

**THE APPLICATION OF A CUSTOMER LIFETIME VALUE MODEL IN THE  
FINANCIAL SERVICES INDUSTRY**

**By**

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# CHAPTER 1

## INTRODUCTION TO THE STUDY

*“Only measure what you plan to improve”*

### 1.1 Introduction

Large organisations have for many years been calculating the profitability of clients within their segmented client base. Various models have also been developed over the years and various metrics surrounding these models have been punted. Analysts and statisticians alike have developed and explored numerous models to determine Customer Lifetime Value (CLV) within specific industries. CLV modelling supports a calculation using three variables. The three that should be taken into account are:

- **Margin** (the annual revenue that customers generate minus the operating expenses a company incurs in servicing them)
- **Retention rate** (the percentage of customers expected to keep doing business with the company)
- **Discount rate** (The rate used to calculate the present value of future cash flows)(Ross et al., 2001)

However the concern raised by Ambler (2002:201) is the usage of CLV in current strategies, yielding current returns as opposed to possible future returns. Although Johnson (2002:14) insists that measuring customer value is more than just a metric. Johnson (2002) also believes that it is **way of thinking and doing business**, which encourages managers to focus long term and rethink traditional assumptions about how to measure corporate performance and make effective decisions.

Customer Value Management (CVM) is a broad and holistic strategy using the CLV predictive modelling approach to enable business to meet the challenge of maximizing the value of Customer Relationship Management (CRM). (Fincentric, 2001).

The paper will explore the areas within the financial services industry and the various strategies employed, where the application of CLV modelling, plays a vital role in adding value to the business.

A brief overview of the areas and strategies to be discussed follows:

- Designing the customer experience through the use of CRM strategies.
- Segmentation, pricing, personalization and service.
- Assisting with the process of marketing, selling and servicing of clients.
- Evaluating strategic alliances
- Deciding on Mergers and Acquisitions.
- Using CLV in performance management
- Risks and obstacles in using CLV and implementing CLV.
- Communication of the CLV principles in the organisation to bring about behaviour change.



## 1.2 Research objectives

This study will determine the value that a Customer Lifetime model can provide within financial services. The study will be a literature study followed by empirical research. The research part of the study will determine the value of the application of a CLV model for the various business areas within a financial services organisation.

The purpose of the study will be to explore the concept of CLV (through definitions, brief analysis of CLV methodology and metrics). Then the areas within a business where CLV modelling within the ambit of Customer Value Management (CVM) can have a positive impact will be explored in more depth through interviews, discussion, short questionnaires and various company based literature. The risks and obstacles involved in using CLV models and implementing CVM will be briefly mentioned, but no in depth study will be made of these evident risks and obstacles. Finally, strategic recommendations will be made with regards to using the model based on a combination of literature and empirical research.

This chapter consists of an overview of the research methodology to be used in this study, a brief definition of CLV and CVM and an overview of the value for business. Then the outline of the chapters will be highlighted.

Various literatures that explore CLV, CVM, CRM, marketing strategies, strategic alliances and performance management will be discussed. These elements of value will be grouped into four functional areas in a business, i.e. marketing, strategic planning, finance and human resources.

### 1.3 Research methodology

The study is a literature-based study followed by exploratory research, that will be conducted to complete the short dissertation. The study is of a qualitative nature. The latest literature on the subject will be analysed and reviewed to draw a clear picture of the subject of the study. Thereafter, through various interviews within Absa the literature will be tested.

### 1.4 Scope, limitations and exclusions

The main purpose of the study is to explore the value in the application of a CLV model within a financial service organisation. The areas where value of the model is being discussed are marketing, strategy, finance and human resources.

**Marketing** will focus on the following areas of value:

- Selecting the customer base
- Assisting with the allocation of resources for marketing initiatives.
- CVM supporting marketing strategies, segmentation and sales and service strategies

Not all the strategies will be explored, only those that derive value out of CLV and CVM.

**Strategy** will focus on two areas namely:

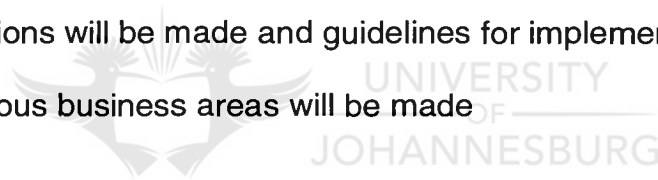
- Using CLV modelling to evaluate strategic alliances
- Using CLV modelling to decide on mergers and acquisitions.

**Finance** will focus on using CVM to increase profits and ROI.

**Human Resources** will focus on using CLV models in performance management and communication.

The discussion on these areas will be limited to a brief overview of the value that CLV adds. The risks and obstacles in employing CLV modelling and CVM practices will be briefly mentioned in chapter two, for awareness purposes only. The reader must not disregard the importance of an in-depth study on the risks imposed and the obstacles experienced, as this is just as crucial when decisions are taken within the business.

Chapter four will explore the empirical research completed and finally recommendations will be made and guidelines for implementation of the model within the various business areas will be made



## 1.5 **Framework of the study**

The following is the format of the study.

### **Chapter 2**

Literature overview of the following:

- Definitions and in-depth discussion on:
  - Customer Relationship Management (CRM)
  - Customer Lifetime Value (CLV)
  - Customer Value Management (CVM)

Finally the critics of CLV are discussed.

### **Chapter 3**

This chapter explores nine areas where the application of a CLV model has added value in the business. These nine are :

- Using CLV to select your customers correctly
- Using CLV for various customer orientated strategies
- Segmenting the client base
- Using CLV in the pricing strategy
- Using CLV to assist with the allocation of resources for marketing initiatives
- Designing the marketing strategy
- Communication of CLV for behaviour change purposes
- Using CLV to measure performance
- Using CLV to evaluate strategic alliances, mergers and acquisitions

### **Chapter 4**

This chapter explores the findings of the qualitative study. The interviews held, questionnaires completed etc.

### **Chapter 5**

This chapter will be the conclusion providing the strategic recommendations and guidelines for the usage of the CLV model.

## CHAPTER 2

### INTRODUCTION TO CUSTOMER LIFETIME VALUE

*“Be careful not to use information technology to simply ‘pave the cow paths’ of traditional business processes that affect customer relationships” (Anton :1996)*

#### 2.1 INTRODUCTION

The genius of free-market competition is that the customer ...  
gets to decide who wins and who loses.

And ultimately, the customer is the biggest winner (Carty D.J., 1999)


This chapter will focus on defining important concepts that will be explored within the study. These concepts include Customer Relationship Management (CRM, Customer Lifetime Value (CLV) and Customer Value Management (CVM). CRM will be the foundation concept for this discussion, whereas the CLV will refer to the tool used within CRM. CVM is the methodology or approach used to employ CLV models within CRM strategies. The comments on the credibility of CLV will also be explored.

#### 2.2 DEFINING CUSTOMER RELATIONSHIP MANAGEMENT (CRM)

The challenge many company's have is to keep their customers. Customer relationship Management is a strategy as well as a tool, which serves as an

enabler to create, maintain and expand customer relationships. CRM is a way of doing business. It is not the responsibility of the sales and marketing team, nor is it the responsibility of the IT team to develop the programmes to support CRM. CRM touches all areas within the business. The CRM approach focuses on adding value to the existing relationship with the customer, so that the customer's interaction with the company will be sustainable, thereby increasing the retention rate of the entire customer base.

Payne (2000:1) defines CRM as” *also known as relationship marketing and customer management concerned with the creation, development and enhancement of individualised customer relationships with carefully targeted customers and customer groups resulting in maximizing their total customer life-time value*”.

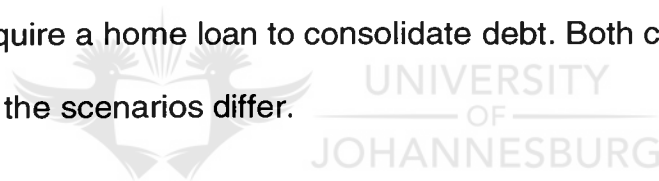


He expands his definition by distinguishing a traditional marketing approach from a customer centric approach to marketing. Traditional marketing, says Payne (2000:2) focuses largely on acquisition, whereas CRM focuses on retention. He believes that relatively few organisations have adopted relationship-marketing approaches to effectively harness the tools of marketing to deliver real customer value.

Traditionally, marketing communications have been of a broadcast nature, with large numbers of people being contacted. This was done in the hope that relatively small numbers of the clients would respond. Specifically in Retail Financial Services (RFS) response rates were between ½% - 2%. (CRM Forum :2001) Thus

a significant trend to improve the sales and marketing communications to clients within RFS has been initiated. Relationship data is a better predictor of customer's future behaviour. (CRM Forum 2001:2) Response rates can therefore be increased if proper segmentation is done based on the relationship data acquired over a period of time.

Seybold (2001:81) reckons that relationship data just helps with the fine tuning of the relationship with the customer. Those relationships, she says do not exist in a vacuum. Thus one has to define the broader "customer scenarios" and then manage them meticulously so that the company can deliver much more value and reap much greater loyalty in return. Thus within the financial service industry you have clients who require a home loan to purchase a home and then you find clients who require a home loan to consolidate debt. Both clients require a home loan, however the scenarios differ.



Swift (2001) defines CRM as "*an enterprise approach to understanding and influencing customer behaviour through meaningful communications in order to improve customer acquisition, customer retention, customer loyalty and customer profitability.*"

Four aspects within a business that should be positively impacted through the proper implementation of CRM is mentioned by Swift. These are namely:

### **2.2.1 Customer acquisition**

Customer acquisition is often seen as a costly activity. These activities often

generate a very small return on investment with very high initial layout costs. (Viljoen M. :2000) The costs of attracting a new customer is estimated to be five times the cost of keeping a current customer happy ( Kotler, 2000:47). Kotler calculated that the cost of attracting a new customer is often higher than the customer's lifetime value with the organisation. The impact thus, is that it forces companies to focus on effective customer relationship management to enable the increase of a customer's lifetime value, with the decrease of the cost of acquisition.

### **2.2.2 Customer retention**

Derfler and Frank (2000) mention that a few regular customers can generate more revenue than hundreds of occasional customers. CRM helps to turn the goodwill into sales. Kotler (2000:49) mentions two ways of strengthening customer retention. The first is to erect high switching barriers. Switching barriers could be in the form of high costs that customers pay to move to a different supplier. Within the financial service industry moving a home loan costs too much due to the set-up costs and conveyance costs. Switching barriers could also be physic costs where the cost of ending the relationship with the company is too high due to some psychological attachment to the company. Coca Cola drinkers find it very hard to change their drink. The second is to create strong customer loyalty through relationship marketing.

### **2.2.3 Customer loyalty**

Customer Loyalty is strongly linked to customer satisfaction. Satisfaction is a person's feelings of pleasure or disappointment resulting from comparing a



product's perceived performance in relation to his experience. Swift (2000:12) coined the phrase "Royalty becomes Loyalty" through consistency of service. In essence, the higher the perceived value the customer experiences the higher the customer loyalty.

#### **2.2.4 Customer profitability**

A profitable customer says Kotler (2000:55) is a person that yields revenue over a specific time. The revenue exceeds by an acceptable amount the company's cost stream of attracting, selling and servicing that customer. He highlights that the emphasis is on the lifetime of revenue and cost, and not on profit from a particular transaction. Customer profitability can also be defined as the identification of an individual customer's or customer segment's contribution to overall organisational profitability based on all current relationships with the organisation. Thus within a banking institution a customer might have various interactions with various SBU' within the business. Thus his profitability should not be calculated focussing predominantly on his retail banking interaction, only if he also interacts on a small or medium business level.

There is however a direct correlation between the potential return on investment and on the customer focus. (Swift, 2000:18). The increase in the level of customer focus has the propensity to increase ROI. The ultimate marketing and ROI opportunity is to facilitate customer loyalty through repetitive purchases of the company's products and services. Customer referrals will then give rise to new business opportunities and new customers. Swift also mentions that the ROI curve in Figure 2.1 does not truly accelerate until an organisation achieves the

capabilities to “retain profitable customers” and migrate “preferred customers” to new products, service, channels or relationships.

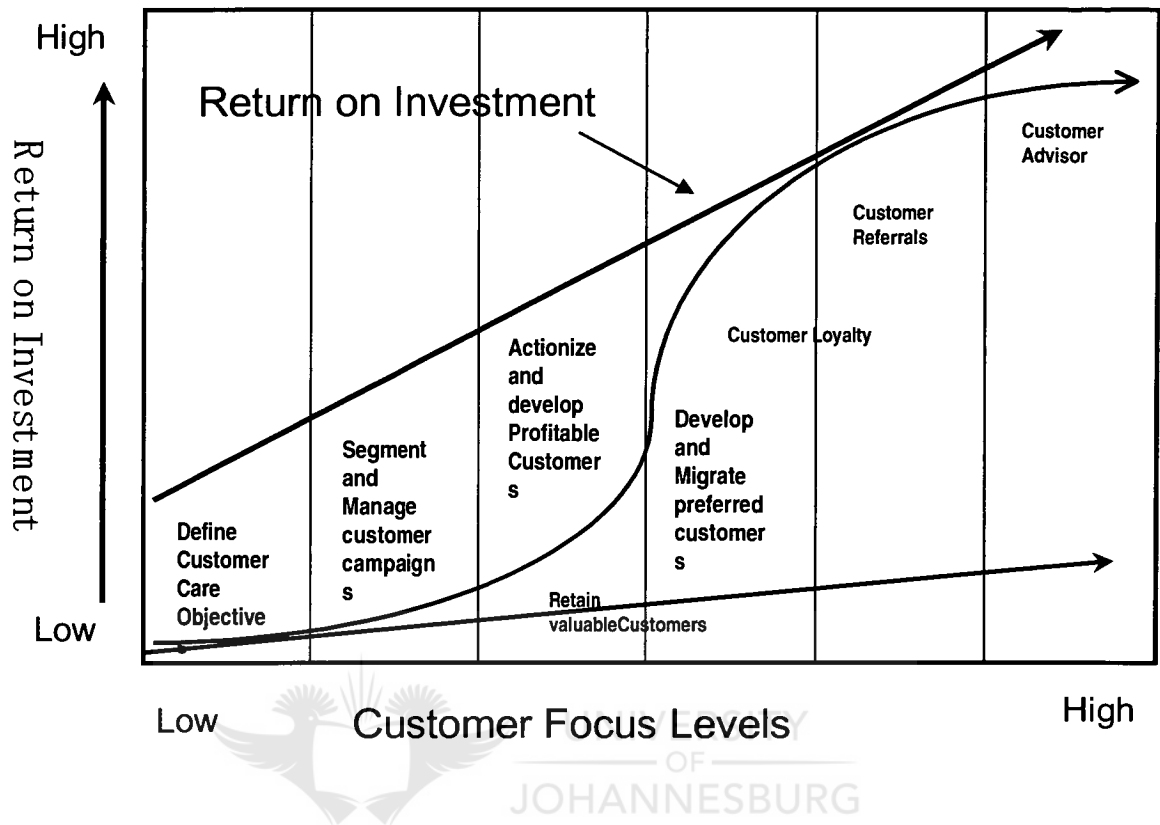


Figure 2.1 Customer focus levels and potential ROI (Swift : 2000)

The highest levels of profitability are achieved in the last stages. When you become the customer’s advisor, you have the customer’s understanding, loyalty and potential wallet share.

