI model.

**CHAPTER 22 COSTS YOU DON'T KNOW ABOUT:
MEASURING TRUE ROI IN BEST CUSTOMER PROMOTIONS**

Bet you think high response rates are always good, right? Wrong! Not when you are spending money to promote to customers who would have bought anyway without a promotion. These not needed (and not wanted) expenses are called subsidy costs, and when you plan promotions correctly using RF scores, you can eliminate most of them, creating much higher ROI campaigns. This chapter talks about where subsidy costs come from, how to measure them, and how to get rid of them in your promotions.

To order the complete book with customer scoring application, visit MarketingSherpa at:

<http://sherpastore.com/store/page.cfm/2115>

For more information on the software application, see:

<http://www.jimnovo.com/software.htm>

APPENDIX: Software ReadMe

The software is not included with this version of the book. Purchase the full PDF or hard copy book to get access to the software application. For more information see:

<http://www.jimnovo.com/software.htm>

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Drilling Down Software 1.3 ReadMe

Note: Download the most current ReadMe file at:
<http://www.jimnovo.com/download.htm>

Note: Microsoft Access and Microsoft Excel with pivot table capability are required to run this application!!

Note: The software is designed to handle the scoring of larger groups of customers, avoiding the manual method used in the book. The software scoring method may become unstable when used with a customer base of less than 2000 customers, particularly if a large portion of the customers have identical behavior metrics. See the Drilling Down book for more details on this subject.

Note: The application has no onboard help. This readme document is the help documentation.

SHORT DESCRIPTION

Creates RF (Recency/Frequency) Quintile Customer Grids

DESCRIPTION

Drilling Down Software 1.3 provides the capability to score each individual customer in a file of customer transactions against all the other customers based on the Most Recent Date of Activity (Recency) and the Highest Total Activity (Frequency) on a scale from 55 (Highest) to 11 (Lowest). Any activity transaction with a Customer ID, number of units, and date of activity can be scored, for example, purchases or page views. Customers with the highest ranking tend to be best customers and have the highest response rate to promotions. Customers with the lowest scores tend to be customers in the process of defecting from the business and have the lowest response rate to promotions.

Customers are divided into five equal groups called "quintiles"; a quintile represents 20% of the customer database. The Recency and Frequency attributes of each customer are assigned a score between 5 and 1, where 5 is the highest (top 20%) and 1 is the lowest (bottom 20%). This score or rank assigned represents the customer's Recency and Frequency attributes relative to all the

other customers. The combination of the Recency and Frequency scores results in a 2 digit score where Recency is reflected first.

For example, the RF (Recency/Frequency) score of 45 means the customer has a 4 Recency, or is in the top 40% of all customers as far as most Recent activity, and a 5 Frequency, or is in the top 20% of all customers, as far as the most total activity.

There are 25 possible combinations of Recency (R) and Frequency (F) scores, resulting in a 5 x 5 RF Grid. The application displays the total customer count at each RF score combination within a cell of the RF Grid format, with Recency on the x-axis and Frequency on the y-axis. Totals for each level of Recency and Frequency are provided. Users can then view and export a table of all customer ID's and their individual RF scores in preparation for a marketing campaign.

The aggregation of multiple transactions for a unique customer ID is derived by selecting the Most Recent Activity Date (Recency) and totaling the Units of Activity (Frequency) from all the imported activity transactions.

PREPARING DATA FOR USE IN THE APPLICATION

The Drilling Down application can import Fixed Width, Comma Delimited, Space Delimited, Tab Delimited, and SemiColon Delimited files. If your customer data is not in any of these formats, it needs to be formatted into one that is compatible with the Drilling Down application.

THE APPLICATION IMPORT READS IN ONLY 3 DATA FIELDS AND THEY MUST BE IN THIS ORDER: CUSTOMER ID, UNITS OF ACTIVITY, AND DATE OF ACTIVITY. WHEN YOU PREPARE YOUR DATA FOR USE IN THIS APPLICATION, MAKE SURE THESE 3 FIELDS ARE THE ONLY FIELDS IN THE FILE AND THEY ARE ORGANIZED IN THE RIGHT ORDER! CUSTOMER ID FIELD CAN CONTAIN ANY ALPHA-NUMERIC COMBINATION.

NOTE: If your file format is fixed width, field sizes should be set according to the following sizes: Customer ID = 20, Activity Units = 20, Date = mm/dd/yy (time stamp is optional). Even if your Customer ID is only 10 digits long, the field size should still be set to 20.

Multiple imports can be performed before the first report is run, or a report can be run after each import. If you have monthly or weekly data and want to see the progress over time, run the report after each import.

NOTE: Each time you run a report, refresh the results in the pivot table by clicking on the "!" icon in the floating toolbar. If you do not have a floating toolbar, then choose Data > Refresh from the Access menu. Failure to do this will result in viewing the previous report results.

USING THE APPLICATION

Double-click the executable to open the application. The About screen with start button and URL <http://www.jimnovo.com/> for the Drilling Down website appear.

Click start button to start. Click OK on the pop-up. On the next page, the sequence of operations is labeled 1 - 4.

1. Locate the folder and file for import.
2. DOUBLE CLICK on the file format being used.
 1. Click ONCE to import each file. NOTE: A DOUBLE CLICK MAY CAUSE THE DATA TO BE IMPORTED TWICE. Press OK on the Import Complete pop-up.
 2. Click ONCE to run the report.

You will see a form with the RF Grid and 4 buttons. To see the whole report, click the "Edit Pivot Table" button, which will open up an Excel pivot table. This spreadsheet can be used to print or export your results.

NOTE: You should see the floating toolbar with the "!" symbol at this point. Remember to press this after each report is run to view the most recently imported data. If you do not have a floating toolbar, then choose Data > Refresh from the Access menu.

REPORTS

Close the pivot table spreadsheet. You will see the report form again, with the "Edit Pivot Table" button and three buttons below it.

If you click once on the left-most button, "Customer Scores", you will see a table with each customer ID and the customer's RF score.

If you click once on the center button, you will see a table with each customer ID, the number of days between the customer's last Activity date and the current date (system date), and the Recency Quintile Score.

If you click once the right-most button, you will see a table with each customer ID, the total units of customer activity, and the Frequency Quintile Score presented.

All 3 of these tables can be printed or saved / exported just like any Access table. NOTE: To save / export a file, choose File > Save As from the Access menu, then enter the name and file type to Save / Export the file.

Closing any of these tables brings you back to the form with the "Edit Pivot Table" button and 3 Reporting buttons.

For FAQ, Help, Support, and User Community, visit:

<http://www.jimnovo.com/>

To order the complete book with customer scoring application, visit MarketingSherpa at:

<http://sherpastore.com/store/page.cfm/2115>

For more information on the software application, see:

<http://www.jimnovo.com/software.htm>