## 2.3 PURPOSE OF CRM

Bulusu and Paracha (2001) mention four generic goals of CRM, which are applicable in all industries. CRM aims to :

- Increase customer satisfaction.
- Decrease operation costs of customer interaction

- Promote sales and create effective marketing campaigns
- Increase overall organisational efficiency

To **increase customer satisfaction** one has to understand the customer relationship data one has on the customer and determine how best to satisfy the customer's needs based on the information at hand.

**Operational costs** of customer interaction can decrease through a multi-channel approach to servicing the customer, i.e. (internet, contact centres, self service terminal, etc)

Knowing the customer's purchase habits can greatly increase the effectiveness of the sale, thus CRM will **promote the sales and create effective marketing campaigns.**



**Organisational efficiency** is increased through the technology employed to enable CRM and through the opportunity the employees have with the help of information to effectively service their clients.

Falla (2001), however argues that the main purpose of CRM is to be **decisive**. As mentioned earlier CRM is considered to be both a strategy and a tool. In this case one can use CRM as a tool to make decisions with regards to the type of interaction required by the different customer segments; the allocation of costs to marketing initiatives on various customers; the type of products that would meet the needs of the different customers, etc. Bascobert in Falla (2001) argues that the shareholders want the good customers to be retained and those who no longer fit

the company's business model to be fired. Swift ( 2001) echoes the sentiment of Bascobert by stating that the high-value, loyal, returning, satisfied, profitable customer is the key focal point for profitable and growth organisations throughout the world. He stresses the importance of CRM, through the reality that customers vote with their purchases and denials of purchases.

Knowing the customer's wishes and knowing their history can provide more benefit to the organisation. CRM programmes record transactional history of a client. When this history is analysed it becomes evident what behaviour the customer is displaying. The customers purchasing patterns can be obtained, his frequency of visits, his preference of product and even his preference of payment. This information when interpreted correctly can provide in-depth knowledge of the customer. Absa has just launched their "my Absa" page which is a Private Domain page where everything about the client is recorded and kept. Thus if the client signs onto this page, he receives a personal greeting and if he wants to apply online for a loan, his application form is pre-populated with his details. Within this private domain, Absa will be able to track purchasing patterns and then market products to the client in line with those patterns. (Absa document, 2003). Crucial to CRM is the information about the customer that is transformed into knowledge of the customer, which is the differentiator for success.

However if one looks at the extent to which the financial services industry has progressed in CRM a somewhat different view is expressed about their progress. It is believed that many financial groups have no more to show for the millions sunk into customer relationship management (CRM) systems than 'glorified call centres'. Often CRM systems fail because financial services groups don't get to

know clients and their needs, what is needed is analytical CRM. The financial services industry has developed more channels to market but they often fail to find out what the client wants. (Financial Mail, 14/02/2003).

Thus Swift (200:14) comments that CRM's goal is to increase the opportunity of communicating with the *right* customer, about providing the *right* offer (product and price), through the *right* channel at the *right* time. All this can be implemented through the improvement of existing processes. In addition he mentions that organisations need to be more specific on the benefits of the goals. An example of the goals one need to achieve follows:

- Right Customer
  - Manage customer relationships throughout their life cycles
  - Realize customer potential by increasing “share of wallet”
  
- Right Offer
  - Efficiently introduce customers and prospects to the company and its products and services
  - Customize the offering for each customer
  
- Right Channels
  - Coordinate communications across every customer touch point
  - Ability to communicate to customer's channel preference
  - Capture and analyse channel information for continuous learning

- Right Time
  - Efficiently communicate to customers based on time “relevance”
  - Ability to communicate with real/near-real time or traditional marketing

## 2.4 CRM AS A PROCESS

Swift (2000:39), proposes a model to define the CRM process. This process is an iterative process that turns customer information into effective customer relationships through the active learning from the information. This model encompasses four process elements. Figure 1.2 gives a graphic display of the process elements and their cycles.

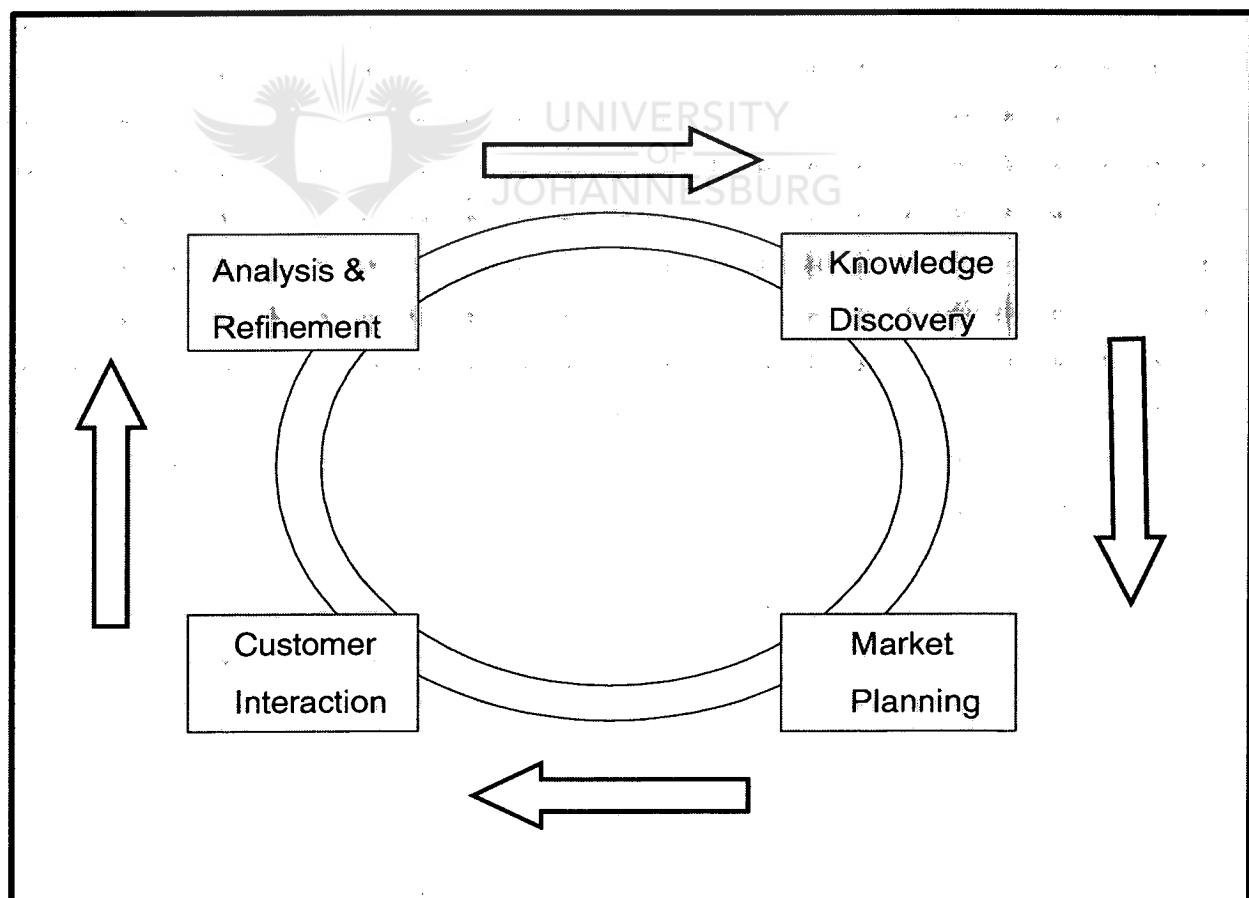


Figure 2.2. The CRM process cycle (Swift : 2000:39)

Each of the elements in the cycle will be briefly discussed.

#### **2.4.1 Knowledge discovery**

This is a process of analysing customer information so that specific market opportunities and investment strategies can be identified. Firstly the customer is identified, then segmentation takes place and finally predictions are made based on his past interactions. The customers within the different segments are profiled according to purchasing patterns. The patterns are used to predict future purchasing behaviour of the customer. Thereafter specific marketing initiatives are designed to take advantage of the predicted pattern.

#### **2.4.2 Market planning**

This process helps to define specific customer offers, delivery channels, schedules and other dependencies. Doyle (2000:216) mentions that the purpose of strategic marketing planning is not to forecast the future, but to encourage managers to ask critical questions about their changing markets so that they can identify the trends that are occurring and capitalise on the opportunities they offer. The value mix variables will then be applied to develop the product offering for the various market segments. (Du Plessis, et al. 2001). The value mix variables are a set of operating decisions that the company makes to gain or retain target customers. Often called the 4 P's or 5 P's. The first "P" refers to the "products" the firm will offer. This includes the decisions about the variety of products, brand names, quality design, etc. People" refers to the service and support the company offers the customers. "Promotion" concerns advertising, sales force, direct marketing, web sites, etc. "Place" refers to distribution channels, coverage, locations, transport and stock

levels. Finally, “price” refers to not only the cost price and sales price, but the discounts, allowance and credit terms. (Doyle :2000,57).

### **2.4.3 Customer interaction**

This is the key action phase and includes a variety of interaction channels that the client will engage in. Knowing where the customer interacts and what types of technology they prefer to utilize is important. Understanding what type of interaction will trigger a value adding response for both the client and the company is just as important. Marketers need to understand the interaction with the customers. When does the customer transact, through which delivery channel does he transact, how often does he transact and even what triggers his transaction. Because e-commerce has become an essential part of almost all Financial Service Institutions (FSI), e-commerce has also become the key driver for the implementation of customer relationship management (CRM) applications at the FSI’s institutional level as well as retail level. (Datamonitor : 2000)

### **2.4.4 Analysis and refinement**

This is the process phase of continuous learning from customer dialogs by capturing and analysing data from customer interactions and refining messages, communications, prices, volumes, locations and approaches. Trends can be identified based on the information retrieved.

After having briefly explored various definitions of CRM, the purpose of CRM and finally the process of implementing CRM, we need to look at the link it forms with other concepts, such as Customer Life-time Value and Customer Value Management.

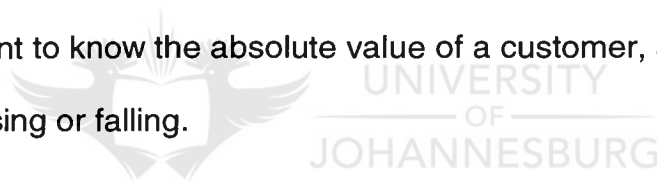


## 2.5 CUSTOMER LIFETIME VALUE (CLV)

A basic insight to concept of CLV is that a company should determine the profitability of each customer over the life time of his relationship with the company by calculating the net present value of future cash flows. (Ambler, 2002)

Resources are then allocated proportionately to the CLV of each customer. If the customer has a negative CLV little or no investment will be made in the customer. CLV helps to determine the allocation of the right amount of resources to the right client.

Jim Novo (2002) sites two kinds of lifetime value measurements. The first he reckons is an absolute measurement and the second is a relative measurement – changes over time. What is most important to measure in CRM is change. It is not nearly important to know the absolute value of a customer, as it is to know whether this value is rising or falling.



Novo (2002) further argues that it may not be necessary for an absolute calculation. The relative calculation will measure repeat behaviour of a client. This one can track through various campaigns and response rates to those campaigns.

One can clearly understand the concern that many financially grounded individuals, focussed on definite empirical data, would have with CLV. CLV in practice should be calculated taking the areas below into account, yet all of these are somewhat illusive. (Ambler, 2002)

- How long each customer will last, i.e. the customer's expected life cycle with the company.
- What competitive products will enter the market and what impact will this have on the customer's purchasing patterns?
- Economic and environmental conditions over a few generations.
- What the brand and other marketer's will do to respond to the changing environmental conditions?
- The interest rates and how this will affect buying patterns.

Novo (2002) highlights some areas for consideration when calculating CLV without absolute values.

- **Estimating average life time**

Look for the best customers in your base that have defected recently. Then look at those who have made a purchase or used the company's service in a specific time ( eg. 9- 12 months) The likelihood is strong that the last visit or purchase was the end of his life cycle, when considering best customers who have stopped buying. When the best customers in your base stop buying, they are usually done. The customer's first purchase and last purchase date must be determined, and then the lifetime can be calculated. This should then be used as the standard customer lifetime for your base. However, bare in mind that the average will be less than this figure.

- **Defecting customers**

Some customers will defect for a while and then begin their purchases with the same company all over again. The industry that a company finds itself in will determine the time standard for defection. Within the Financial Service Institutions a client who operates and account becomes dormant when he has not interacted with the institution for 90 days. Other industries might only classify a defection after 12 months. If the customer starts up again, they would be a “new customer”, for marketing and modelling purposes. If these customers are considered to be old customers then their life cycle becomes infinite and the relevance of the metric is lost.

Another definition of CLV mentions that it represents the profit or loss generated by a lifetime relationship with a customer. (Fincentric, 2001) expands this definition by adding that it takes the value of the current business relationship with the potential value of each customer’s future contribution to profits.

Gurau and Rachod propose a seven-step process to measure customer lifetime value. The approach is more of an absolute measure than a relative measure. Figure 2.3 supplies a graphical explanation of this process.

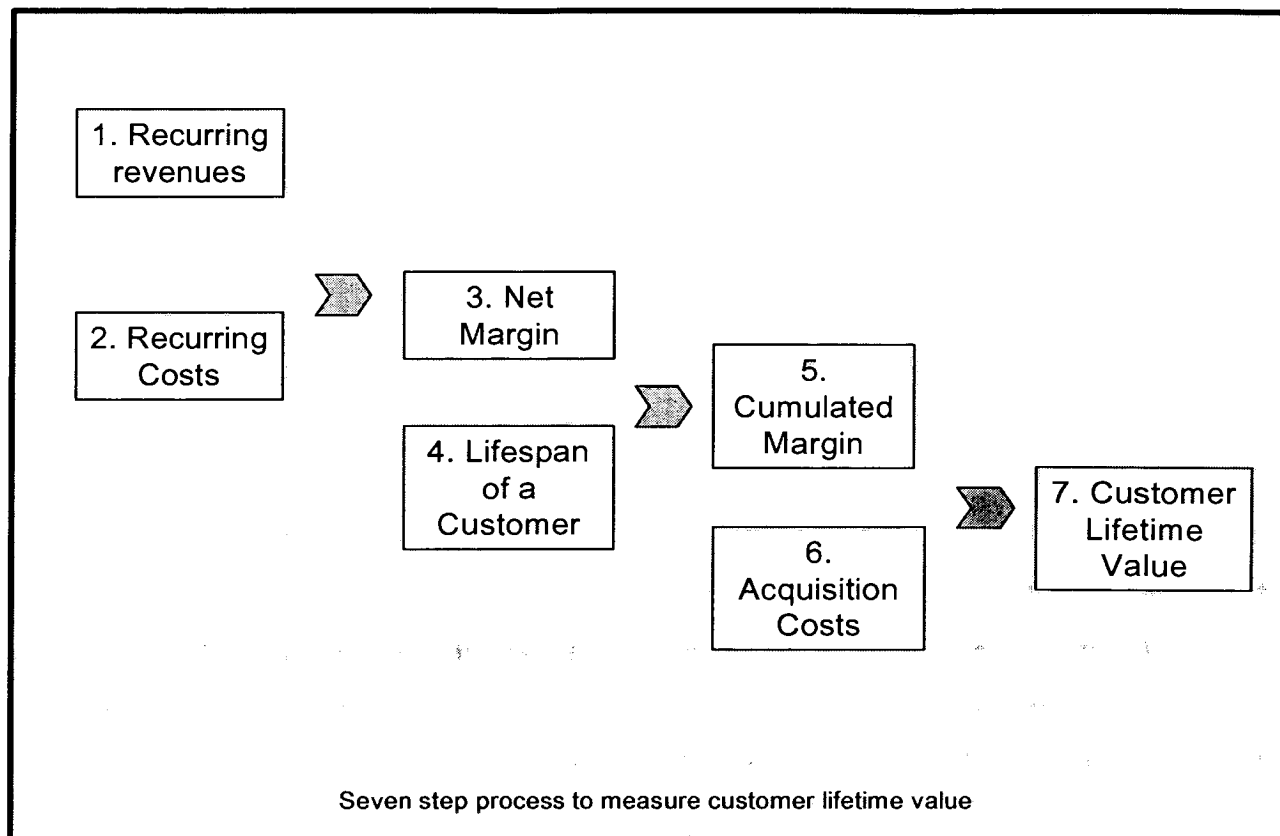


Figure 2.3 Seven step process (Gurau and Ranchod, 2001)

In mathematical terms, CLV consists taking into account the total financial contribution, i.e. revenues minus cost, over the entire life of a customer's business relationship with a company. Despite its simplicity, the measurement of CLV requires great care. All cash flows involved in the process have to be identified and measured on a very detailed level, and allocated precisely to each customer or type of customer. Thus translating the figure 2.3 into mathematical formulae would be:

$$CLV = (RR - RC) Y - AC$$

$$P = CLV \times C$$

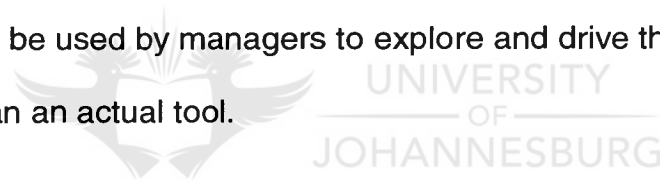
$$P = [(RR - RC) \times Y - AC] \times C$$

**CLV** = Customer Lifetime value; **RR** = Recurring Revenue; **Y** = Lifespan of the customer; **RC** = Recurring costs; **AC** = Acquisition Costs; **P** = Total profits; **C** = Number of customers.

## 2.6 CUSTOMER VALUE MANAGEMENT

A Fincentric white paper of October 2001 defined Customer Value Management (CVM) as a broad and holistic strategy that enables institutions to use CRM and the metrics of CLV to enable growth in the contribution value that customers deliver to the business.

It ties together customer segmentation, relationship pricing, customer loyalty, customer lifetime value and relationship marketing. CVM is more of a methodology or approach to be used by managers to explore and drive the value of the customers, than an actual tool.



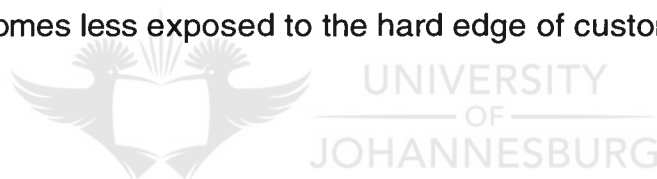
## 2.7 EXPLORING THE CRITICS

Identifying some customers as more valuable necessarily means others are of lesser value and ultimately, less worth taking into account and focussing on. (Shaw: 2001). Shaw (2001) further comments that where the focus is on strategies for developing the lifetime values of customers of different kinds, and all customers seem to be equal, the reality is that some will be treated as more equal than others. The concern that Shaw clearly indicates is that of valuing customers as opposed to calculating the lifetime value of the customer and treating the customer accordingly. Knowing the lifetime value forces you to value some customers less

than others, and this principle is cause for concern. A company's action towards customers can influence the customer lifetime value greatly.

Shaw (2001) also mentions that alternatives and lower switching costs are the champions and not CRM. Regardless of whether company's know their clients well and can predict their behaviour the choice still remains with the client to choose the alternative if they do not feel that they are being valued. Customers usually choose between a few alternatives suppliers of a product, taking one supplier's whole offering arts and all. In theory, a customer could buy currency and travellers' cheques from different sources: in practice most customers have no concern for where they buy their cheques. There is a definite trade-off between effort and getting precisely the service required. CRM offers reduced effort to the client and thus CRM becomes less exposed to the hard edge of customer preference.

(Shaw:2001)



Attaching a monetary value to a customer cannot ensure that customers are valued properly. As mentioned lifetime analysis causes company' to place the interest of one group of customers above the interest of others. CRM, Shaw (2001) reckons offers no guarantee that the key target customers will receive the relevant service as their lifetime value dictates.

Ambler (2002) reckons that the traditional marketing textbooks should not be discarded as yet. CLV tend to look better on the drawing board than in practice. Concerns raised include those of the impact of future environmental and economic forces on the lifetime value indicator. The impact that brand equity will have on the value of the customer in the future is also a concern.

Measurements of today should be more important to marketers than metrics of tomorrow. That is why business relies more on market metrics than shareholder projections. (Ambler: 2002). He also believes that here-and –now numbers are more credible than never-never numbers. CLV and shareholder value techniques require the managers to live in the future and not the present. The advice Ambler (2002) gives is for managers to focus on what customers want now and not what you think their current behaviour tells you about their future behaviour.

## **2.8 CONCLUSION**

The focus of this chapter was on introducing the concepts of CRM, CLV and CVM. CRM we determined was a more tangible strategy that enables marketers and managers alike to make decisions, position products and services and ultimately interact at the right level, with the right client through the right channel, ensuring retention of the client.

CLV had as its primary goal the metrics of determining the value that a client will have for the business over a lifetime, which can be determined once the lifecycle of the clients has been established.

For the purposes of discussing the possible business value the implementation of a CLV model will have for the business, certain assumptions will have to be made. When looking at the Financial Services Industry, we are aware that CLV modelling is being researched and models have been proposed that consequently measure the CLV of their segmented clients. If the models built by the mathematicians and statisticians and information managers based on the variables highlighted above

are credible, then the value for the business other than just ROI will be explored. The chapters that follow will explore the value based on this assumption.

A brief look at CVM, which is the methodology or approach, used to implement CRM and CLV and finally a brief discussion on the critics, with regards to the measurement and application of CLV was discussed.

The diagramme below highlights what has been defined and what still has to be discussed. CRM as we see is the foundation followed by the metrics of CLV. CVM runs throughout as a methodology and the strategies are built on the CRM and CLV blocks.

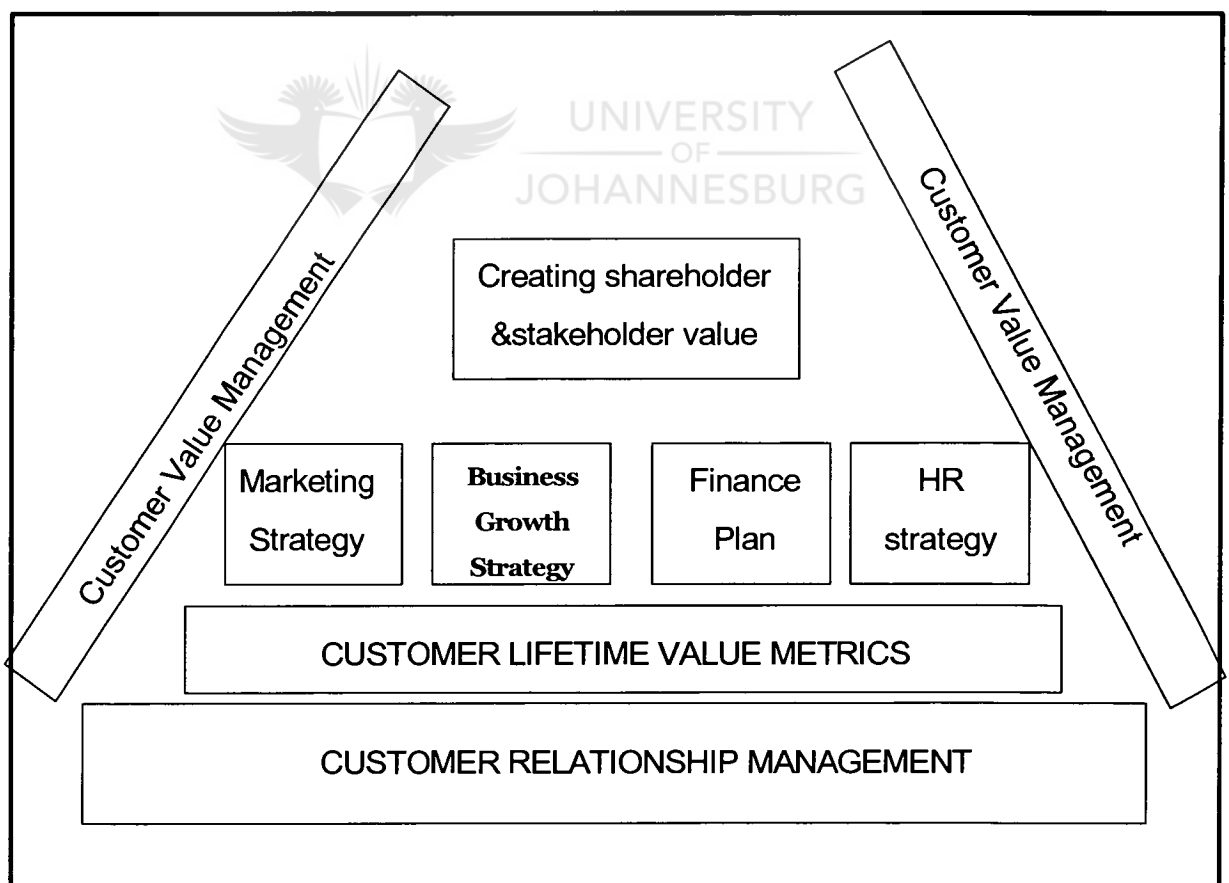


Figure 2.4 Discussion Model for application of CLV



## CHAPTER 3

### Evaluating CLV's impact on various strategies

*"...Lifetime value numbers in and of themselves have no particular significance. What makes them important is when they are used in comparison with other numbers to evaluate the effect of proposed strategies"* (Hughes : 2003)

#### 3.1 Introduction

The estimation of customer lifetime value can trigger several types of actions that would benefit the organisation. Among these actions are

- The marketing strategies one embarks on
- The evaluation of the effectiveness of a number of relationship marketing strategies,
- The segmentation of clients through the identification and tracking of their behaviour
- The correlation between customer satisfaction and CLV
- Allocation of resources to various marketing initiatives.
- Communication of the information to the employees within your organisation
- Evaluation of Strategic Alliances
- Decisions on Mergers and acquisitions
- Performance measurement programmes
- Customer – oriented marketing strategies

These are just a few of the many actions that can be explored when making use of CLV models.

This chapter will focus on understanding the impact of a lifetime value models for the business. The assumption will be made that regardless of the accuracy of the measurement of the model, that principles and application surrounding the value of the model will be tested.

### **3.2 OVERALL MARKETING STRATEGY**

The field of marketing has indeed changed substantially over the past two decades and a particular shift from a dominant transactional type marketing approach to a relationship type marketing approach has been experienced (Morgan and Hunt : 1994)



Sargeant, (2001) goes on to explain the impact of these approaches on the estimation of value. In a transaction based approach the marketing strategy is based on the return on investment that a marketing campaign will yield. Thus even with any of the acquisition strategies there will be a strive to make break even on the campaign measuring the initial costs against the revenue generated from that campaign. Thus the customer receives a standard marketing approach regardless of the segment that he or she is in.

The relationship approach on the other hand recognises that it is not essential to break even on the first communication with the client, or even the second or other consequent communication interventions thereafter. These marketers are content

to live with lower ROI in the initial phase of the relationship. Acquisition costs are less of a major issue, because of the realisation that return on the initial investment will be fully realised over the duration of the life long relationship with the client.

Doyle (2000 : 70) builds on the concept and defines value –based marketing. This he says is “... the management process that seeks to maximise returns to shareholders by developing and implementing strategies to build relationships of trust with high-value customers and to create a sustainable differential advantage”

What is evident in Doyle definition is the value that should be created for the shareholders, by focussing on the customers who have the propensity to generate value for the organisation.



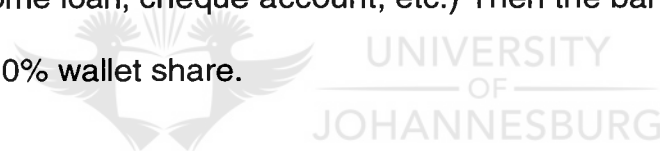
Choosing the right customers is important because some customers do not offer the potential to create value, because the costs of serving them exceed the benefits they generate. Marketing strategies based on generating value want long-term relationships with its chosen customers, because loyal customers make it possible for profitable growth.

Sargeant (2001) stresses that at the heart of the relational approach to marketing is the concept of “customer lifetime value” (CLV). This concept provides the bases for **segmentation**; it drives the nature of the **contact strategy** with the client and it assists in determining **the initial investment** that an organisation wishes to spend on acquiring a client.

Along with these concepts, it is important to define the three types of customer metrics that will be used in the ensuing discussions. These three are profitability, wallet-share and lifetime value. All three are important except that lifetime value is the key to understanding the customer and long-term business growth.

Current **customer profitability** is the identification of an individual customer's or customer segment's contribution to overall organisational profitability based on all current relationships with the organisation.

**Wallet share** refers to how much this represents of the clients total business. In the financial services industry a client might have a cheque account at one bank and nine other products with another. Thus if his total wallet share is ten products (credit card, home loan, cheque account, etc.) Then the bank that has one of the products has 10% wallet share.



**Lifetime value** as mentioned before is an estimate based on the customer's current profile information, expected length of relationship, delivery costs, retention costs and projected life stage changes.

However what is important in the marketing strategy is the understanding of the behavioural patterns of the customers. (Novo: 2002). Customers in the aggregate tend to follow similar behavioural patterns. If the customers deviate from the norm, this can be a sign of problems or opportunities. For example, if the average cell phone customer calls customer service 60 days after initial contact and an individual customer calls customer service 5 days after the start, this customer is exhibiting behaviour outside of the norm. One needs to ask the following:

- Is there a potential problem or opportunity?
- Does the customer have difficulty understanding how to use advanced services on the phone?
- Is the customer happily inquiring about adding more service?

Regardless of whether a problem or opportunity exists, there is an opportunity to increase the value of the customer if timeous reaction to the situation occurs.

In summary a relational value-based marketing approach is one where the process of customer interaction involves creation of value for both the customer and the shareholders. CLV as mentioned remains pivotal to the marketing strategy.

### **3.3 SEGMENTING THE BASE**

The lifetime value perspective provides a new way to segment customers. Today's technologies let organisations gather unprecedented volumes of information about customers, not only on their demographics and preferences but also on their profitability. Within the financial services industry, mutual fund giant Fidelity classifies its customers into segments on the basis of profitability and then uses that information to tailor its offerings to the various segments. (Johnson: 2002)

Financial services companies have an added challenge with regards to segmentation, because of the hundreds of thousand customers they have. However, investing in detailed interaction with these customers is not cost effective. Thus the objective of segmentation changes. (Doyle: 2000 : 339). The

aim should be to segment based on the potential lifetime value of the customer and not on the similarity of needs or demographics, as is the current practice.

Dell computer Corporation uses a hierarchical model of segmentation based on the potential lifetime value of their client. Figure 3.1 below shows the five segment classes. The higher in the hierarchy the client is, the greater the investment in the relationship. The model shows the medium of interaction per segment and the depth of interaction based on the CLV of the customer.

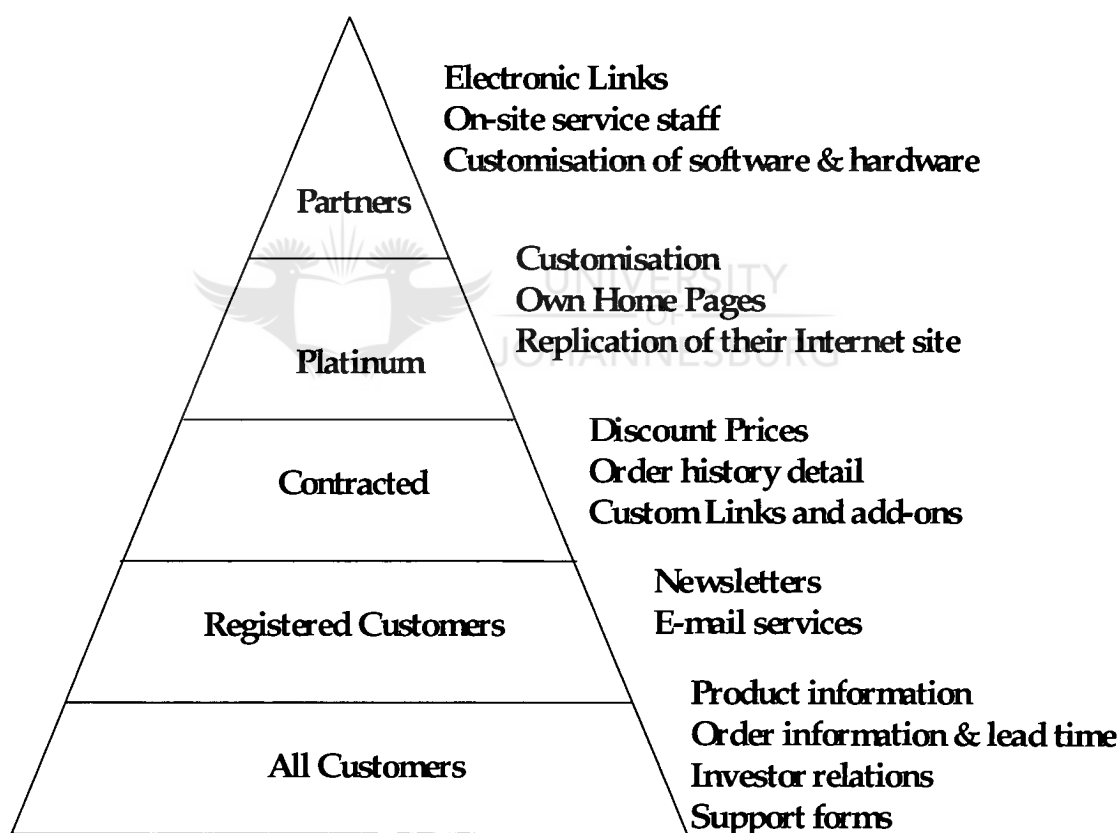


Figure 3.1 Dell's Customer Segmentation Policy (Johnson :2002)

Similarly Hughes (2003) illustrates a model for segmentation based on the value

that the customer brings to the organisation. He divides the customers into five groups (quintiles) from the most profitable to the least profitable and suggests marketing strategies appropriate for each group. The Gold customer in figure 3.2 should not be bombarded with marketing programmes for further acquisition of products, but for retention purposes. They should also be receiving superior service. The middle three quintiles should be targeted with the marketing programmes to move those customers up to the Gold level. The bottom quintile should either be reactivated or fired. Natural attrition models can be built around this quintile.

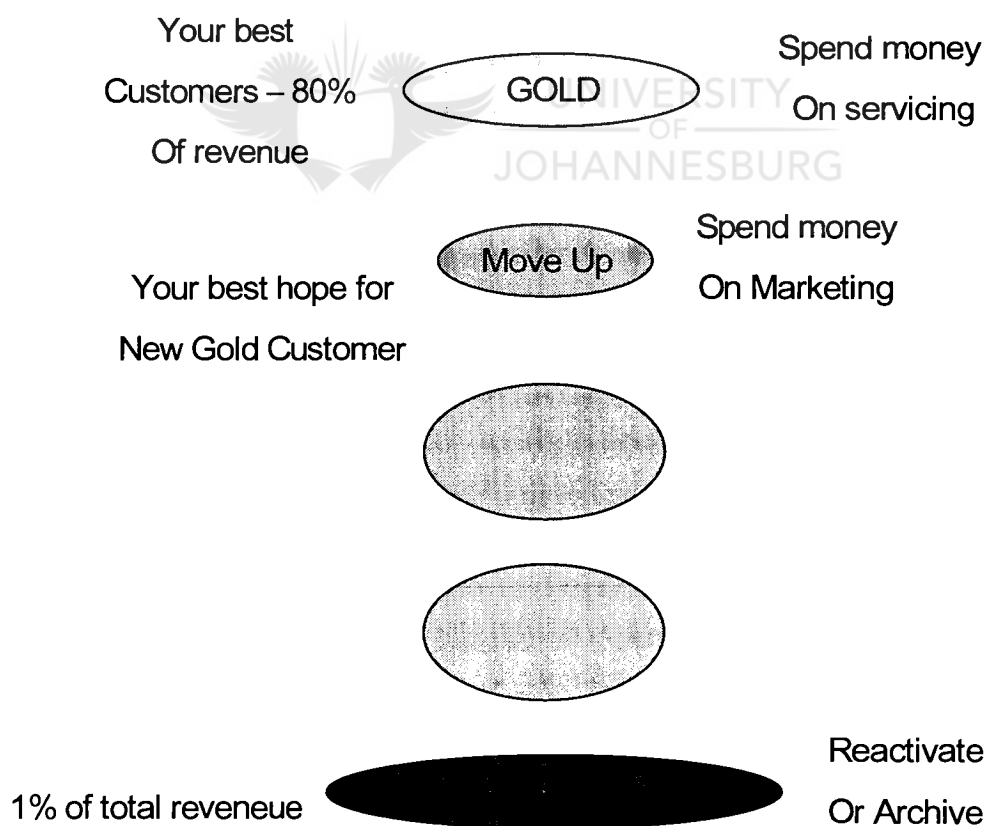


Figure 3.2 . Marketing to Customer Segments (Hughes :2003)

Dell's model sums up the principles of modern segmentation very appropriately.

- Using information technology to ***understand the customers*** and offer superior value to all of them.
- ***Establishing priorities***. The higher the lifetime value of the customer, the greater the investment in the relationship with the customer.
- Aim to ***build relationships*** through individual customisation of communication and solutions.

### 3.3.1 PROCESS FOR CALCULATING THE CLV OF THE SEGMENTS.

Five stages were identified by Sargeant (2001) , which gives guidelines as to the process to follow when calculating CLV of the segments in your client base.

- Stage 1 – Get clarity in respect of the ***purpose of the analysis*** to be done.  
The purpose could be to determine what amount of acquisition allowance will be assigned per segment. Thus CLV will determine the amount.  
Another purpose for this analysis would be to determine the contact strategy to be used per segment. Thus those clients with low CLV's will not receive as much contact as those with higher CLV's.
- Stage 2 – Decide on ***the period of analysis***. Common practice has taken a period of five years into calculations. This ultimately depends on your product or service being sold.



Stage 3 – Divide or segment the database into manageable cells on the basis of the primary variable to be explored. Explore an example of this within a banking arena. All customers who made their first purchase of a home loan with the bank. Thus the customers are divided into a number of cells based on the amount of the initial home loan. As a general marketing rule between 10 and 30 cells are recommended.

- a) Home loans between R100,000 – R250,000
- b) Home loans between R250,000 – R450,000
- c) Home Loans between R450,000 – R1000,000

- Stage 4 – Establish the buying behaviour of the cells identified. Do a historical analysis on each of the cells within the segment. Examine the attrition rate and the purchase patterns of these clients within the cells.

- Stage 5 – Outline the intended development strategy, i.e. the number of contacts, with the projected costs of those contacts.

### **3.4 CLV AND COMMUNICATION WITHIN THE MARKETING STRATEGY**

An integral part of the marketing strategy is communication with the stakeholders. These include the communication to the shareholders with regards to the strategies embarked on, communication to the staff and communication to the customer.

Phil Bressler, an owner of approximately 20 Domino's pizza outlets in Baltimore, discouraged his employees from thinking of an individual customer's order for one pizza as just an \$8 pizza. After calculating the lifetime value of his customers over a period of 10 years eating a pizza a week, amounting to approximately \$4000 for a frequent pizza eater, he encouraged his staff to think differently. "*Think of the customer as having \$4000 pasted on his forehead, which you peel off \$8 at a time. Then act accordingly.*" (American Lawyer, 2003, Vol25, p.74). It is evident then that the mere communication of customer lifetime value principles to staff can have a profound impact on the behaviour of the customer-facing personnel. This particular case study showed the decline in client complaints and staff were rewarded. Making staff aware of the CLV information typically influences the behaviour as well.

Specifically within a financial service organisation the value that communication with regards to CLV would have on the interaction with the clients should be considered. This then supports the relationship marketing principles discussed earlier.

Doyle (2000) proposes a value –based communication model that evaluates marketing and communications spending not in terms of sales or immediate profits, but in terms of the projected impact on the net present value of all future cash flow.

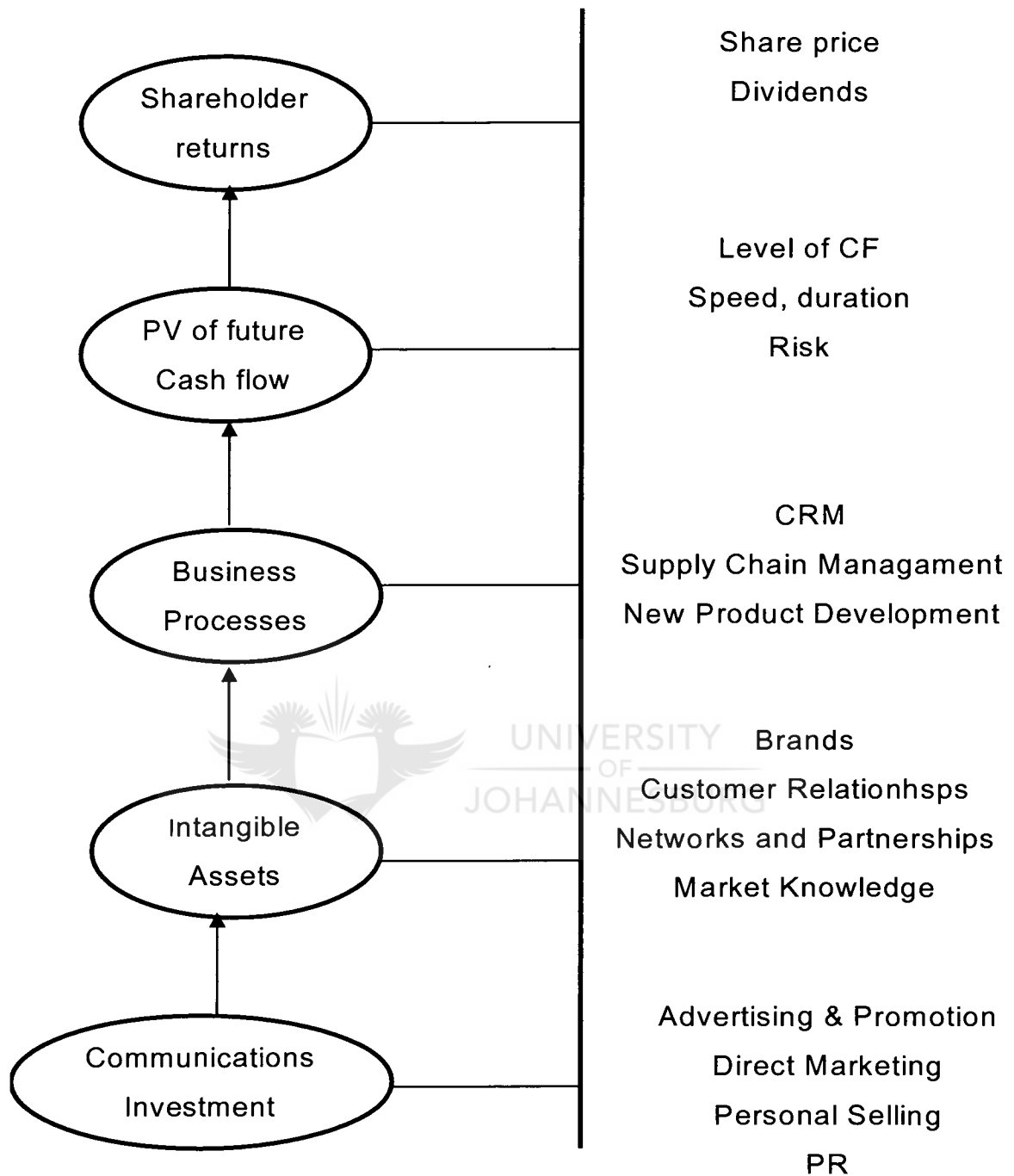


Figure 3.4 The Value-Based Communication Model

In figure 3.4 we notice that much of the organisation's communication spending is an investment to build intangible assets, of which effective Customer Relationships that would yield an increase in CLV, is one. Developing a

communication strategy not only supports the strengthening of the brand, but also builds the organisation knowledge and understanding of its markets.

These intangible assets enable the organisation to enhance the effectiveness of its core business processes. For example, powerful brands, marketing expertise and strong relationships enable it to be more effective at launching new products, maintaining customer loyalty and running an efficient supply chain. Thus these processes increase the potential to increase the shareholder value. (Doyle : 2000: 300)

Sargeant (2001), proposes that lifetime value analysis can be used when choosing the media for the initial customer acquisition. The traditional marketing approach would look at calculating the immediate ROI for each media type, along with the response rates received from these mediums in the past. Along with this marketers would calculate the acquisition costs by taking the total cost of the campaign and divide that by the number of customers attracted.

The other approach is to examine the customer behaviour of those clients recruited through the different medium. If the clients recruited through a particular medium that brought the highest number of new recruits, do not make subsequent purchases, why would we want to make use of this medium again. Marketers need to look at the medium where the greatest potential for repeat business exists from the customers recruited. This medium of communication will be a conduit where customers will exhibit a greater degree of loyalty.

In summary, communicating lifetime principles to staff as well as implementing a communicating strategy that impacts the NPV of future cash flows is important. Determining the medium of communication is also crucial in generating customer loyalty through repeat purchases. Shareholders will require the trend that CLV will take and a comparison against the benchmark.

### **3.5 ALLOCATING RESOURCES BASED ON CLV MEASUREMENTS**

Hughes (2003) mentions that long-term loyal customers are different from new customers in that they buy more often. These customers also buy higher priced items, are less costly to serve and have higher retention rates. Therefore a justification exists for spending more money on the acquisition of these clients.

Sargeant (2001) mentions that an understanding of the lifetime value of an organisation's customers can guide the determination of how much a particular organisation may be willing to spend to recruit new customers within a given segment. Thus a higher spend on acquisition costs will not be met with resistance if marketing can justify the future income streams expected from the customers, through the calculation of CLV.

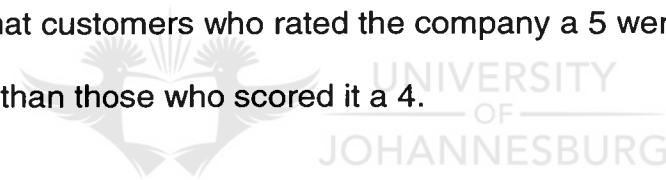
Thus a **traditional approach** to determining the ROI of an acquisition campaign will be :

ROI = Immediate Revenue generated divided by the cost of acquisition

A **value –based approach** based on the CLV principle would be :

ROI = Initial Revenue + (NPV of all future income derived from the client) divided by the cost of acquisition.

Typically surveys measure customer satisfaction on a 1 to 5 scale where 5 is 'very satisfied' and 1 is 'very dissatisfied'. Loyalty, which is closely linked to a propensity to have a higher lifetime value, is measured by repeat buying behaviour or intentions to repeat buy. This relationship often appears to be non-linear says Doyle (2000). Figure 3.5 reflects this relationship. People rating at either extreme end of the scale tend to have intense feelings about the company. Those in the middle, scoring 2,3 or 4, fall into a zone of indifference where there is little association between the satisfaction score and loyalty. Doyle (2000) mentions that Xerox found that customers who rated the company a 5 were six times more likely to repurchase than those who scored it a 4.



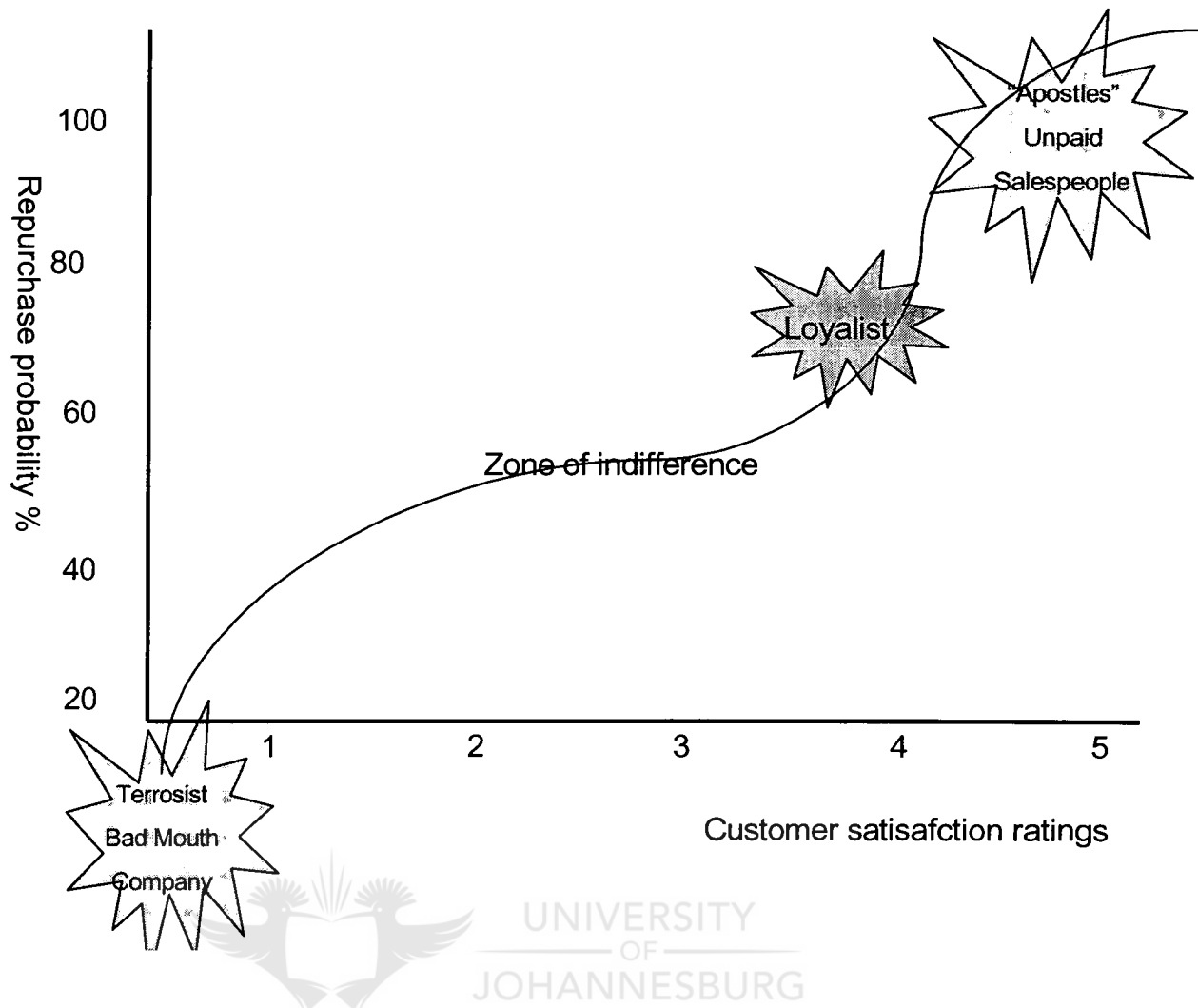


Figure 3.5 Customer satisfaction and customer loyalty (Doyle :2000)

The customers who score themselves at the top end of the scale have been called “apostles”. They can be considered as unpaid salespeople, because they spread the word spontaneously without prompting, recommending the company’s service to many they come into contact with.

Those at the other extreme are called “terrorists” or “mercenaries”, because they have so much anger towards the company that they actively ‘bad mouth’ it and they advise all they come into contact with not to do business with this company.

With regards to resources been allocated to the type of customers and article in American Lawyer (2003, Issue 3, p.74) mentioned that it is easy to jump to the conclusion that all marketing resources should be redirected to the task of converting mercenaries (terrorists) to loyalists and even apostles. However the article mentions that a limited amount of research suggests that only a relatively small proportion of customers exhibiting price-sensitive mercenary behaviour have the mind-set or the economic means to become loyalists.

The best investment of marketing funds for retention purposes is the funds devoted to the development of vitality among loyalists and eventually the expansion of the pool of apostles. Once they are identified, steps can be taken to involve them as partners in the marketing effort by providing them with additional information useful in fostering the viral process. Frequent contact can make them feel that they are special emissaries of the company, members of a club or community of like-minded customers. This kind of investment, for example, has done as much as anything to foster the resurgent success of the once moribund producer of Harley-Davidson motorcycles. Harley-Davidson has organised a fanatical group of owners and fans by catering to their latent willingness to serve as apostles for the product. This investment has greatly expanded the “sweet-spot” for the company’s products. (American Lawyer:2003)

Some customers over time will assume a sense of ownership. This is evident in the frequent flyer clubs that various airlines have and the links it has with financial institutions and credit cards institutions. American Lawyer (2003) sites an example of Southwest Airlines who are regularly inviting their frequent flyers to assist the company in selecting new cabin staff and counter attendants for the airline. A



customer was asked why he had taken time off from work to help Southwest. He said that he wanted to see how a successful organisation selected new employees and thought that it would be fun to spend the day finding out. Then he added, "Besides, it's my airline". This customer displayed that ownership/ apostleship, spoken of earlier.

Jim Novo (2002) mentions that Data Driven programmes (programmes that accumulate data on the interaction or transactions with the customer) are among the very few approaches allowing you to accurately measure ROI. Data Driven programmes are about allocating resources. Thus the data tells a story about the client and his/her interaction with the business. *"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?"* (Jim Novo: 2002). This idea is at the centre of ROI thinking, where capital is reallocated, from low return to higher return projects or programmes in order to generate higher profits in the process.

### **3.6 USING CLV TO SELECT YOUR CUSTOMERS**

Successful marketing is focussing on key customers. CLV analysis can also suggest groups of customers that the organisation would be better off without. (Sargeant : 2001) There are many companies willing to do business with any customer willing to spend. These companies end up with large numbers of

unprofitable small accounts. (Doyle: 2000) Within the banking arena many major banks face this problem. It costs the bank more to keep these unprofitable accounts, because it increases the risk provision that banks must make. Initially banks recruited their customers solely on the assessment of initial risk level and not on the propensity to generate value and decrease the risk.

Numerous studies have shown that the Pareto principle can be applied to the customer accounts. 20% of the customer base of an organisation generates 80% of the profits. Therefore proper selection of customers becomes crucial in maintaining an income stream well into the future.

Whitney (1996:84-89) suggests four criteria to be used when selecting customers who will have a high lifetime value for the company.



- ***Strategic importance***

Strategic importance has three dimensions. The organisation should seek customers who desire its value proposition and so fits its core capabilities. Secondly, customers are strategically important if they are expected to grow, either because they are fast in growth markets or because they have strong competitive advantages. Finally a customer can be important if it is an opinion leader. As part of Absa's (financial services organisation) core strategies is the need to grow in the black personal market. (Absa Documents:2003) This is twofold, in that many opinion leaders, both politically and in business are in this group. These lead customers can open the door to other customers who are influenced by them. "Word of mouth" marketing is an effective strategy used by financial service organisations.

- ***Customer significance***

Significance refers to the percentage of total income and gross profit the customer accounts for. Be aware that size is not always correlated with profitability. Some large account demand big discounts and onerous levels of servicing, which shrink the operating profit they generate. However size should be significant, especially if managed correctly. Big customers should offer more opportunities. They are difficult to replace and their loss can have a devastating impact on the business.

- ***Customer profitability***

The main reason why the majority of companies are saddled with many over-serviced and under performing accounts is that they do not measure customer profitability. At best they measure contribution (income less variable cost). Contribution can easily massively overstate the account profitability. Some companies employ activity based costing which attempts to charge costs to products and channels for the resources they consume. When such estimates are made management is usually shaken by the losses that unfocused growth has brought. Thus the strategy should change to make the unprofitable account profitable or get rid of those unprofitable accounts, by increasing their cost for services.

Sargeant (2001) warns that terminating the relationships with these customers can increase the risk of a negative backlash within their market. The first option that organisations can elect to pursue is to engage in a strategy of benign neglect. Under this option no further efforts would be made to communicate

with these customer groups and the profile of this unprofitable group would be used to inform customer recruitment strategy to ensure that others matching this profile are not recruited in future. The second option with this group of customers is to comprehensively review the nature of the relationship the organisation has initiated, with particular emphasis on the channels of distribution employed. It may just make some previously unprofitable customers profitable by switching these customers to a channel of distribution that is lower in costs. In financial services, rather than dealing with the clients through Relationship Managers, migration to the electronic channels could prove beneficial as an income generator and by the same token decrease the costs of servicing them.

- ***The loyalty coefficient***

If the company wants to create long-term partnerships, it needs to identify customers who would be interested in such a commitment. Some customers are inherently more loyal than others. In business-to-business markets, some purchasers are focused solely on price and they will switch from month to month according to which supplier is offering the best deal. For most companies, lifetime value of these customers is very low. In consumer markets too, some types of customers are inherently more loyal than others. In financial services, for example, there are striking variations in loyalty by demographic and social characteristics. In car insurance, loyalty is higher for married people than singles, for homeowners than renters.

### **3.7 PRICING STRATEGY AND CLV**

Effective pricing makes up an integral part of the overall CRM strategy within any organisation. With proper segmentation based on the propensity for customers to increase the value contribution to the company over a lifetime or length of service with the organisation; one can tailor customer specific pricing within the segment.

Pricing has not had the attention its importance merits. In seeking to improve profits and cash flow a great deal of attention has been given to reducing costs and capital. These have been the primary goals of reengineering and supply chain management in recent years. Sales and Marketing people have focussed their efforts on increasing sales and market share. The fourth variable in the cash flow equation, namely price has been neglected. (Doyle :2000).

### **3.8 USING CLV MODELS TO EVALUATE STRATEGIC ALLIANCES, MERGERS AND ACQUISITIONS**

Flower retailer Gerald Stevens Inc., determined to build a strong presence on the Internet, made deals with several online companies and established its own Web site. It declined one deal with AOL because AOL wanted \$75 for each of its customers. How wise was this strategy overall? By using the CLV model, Gerald Stevens estimated its typical Internet customer's CLV at \$60. This was less than the acquisition cost of \$75. They then calculated the lifetime value of their average retail customer in the physical channel at several hundred dollars, with an acquisition cost of around \$50. Overall they decided that regardless of the e-prophets punting the e-channel, they would settle for a physical channel and not pursue the strategic alliance. (Johnson: 2002)

Similarly the lifetime value framework can generate valuable insights about mergers and acquisitions, particularly for investors. Specifically, if an investor company can calculate the lifetime value of the company's customers and forecast the growth in a company's number of customers, it will be able to gauge the organisation's current and future customer base. To the extent that this base forms a large part of the concern's overall value, it can provide useful insights for the acquirer. (Johnson :2002).

### **3.9 CLV AND PERFORMANCE MEASUREMENTS**

Doyle (2000) argues that purely financial measures in a business does not give reliable indications on whether current performance is creating the long-term value that shareholders expect. Because of the weaknesses of performance measures based on annual accounting measures and the subjectivity inherent in estimating the changes in value, indirect measures have to be employed to decide whether current accomplishments are creating the long-term value. These indicators are termed the strategic value drivers. Strategic value drivers are those organisational capabilities that have the most significant impact on the company's ability to create shareholder value. Thus the question is whether the increase of CLV will lead to the ultimate increase of shareholder value.

To measure whether value is being created in any one year one has to (1) identify those organisational variable critically affecting competitive advantage and long-term cash flow; (2) set target levels of performance on these variables; and (3) measure performance against achieved targets.

Thus a company has to identify the strategic value drivers. Doyle (2000) identifies three characteristics of a strategic driver:

- It should be a current asset or capability that has a significant impact on the long-term value of a business.
- It should be capable of been measured and communicated.
- It should be capable of being influenced by management decisions

The increasing of CLV measurement meets the requirements of a strategic driver. Most successful businesses will have a set of value drivers including financial resource such as strong operating margins and cash flow; marketing resources including the brand, customer loyalty, customer satisfaction and distribution partnerships.

Once the value drivers are identified, the levels of performance that are acceptable have to be determined. The best approach is to benchmark performance against a peer group or other companies that the business aspires to emulate. (Doyle:2000)

Successful companies are accepting that performance and plans cannot be built around a single measure such as return on capital or earnings per share. Instead they need a set of indicators to track performance and ensure that managers are achieving on the drivers of long-term performance. The most systematic and popular approach in recent years to developing such lead indicators has been the balanced scorecard developed by Kaplan and Norton (1996).

The balance scorecard was motivated by the recognition that companies cannot rely on short-run financial indicators to measure long-run performance. What is need is a set of measures to link short-run achievement to long-run value creation. Four common sets of perspective must be developed and within one of those perspectives, the calculation of the CLV and the benchmarked CLV must be added.

Figure 3.6 clearly illustrates The Balance Scorecard philosophy. CLV fits into the customer perspective quadrant.

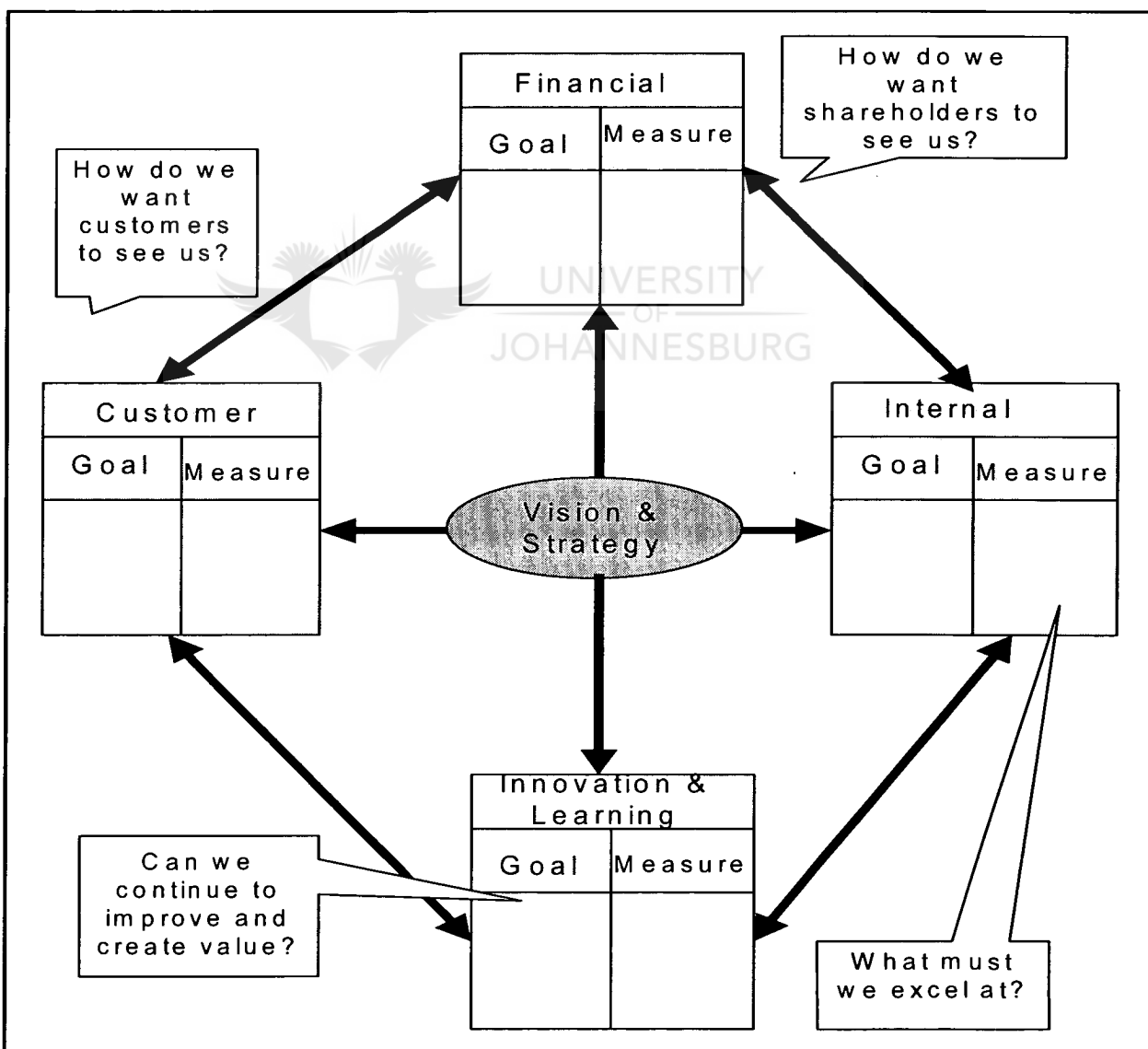


Figure 3.6 The Balance Scorecard (Doyle: 2000)



The ***financial perspective*** incorporates the financial drivers of shareholder value.

The business sets objectives for and measurement of :

- Return on capital employed
- Operating margins
- Economic value add
- Cash flow
- Sales growth

The ***customer perspective*** examines the ability of the company to satisfy the customers. Measures of marketing performance are normally leading indicators of financial results. Goals and measurements will usually be required for:

- Market share
- Brand image and awareness
- Customer satisfaction
- Customer retention
- Customer acquisition
- Ranking by key accounts
- Customer lifetime measurement

Different customers in different segments will requires different measurements  
(Doyle: 2000)

The internal perspective focuses on those internal processes that have the greatest impact on customer satisfaction. These include:

- Percentage of sales form new products
- Manufacturing costs, cycle times

- Quality indices
- Inventory
- Technological capabilities

Innovation and Learning perspective look at the competency developments in the following areas:

- Product development
- Purchasing
- Manufacturing
- Technology
- Marketing and Sales

Thus the balance scorecard philosophy emphasise the complex nature of measurement within a business. There are no single measures that can summarise the performance in the short run. This section highlighted where CLV fits into the balance scorecard, and the value it adds to obtaining a measurement that reflects on the company' performance.

### **3.10 CUSTOMER-ORIENTATED STRATEGIES BASED ON CLV ANALYSIS**

Garau and Ranchod (2001) highlights the complexity of the operational requirements needed to implement customer –oriented strategies based on customer lifetime analysis. Table 1 below highlights these strategies. These strategies must be used in line with the formulae proposed in chapter 2 with regards to calculating the lifetime value of a customer.

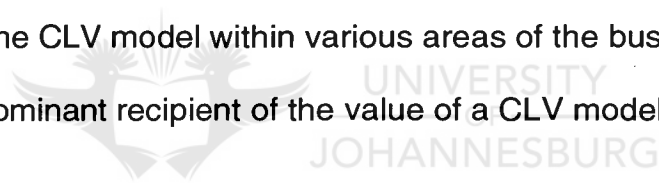
<b>Strategy</b>	<b>Tactics</b>	<b>Operation</b>	<b>Requirements</b>
<b>Increase the number of customers (C)</b>	Improve the existing offer in order to attract potential customers close to the existing customer segments	Improve: Product, Price, Distribution, promotion	Research Segmentation Investment
	Diversify the offer in order to attract new segments of customers	Increase the product / service portfolio	Research Segmentation Investment
<b>Increase Recurring revenues (RR)</b>	Increase the volume of sales	Diversification Stimulate demand	Research Segmentation Investment
	Increase the value of the sales	Upgrade the offer	Research Segmentation Investment
	Increase both the volumes and value of sales	Diversification Stimulate demand Upgrade the offer	Research Segmentation Investment
<b>Reducing Recurring Costs (RC)</b>	Reduce general costs (administration, maintenance, etc.)	Increased efficiency	Research Segmentation Investment
	Reduce the cost of: Product /service Distribution Communication	Cheaper supplies Cheaper outsourcing Increased efficiency	Research Segmentation Investment
<b>Retain and increase the lifespan of a customer or number of transactions (Y)</b>	Increase customers' loyalty by maintaining and/or increasing customer satisfaction	Improve present offer Better Targeting Score better than the competition	Research Segmentation Investment
	Better Targeting of potential customers	Improve offer Improve Targeting Use the same resources more efficiently	Research Segmentation Investment
<b>Reduce acquisition costs (AC)</b>	Better targeting of potential customers	Improve offer Improve targeting Use the same resources more efficiently	Research Segmentation Investment

Table 1 : Garau and Ranchod (2001) Customer –oriented strategies based on customer lifetime analysis

What is evident in the table above is the realisation that CLV is not only a tool to be used on a strategic level, but also on a tactical and operational level. A discussion on the implementation of these tactical and operational strategies will not be discussed in this study.

### **3.11 CONCLUSION**

Organisations are keen on building models, which provide information about the business, the impact of the strategy followed and the way forward in terms of objective and goals that must be achieved. It seems that little consideration is given to the effective implementation of models within the business. Strategic models have great value, but that value can easily be diluted by the ineffective application within the business. Thus as highlighted in this chapter is the application of the CLV model within various areas of the business, with marketing being the predominant recipient of the value of a CLV model.



## CHAPTER 4

# RESULTS OF THE EMPERICAL RESEARCH INTO THE APPLICATION OF A CLV MODEL WITHIN FINANCIAL SERVICES INDUSTRY

*“Less than five percent of the world’s firms achieve the full potential of their customer relationship initiatives. The rest are caught in its paradox.” (John McKean) (Swift :2001:65)*

### 4.1 INTRODUCTION

Johnson (2002:14) described the measurement of customer value as more than just a metric; he described it as a way of thinking and doing business, which encouraged managers to,

- Focus on long term plans
- Rethink traditional assumptions about measuring corporate performance
- Make effective decisions.

Hughes (2003) also emphasised that lifetime value numbers in and of themselves had no significance. What makes them important is their use in comparison with other numbers to evaluate the effect of proposed strategies.

Against the backdrop of this theory on the application of a CLV model, an exploratory study was undertaken which yielded the results that follow in this chapter. This chapter will focus on the results as obtained through an exploratory

study of the application of a CLV model within financial services industry. The discussion will focus on three areas namely:

- The understanding of **definitions** within the CRM environment.
- The importance of a **CRM strategy**.
- The **application of a CLV model**.

The respondents interviewed and the approach followed will be made clear in the next section

For many, CLV seems an easy concept to understand on the drawing board, but much more complex in practice. CRM too seems to be a concept that has elicited various definitions, all of them specific to the realm of understanding and realm of experience of the respondent. These **definitions** will be discussed in this chapter.

CLV although seemingly important within the scope of a **CRM strategy**, was not clearly evident in the focus group discussions, yet very evident in the structured questionnaire. This too will be discussed in great lengths during this chapter.

It is however amazing that the “here and now” tangible measures take a far greater prominence in strategic actions than the **propensity modelling**, of which CLV is one.

## 4.2 METHOD OF RESEARCH

The research conducted was of an exploratory nature. The primary aim of the research was to identify the areas where a CLV model can be effectively implemented to bring about value for the organisation. This research was done by means of unstructured personal interviews and focus group discussions. To

ensure consistency in the questions asked and responses received in interviews and focus group discussions a consistent set of questions (Appendix A) were asked with each of the interactions. These interviews and discussions were then followed up by a set of questions in a post discussion questionnaire where a Likert scale and a ranking type question were asked. The purpose of this post-discussion questionnaire was to assist the researcher to determine the individuals' true perspective on CRM and CLV, in the event that their true views were watered down in the discussion or their true views were not voiced. This post discussion questionnaire also provided a summary of the answers to the discussion questions.

The respondents interviewed were all in the employ of Absa, but within different segment Strategic Business Units (SBU). The following SBU's were selected for the personal interviews:

- Absa Private Bank

Two Regional General Managers were interviewed. One was responsible for the Personal Suite and the other responsible for the Family Office Suite where families who have great wealth are taken care of. Private Bank focuses on clients who already have a personal net asset worth of five million rand or family net asset worth of fifty million rand and above, respectively.

- Personal Financial Services (PFS)

A focus group discussion was held with specialist in the Business Planning division of this SBU. The group was made up of Business Project Managers who were responsible for various client initiatives and divisional strategy and Business Consultants, responsible for the tactical conversion of strategic models and for the guidance of the operationalisation of these models

throughout the SBU. Personal Financial Services qualifying criteria are clients who earn a minimum of R400 000 per annum.

- Retail Banking Services (RBS)

A Senior Manager responsible for the Direct Sales in RBS was interviewed. A great deal of the sales initiatives in this division is done within the e-environment through contact centres. Qualifying criteria for RBS is R3000 per month.

- Flexi banking Services (FBS)

Account Executives for e-channel sales and relationships were interviewed. Their primary role was to develop business solutions within the e-channel environment. FBS does not have a sales force within the physical channel and rely on the contact centre to generate sales and service clients.

- Information Management division (IM)

An information analyst and the statistician, responsible for the development of the CLV model for the bank were interviewed. Information management as a division is responsible for the generation of information in a format that allows for SBU's to make sound business decisions, regarding their client.

The primary objective of the research was

- To obtain the respondents view on the various activities and areas within the organisation where the CLV model could be applied.
- To obtain the respondent's view on the areas as identified by the researcher.



The secondary objective was to gain an understanding of the level of comprehension of CRM and CLV principles within the organisation.

The findings that emerged from the interviews and the focus group discussion are set out below.

### **4.3 RESPONDENTS' VIEW ON CONCEPTS SURROUNDING CRM AND CLV**

The purpose of the focus group questionnaire (Appendix A) was to establish the level of understanding and possibly the level of implementation within the affected business unit of various concepts surrounding CRM and CLV.

#### **4.3.1 Private Bank**

It was clear from the interviews and focus group discussions that an overall generic view of CRM is understood, but not yet optimally applied. The Pareto principle (80/20) was mentioned in every discussion. Most of the respondents believed that CRM is effectively applied when organisations can generate 80% of their income from 20% of their clients.

Private Bank family office saw CRM as a methodology of retaining existing clients and gaining new clients. Because of the small client base of approximately 80 high net worth families countrywide in the base, CRM can be effectively applied through daily to weekly contact with their clients. One respondent aptly commented, “...we *practically live with the clients.*”

One respondent clearly stated what CRM was not. It was not technology. This was also evident in other discussions

What was really interesting in an interview with the Personal Office of Private Bank was the definition of CRM, with a personal balance scorecard approach to CRM. CRM was considered to be about how well one knows the client and all his facets of value. These facets included aspirations and the client's personal balance scorecard. The areas of the scorecard were, finance, external environment, internal environment (psyche) and learning and development. Understanding what the goal of the individual is in each of the quadrants assist one in meeting the need in those specific quadrants.

Questions two, four and five's answers were invariably intertwined. The responses to the understanding of CLV, the expected life cycle of a client that is needed to determine the CLV and finally the figure attached to CLV, i.e. absolute figures or relative figures were discussed simultaneously. Thus in the discussion on the concept CLV, the life cycle and actually figure was discussed.

CLV was not clearly defined; in fact no definition was explicitly given. However, the concept of life cycle was easily embraced and explained. Life cycle was seen as "real life and business life intertwined". Thus as long as the client lived they would have the client's business, because of the retention and loyalty strategies embarked on. The passing on of wealth from one generation to another ensured a longer lifetime with the client's business provided that the good customer service is maintained. One respondent saw life cycle as much longer in this SBU than in any other, because of value proposition and unique processes a Private Bank follows.

Another respondent commented that clients have complex interactions with the bank and thus switching to another bank provides too great an inconvenience, thus clients remain longer.

Relative values were seen as acceptable for measuring CLV, because of the environmental impact on the value. One respondent commented that CLV has no guarantees, just like glue. If the directions are not followed and the environmental conditions are not conducive to the glue sticking then the glue will not work. Thus the same with CLV, one can plan around it, but no guarantees exist, because of the economic and environmental conditions that can impact the value and ultimately the plans.

In question 7, acquisition strategies were seen more as a “people’s game”. Referrals rather than marketing campaigns would draw clients. Retention was considered to be a holistic approach; slowly winning the greater share of wallet over a period of time. Loyalty strategies were not discussed, because it was seen as the same as retention strategies.

The second part of the questionnaire that focussed on the application of the CLV model will be discussed later.

### **4.3.2 Personal Financial Services**

In this focus group discussion certain phrases were mentioned when the question about CRM was asked. Phrases such as “regular interface”, “convenient service”, “constant contact”, “understand your customer, and what he is prepared to pay”

were mentioned. The relationship should remain in tact regardless of who has the relationship. Some respondents saw the “management” aspect as crucial. Having a relationship is one thing, managing that relationship to add value to both the client and the organisation is another. The issue of trust was also very prominent in the discussion as been pertinent in the implementation of a CRM strategy.

The respondents also commented that a traditional marketing approach should not be discarded, but the CLV approach should be added on as crucial to effectively generate overall value for the company. The application of CLV was seen as important in any below-the-line advertising strategies. For the above-the-line they considered the traditional marketing approach as still being affective.

Question 2 with regards to the understanding of CLV, was met with much debate. It was however very evident that the concept of CLV was given much thought and research as part of the SBU’ existing Customer Relationship Programme (CRP). One respondent commented that it was the present value of future income streams. The respondent that had an IT focus mentioned that it was imperative for business to understand the current value of the client, before pursuing the CLV. It was also mentioned that a client might be reflecting a low CLV, due to an incorrect assessment of his needs and product mix. Thus the Relationship Manager and Financial Planner’s identification of the client’s needs and management of the product mix the client has is crucial to ensure a high CLV.

Another view from a respondent was that a consolidated view of the client was important to ensure that adequate value is generated from the client. One of the managers also commented that a restructuring of a client’s portfolio could ensure

that not only value being created for the organisation, but also for the client. Thus CLV was seen here as value been generated for the organisation as well as the client. Thus CLV could be considered as a win-win approach to managing relationships.

Customer significance as a contributor to the value measurement was also discussed. The respondents in the group felt that that one could not place a value on the significance of the client and thus the CLV value then becomes a relative figure. Influence that a client has and the referral business the client generates currently and the expected referral business in the future cannot be discounted into the equation. Thus the CLV figure is relative and should be used with caution and with full view of the potential risks of making decisions based on this value.

With regards to the expected life cycle, some respondents felt that the life cycle could not be determined quite accurately. In the new economy the client has very low switching barriers and thus can move to another bank fairly easily. One notices that in discussion with RBS switching barriers was not a threat. The RBS respondent saw the need to obtain stability of a credit record with one institution presented a high switching barrier in itself. PFS respondents concluded that based on the study of relationship data one would be able to determine the expected life cycle.

CLV was also considered to be a relative value and not an absolute value. This was due to the impact that environmental and economic factors would have on the value. With regards to question 6, the respondents agreed that scenarios would have to be built around the profile of the customer to determine what possible

economic and environmental forces could impact the life cycle of the client. According to them this makes CLV more dynamic as opposed to static. An example was given where the client's CLV could possibly change with the acquisition of a new product. His risk grading, based on behavioural scoring gets affected as well as his propensity to generate value in the future. Choice of product then largely can impact the CLV measurement both negatively and positively.

When asked question 7 the application of the model for acquisition-, retention-, loyalty- and profitability strategies, the respondents discussed the segmentation process for profiling the type of client the SBU wanted to do business with. Various comments with regard to justification of the acquisition costs were made. The respondents agreed that if segmentation based on propensity to create value in the future (CLV) was made then marketing could easily justify the acquisition cost of selected clients. The CLV model according to the respondents could be affectively used to enhance the existing loyalty programme. Identifying the clients with high CLV's and then adjusting the rewards to be commensurate with the CLV and not with the actual purchase can enhance the rewards programme.

#### **4.3.3 Retail Banking Service (RBS)**

The understanding of CRM was clarified by explaining it in conjunction with the client's life cycle and/or buying cycle. With the different operating model true relationship management as practised by PFS is not possible. Understanding the clients' behaviour so that the right product at the right time is offered is crucial. This is done through the contact centres, using technology like event based trigger

marketing and various other propensity models. Customer profitability indicators and contact strategies are developed as part of the overall CRM strategy. The sales within the SBU relied heavily on the virtual relationship management in the contact centres. Physical infrastructure is proving to be more expensive, and possibly less effective.

Lifetime value was considered to be a value based on the life stages of the client. The life stages are defined as having specific milestones. An example, student life, middle market, etc. The life cycle of each of the stages is determined and then an overall value is calculated.

RBS embarked on a multi-channel delivery strategy, therefore including the CLV of the client becomes paramount when determining the channel that would possibly generate the most income over a specific period of time. CLV modelling was seen to have a place within the existing marketing approach. Recency strategies are also used in the customer centric strategies.

A consistent response was received for question 5 and 6, in that values could not be absolute, because of circumstances of the individual clients changing.

Economic and environmental changes also impact the CLV and thus CLV should be used with the understanding that no guarantees are given. Assumptions or scenarios with regards to the economic and environmental conditions must be built around the calculation of the value.

The respondent in RBS also mentioned that CLV should be used to direct an SBU's resources effectively and in this gain credibility. Opportunity costs should be

taken into consideration when using the CLV model. The model would assist the SBU to contact more of the right customers. Not using the model would not be able to do this. The optimisation of the resources should be the main focus and not the complete accuracy of the value.

#### **4.3.4 Flexi Banking Services (FBS)**

CRM was seen as a philosophy of dealing with a client. One respondent commented that it was more than just an IT system. CRM involved the clustering or segmenting of clients based on needs. CRM was also seen as a database of names and interactions with the clients upon which contact action plans are made and decisions are affected.

CLV was seen as the value a customer is likely to generate over a period of time. This “value” was not just income value; it was also the influence value. The respondent did however agree that in practice this might be very difficult. FBS respondents felt that they did not have much say in the type of client they acquired, due to socio-political impact, however sound business principles would still dictate the business actions.

The respondents felt that CLV implementation could have a huge cost associated with it and some traditional marketing approaches would still be more effective within the client base. CLV was however seen as a value-add for the business, especially for the identification of clients who had the propensity to be migrated to RBS. The pool of products seemed fairly limited and thus the migration into RBS would allow the client to purchase more products and increase his profitability.



Question 5 and 6 received a similar response as RBS. The impact of economic and environmental forces would affect the absoluteness of the CLV measurement. A relative CLV for purposes of planning and decision-making was acceptable. Product development was seen as crucial to increasing CLV of FBS' customer base

#### **4.3.5 Information Management**

CRM was seen as a managed relationship programme where client expectations were managed holistically. CLV was described by one respondent as a model that predicted client profitability over a period of time. Another respondent did not agree fully to this definition, because of the concept "profitability" being used interchangeably with "value". The definition that was eventually agreed to was the "net present value of future contribution over a life time".

The respondent saw the mixture of both a traditional and CLV approach to marketing as more effective and CLV was seen as enhancing the existing marketing strategy.

The use of survival probability calculations were seen as effective enough to determine the expected customer life cycle, due to the nature of the business in the financial services industry.

With regards to the absolute versus relative figure, one of the respondents argued that depending on how "absolute" was defined one could determine an absolute CLV. If an actuarial approach was used then a relative figure would be calculated.

The economic and environmental conditions were seen not to have a huge impact, if this was discounted into the initial calculation.

With regards to the acquisition, retention, loyalty and profitability impact, a word of caution was expressed by one of the respondents in relation to applying the model to acquisition. It was argued that a full base is needed to keep an infrastructure going regardless of the propensity of some clients not to create value. The risk profiling could be influenced, yet a decision to exclude certain clients in acquisition based on the CLV should be practised with great caution.

CLV was considered to be effective in allocation of marketing resources within retention strategies. One respondent commented that product suitability could affect the CLV tremendously, thus by slight restructuring one could increase the CLV of the client and increase the value that the client perceives.

This concludes the report on the focus group discussions and interview sessions. The post-discussion questionnaire results will be discussed in 4.4.

#### **4.4 POST-DISCUSSION QUESTIONNAIRE**

A post-discussion questionnaire was used for the purposes of determining the respondents' true personal view on various discussion questions. Another objective of the questionnaire was to allow the participant to commit to a viewpoint, in the event that they were not able to voice it in the interview or discussion. This questionnaire used a likert scale where viewpoints with regards to statements

were determined. A ranking order question was also asked to determine the level of importance of the identified applications of the CLV model. Each of the questions will be discussed using an analysis table of the responses.

#### **4.4.1 Statements on CLV**

A question using a likert scale was used which required of the respondents to rate on a scale of one to five where one was totally agree and five totally disagree, their view of the statements made. Figure 4.1 provides a summary of the responses.

Five respondents totally agreed that CLV was an interesting idea, yet the traditional marketing textbooks should not be discarded, and seven agreed to some extent. Interesting to note is that two respondents who disagreed to some extent with this statement have had greater exposure to the CLV model. One of these respondents is the statistician that has already developed the CLV model for an SBU in the bank.

All the respondents did however agree that the CLV model would add value to the business. Eleven of the respondents totally agreed with the statement while three only agreed to some extent. This reflected an overwhelming acceptance of the CLV model within the respondent group.

The statement: "It is important to have an absolute value as opposed to a relative value for CLV when applying the model to business" reflected a varied view from the respondents. Two respondents totally disagreed and seven disagreed to some extent.

Totally Agree = 1; Agree to some extent = 2; Unsure = 3; Disagree to some extent = 4; Totally disagree = 5	CLV is an interesting idea, but do not throw out your traditional marketing textbooks yet	CLV is a model that can add value to your business	It is important to have an absolute value as opposed to a relative value for CLV when applying the model within business	CLV works better on the drawing board than in practice	Relationship data is a good predictor of a customer's future behaviour
<b>Personal Financial Services</b>					
Profitability Consultant	2	1	4	4	4
Manager - Business Planning	2	1	4	5	2
Manager - Business Projects	1	1	3	2	2
Communication Consultant	1	1	4	2	2
IT Management Consultant	2	2	4	4	2
Consultant - Business Projects	1	2	5	2	2
Manager - Business Projects	2	1	5	4	2
<b>Flexi Banking Services</b>					
AE - Echamel FBS	2	1	3	4	2
AE - Echamel FBS	1	1	1	3	2
<b>Retail Banking Services</b>					
Manager - Direct Sales	4	2	4	3	1
<b>Private Bank</b>					
Regional General Manager	4	1	4	4	1
Regional General Manager (Family Office)	2	1	4	5	2
<b>Information Management</b>					
Information Analyst	1	1	2	3	1
Statistician	2	1	2	4	1
<b>Summary</b>					
	CLV is an interesting idea, but do not throw out your traditional marketing textbooks yet	CLV is a model that can add value to your business	It is important to have an absolute value as opposed to a relative value for CLV when applying the model within business	CLV works better on the drawing board than in practice	Relationship data is a good predictor of a customer's future behaviour
Totally Agree	5	11	1	0	4
Agree to some extent	7	3	2	3	9
Unsure	0	0	2	3	0
Disagree to some extent	2	0	7	6	1
Totally Disagree	0	0	2	2	0

Figure 4.1 Analysis of question 1 (Appendix B)

Two respondents were unsure of the statement, two agreed to some extent and one respondent totally agreed. Yet again the information management respondents seem to have the idea that an absolute value has more importance than a relative value and in their discussion they did indicate that an absolute value could be determined. This response to the statement reflected a predominant view that a relative value is acceptable. One could argue that the lack of exposure to the calculation of CLV or the development of the CLV model could have deterred the respondents from accepting that an absolute CLV could be attained.

Three respondents agreed to some extent that CLV worked better on the drawing board than in practice. Three respondents were unsure and six disagreed to some extent. Two respondents totally disagreed with this statement.

The statement about relationship data being a good predictor of future behaviour drew nine people who agreed to some extent and four who totally agreed. Only one respondent disagreed to some extent.

#### **4.4.2 CRM and CLV statements**

Figure 4.2 provides a summary of the responses to question 2 of the questionnaire. The second question rated the importance of two statements. The first statement tested the importance of having a **CRM strategy** in place. Eleven of the fourteen respondents indicated that this was **extremely important**. The remaining three indicated that it was **important**. Thus CRM has a high level of importance in financial services.

The second statement made reference to the pivotal nature of CLV in the CRM strategy. Eight respondents found this **extremely important** and six indicated that it was **important**. None of the respondents indicated that these statements had no importance.

	Have a CRM strategy in place	Include CLV as pivotal in the CRM strategy
<b>Personal Financial Services</b>		
Profitability Consultant	1	2
Manager - Business Planning	1	2
Manager - Business Projects	1	2
Communication Consultant	1	2
IT Management Consultant	2	1
Consultant - Business Projects	2	1
Manager - Business Projects	1	1
<b>Flexi Banking services</b>		
AE - E Channel FBS	1	1
AE - E Channel FBS	1	1
<b>Retail Banking Services</b>		
Manager - Direct Sales	1	1
<b>Private Bank</b>		
Regional General Manager	1	1
Regional General Manager (Family Office)	1	2
<b>Information Management</b>		
Information Analyst	1	2
Statistician	2	1
<b>Summary</b>		
Extremely Important	11	8
Important	3	6

*Figure 4.2 : Summary of Question 2 (Appendix B)*

### 4.4.3 Ranking order

Question 3 identified the application of the model based on research findings and respondents were asked to rank the level of importance of usage of a CLV model within their environment.

Figure 4.3 provides a summary of the ranking order. The overall ranking of the respondents from most important to least important were as follows:

- Use CLV to select your customers correctly
- Use CLV for various customer orientated strategies
- Segmenting the client base
- Using CLV in the pricing strategy
- Using CLV to assist with the allocation of resources for marketing initiatives
- Designing the marketing strategy
- Communication of CLV for behaviour change purposes
- Using CLV to measure performance
- Using CLV to evaluate strategic alliances, mergers and acquisitions

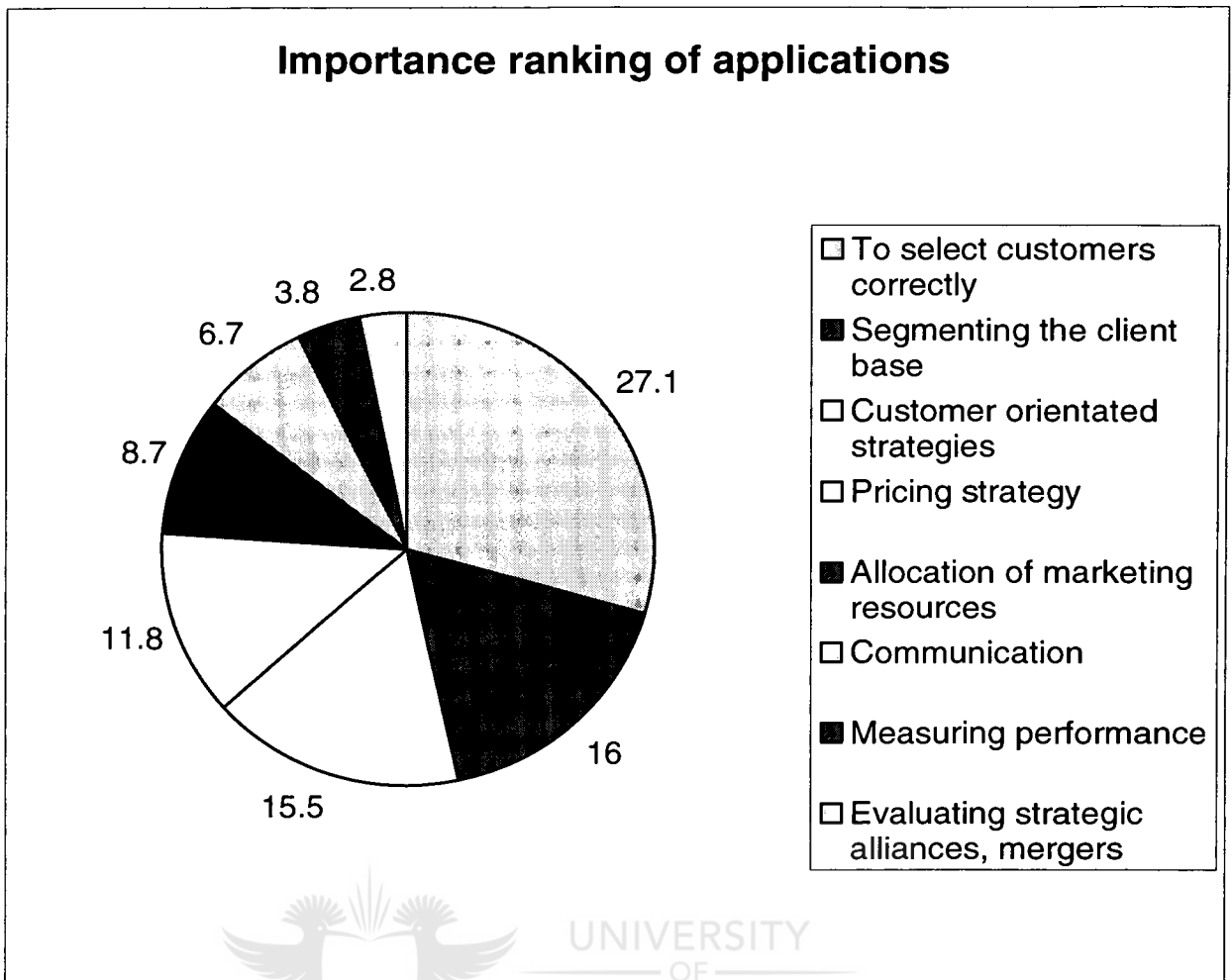


Figure 4.3

The analysis technique used in figure 4.3 reflects the likelihood of statements been reflected as most important. The pie graph in figure 4.3 shows that selecting customers correctly through the application of a CLV model, had a **27,1%** likelihood of been ranked most important, by the respondents. Segmentation of the client base had a **16%** likelihood of been ranked most important and customer orientated strategies a **15%** likelihood. Interesting to note is that selecting the customers had a **100%** lead on segmentation with regards to importance. Another interesting observation is the percentage likelihood of importance of application; **“Segmenting the client base”** and **“Customer orientated strategies”** are



almost similar, indicating that respondents saw these two applications as equally important. In summary this technique proved that the CLV model has a strong likelihood of being used to **select the customer base correctly**.

Figure 4.4 Overall summary of question 3

Designation of respondents	Design of the Marketing Strategy	Segmenting the client base	Communicating CLV principles so that behaviour change can take place	Use CLV to assist with the allocation of resources for marketing initiatives	Use CLV to select your customers correctly	Use CLV in your pricing strategy	Use CLV to evaluate your strategic alliances, mergers and acquisitions	Use CLV to measure performance	Use CLV for various customer oriented strategies
<b>Personal Financial Services</b>									
Profitability Consultant	5	6	7	4	2	1	3	8	9
Manager - Business Planning	5	2	6	4	3	7	9	8	1
Manager - Business Projects	6	3	1	7	4	5	9	8	2
Communication Consultant	4	1	6	5	3	7	9	8	2
IT Management Consultant	9	1	4	5	2	7	6	8	3
Consultant - Business Projects	6	1	8	4	5	3	9	7	2
Manager - Business Projects	4	3	9	5	2	1	8	6	7
	5.57	2.43	5.86	4.86	3.00	4.43	7.57	7.57	3.71
<b>Flexi Banking services</b>									
AE - Echannel FBS	2	4	9	1	8	6	5	7	3
AE - Echannel FBS	7	3	2	9	1	8	4	6	5
	4.5	3.5	5.5	5	4.5	7	4.5	6.5	4
<b>Retail Banking Services</b>									
Manager - Direct Sales	3	1	9	5	2	4	7	8	6
<b>Private Bank</b>									
Regional General Manager	8	6	5	7	1	3	9	2	4
Regional General Manager (Family Office)	7	9	1	6	2	3	8	4	5
	7.5	7.5	3	6.5	1.5	3	8.5	3	4.5
<b>Information Management</b>									
Information Analyst	4	7	8	5	2	1	9	6	3
Statistician	5	7	3	4	2	6	8	9	1
	4.5	7	5.5	4.5	2	3.5	8.5	7.5	2
Overall summary	5.36	3.86	5.57	5.07	2.79	4.43	7.36	6.79	3.79

Figure 4.4 reflects the results of the ranking of the application of CLV model, by using a technique, where the means are calculated. Interesting to note is the difference in order of the top three applications of the CLV model. This technique reflected that the lower the mean calculated, the higher the ranking of importance.

Thus the results of the top three were as follows:

- Selecting the customer base - a mean of 2,79
- Use CLV for customer orientated strategies – a mean of 3.79
- Segmenting the client base – a mean of 3,86

For PFS, using the CLV model in the segmentation process of their customer base was considered to have the most importance. Yet for the entire respondent base segmenting the client base was the third most important usage of the CLV model.



Using CLV to select customers correctly was ranked as second most important by PFS in terms of application of the model. This statement was ranked as most important overall. The two least important statements were the same for PFS as it was for the overall respondents, namely the use of the model for measuring performance and evaluating strategic alliance, mergers and acquisitions.

PFS ranked the importance of usage of the CLV model as follows:

- Segmenting the client base
- Using CLV to select customers correctly
- Using CLV for various customer oriented strategies
- Using CLV in the pricing strategy

- Use CLV to assist with the allocation of resources for marketing initiatives
- Designing of the marketing strategy
- Communication of CLV for behaviour change purposes
- Using CLV to measure performance
- Using CLV to evaluate strategic alliances, mergers and acquisitions

#### 4.4.4 Other usages for the CLV Model

Other usages or areas within financial service where the CLV model could possibly be used were identified from the respondents. The following were identified:

- **Product development**

The development of new products within the industry that would facilitate an increase in the CLV or an acceptable CLV was considered to be an area not explored.

- **Migration strategies**

These were migration strategies within the bank, from one segment to another. Thus one would determine the clients CLV and based on set criteria, migrate them to a segment SBU, where an acceptable CLV can be derived.

- **Attrition strategies**

The CLV model will be able to identify the client who will have the propensity to shorten their life cycle with the bank, yet have the propensity to generate a high CLV. These clients will be identified and an attrition strategy will be implemented to manage this.

## 4.5 Summary

This chapter summarised the exploratory study made and the responses from the respondents. Recommendations, based on these responses will be made in the final chapter.



## CHAPTER 5

### RECOMMENDATIONS, GUIDELINES AND CONCLUSION

*“if a new product does not live up to expectations then it must be somebody’s fault ... there is more often a ‘search’ for culprits than for lessons when initial goals are not reached ... With risk so personalised, it is not surprising that when failure does occur, there often a race to get the body to the morgue before anyone can do an autopsy. The result is a missed opportunity to learn” Hamel and Prahalad in Adcock (2000)*

#### 5.1 INTRODUCTION

This study had as its objective to determine the value that the application of a CLV model can provide in the financial service industry. Chapter two of the study explored the concepts surrounding CLV, CRM and CVM. Chapter three identified the areas within the business where the application of the CLV model could provide great value. Then a qualitative, exploratory study was done, by means of interviews and focus group discussions. These results were recorded and discussed in chapter four. This chapter will explore the recommendations for the use of CLV model, guidelines and conclusions.

#### 5.2 CRM and CLV conclusions

CRM is a concept that is readily understood, yet not optimally applied. CRM strategies are put in place, yet the tactical and operational application of CRM has not been enhanced. CRM is however considered to be a strategy that adds great value to the business.

CLV calculation on the other hand is not clearly understood by managers who have to implement this model. The value that the application of a CLV model can provide is understood however to transform it to an operational level will still present a great challenge. The CLV model can be applied to the marketing, strategic, financial, human resources and product development areas in the business.

The areas agreed upon and identified as deriving great value from the application of the CLV model were determined as follows:

- Segmenting the client base
- Using CLV to select customers correctly
- Using CLV for various customer oriented strategies
- Using CLV in the pricing strategy
- Use CLV to assist with the allocation of resources for marketing initiatives
- Designing of the marketing strategy
- Communication of CLV for behaviour change purposes
- Using CLV to measure performance
- Using CLV to evaluate strategic alliances, mergers and acquisitions
- Using the CLV for product development
- Using CLV for migration strategies
- Using CLV for attrition strategies

### 5.3 GUIDELINES TO THE APPLICATION OF A CLV MODEL

This study has allowed the researcher to conclude with guidelines for the implementation of the CLV model with the organisation. These guidelines will be listed below.

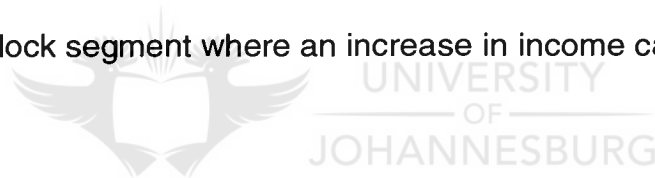
- **Understanding the methodology** around the design of the model is paramount for managers and specialists who implement this model in the organisation.
- Managers should guard against implementing the CLV model with **mediocrity**. Thus managers should be passionate about deriving full value for the business out of the implementation of this model.
- The potential for the CLV to generate value must not be obscured by the **ineffective application** of the model.
- **Caution** should be exercised when relying solely on the merits of this model, without taking into consideration the economic and environmental forces that impact the industry.
- **Effective communication** and possibly orientation needs to take place once the model has been accepted by the SBU.
- **Guidelines** for each of the possible applications must be developed and communicated to the specialist or line managers using the model.
- The model can be used effectively to **justify marketing decisions** and actions.
- Use the CLV model in the **development of business cases** to justify marketing-spend on acquisition, retention and expansion strategies.

- The CLV should not be applied in isolation. It belongs within the realm of an **effective CRM strategy**. Thus develop the CRM strategy and include CLV as pivotal in the strategy.

The value that the model can add to the organisation far outweighs the risks and criticisms expressed by the critics of the model. However, when applying the model, one should be aware of the inherent risks.

#### **5.4 In summary**

CLV should not be considered to be just another marketing fad. It has value that goes beyond a mere financial calculation. It is a model that if applied correctly throughout the organisation can enhance processes, influence decisions, justify actions and unlock segment where an increase in income can be exploited.





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