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Value gap marketing: Customer value optimisation using database marketing

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Abstract
Your organisation's marketing database is a goldmine of customer information that helps you separate your most valuable customers from the rest. But are you getting as much value from your best customers as you can? Do you know that some of your low-value customers are worth even more than you currently think? Or which customers will be your best ones three years from now?

Value gap marketing, an innovative methodology that heralds the next generation of database marketing, can help you determine which customers represent the greatest potential value over time. Value gap marketing is an eight-step process for getting the most out of your database marketing effort. Case examples are given from the fundraising, retail bank and credit card industries.

Keywords Value gap marketing, customer value, customer potential, database marketing, potential value

Introduction

For years, database marketers have worked from the premise that not all customers are created equal. They have succeeded by focusing marketing efforts and budgets on the top customer deciles. Value gap marketing (VGM) takes this a step further by examining existing customers and prospects to determine their current and potential category spending. If customer valuation focuses solely on historic activity, the bigger picture of category spending is missed. By comparing their current share of category and examining the customer demographics and psychographics of top category spenders, it is possible to identify current and future customer potential irrespective of their history of spending. This allows the use of database marketing to target the highest future potential buyers as well as the highest current and past value spenders.

DBM looks backward, VGM looks forward

Table 1 shows actual data for several spending categories. The disparity between the top and bottom deciles is common for most companies operating in these categories. A classic marketing approach which has a high ROI is to focus retention, upgrade, cross-sell and other tactics on the top customer deciles and minimise or eliminate targeting lower spending deciles. And this virtually always works. In fact, it is an 'early harvest' strategy that yields immediate returns and very often leads to a proliferation of new products and offers to be marketed to these high ROI customer segments.

VGM redefines customer value by refocusing on the difference between a customer's current value measured as net revenue or profit, and

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Gap between spenders

Table 1: Differences in customer spending

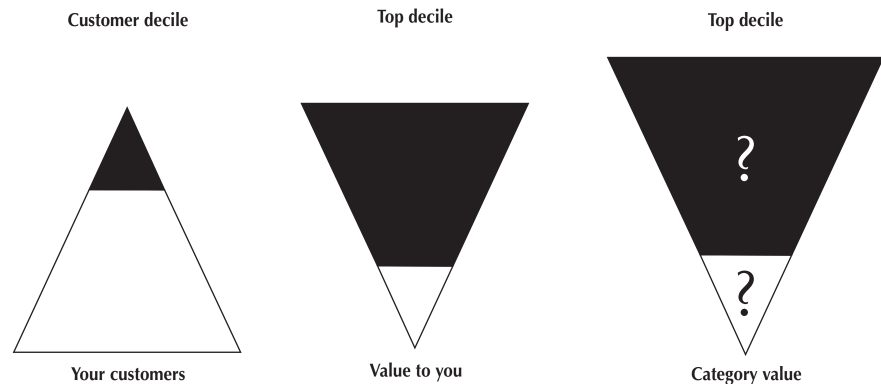
	Top decile	Bottom decile
Retail spending	$1,500	$50
Airline spending	$10,000	$300
Fundraising	$100	$5
Bank deposits	$70,000	$500
Credit card balance	$4,000	$100
Long-distance telephone	$850	$60
Technology spending	$160,000	$2,000

the total value that he is projected to generate today and over time across multiple brands in the product/service category — ie category value.

As illustrated in Figure 1, a customer's current value may be a small slice of a larger pie. In short, the philosophy behind value gap marketing is this: don't be satisfied with your piece of the pie until you know how big the pie is.

Decile v category

Figure 1: Customer value — next dimension



While it is important to know how valuable customers are, it is more important to know your share of their category spending by knowing how valuable customers are in the category

How big is the pie?

Share of future wallet

Customers or prospects once dismissed as low value or having reached their full potential may now represent bigger profits. For example, they may be splintering purchases across a variety of brands in the category, such as in supermarket shopping where customers typically spend 60 per cent of the volume with one store and spread the remaining 40 per cent among seven or more other stores. They may be early in a purchase cycle history and showing low values which are really just the beginning of a future high spending pattern. Parents of infants are a good example of this phenomenon.

Rather than relying solely on current share of wallet to drive marketing activities, VGM assesses a customer's potential value over the normal customer life cycle to help determine how much to invest in

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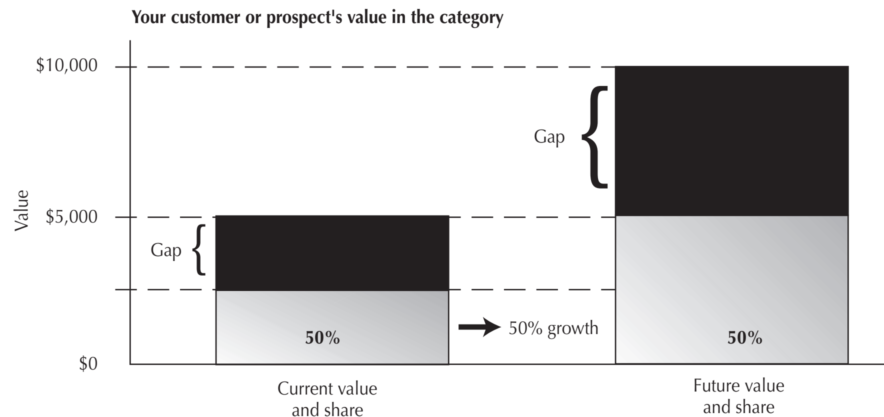
Figure 2: Value gap — next dimension



Over time, the value gap can expand even if your share of that customer's spending remains the same. Similarly, prospects that spend very little with you may be increasing category spending, leaving you a decreasing share.

Growth in share of category

Lifetime category value

cultivating that customer relationship. Whereas lifetime value calculates how much is likely to be spent with you over time, VGM helps measure how much they will spend in the total category.

In Figure 2, a credit card holder who maintains a $1,000 average balance may be worth $50 per year to the issuer of that card. If the customer maintains an average of $5,000 in total outstanding credit balances, then the issuer can say it has a 20 per cent share. All things being equal, this customer may be generating $250 per year in value to all his credit providers, and therefore the value gap to the card issuer is the difference of $200. If, three years from now, the customer's balances average $2,000 and $10,000 in total, the issuer has both maintained a 20 per cent share and shown secular growth of 50 per cent. But value to the issuer would be $100 per year versus $500 in total, so the value gap has actually expanded to $400.

Which customers to retain?

This simple example is important for marketers to consider, because traditional metrics such as customer retention, customer loyalty, and share may be deceptive if the value of the customers in the market category is changing. The value gap can expand even when share remains the same and revenues are rising. In this case, the gap grew by 60 per cent.

The challenge to marketers eager to deploy value gap marketing is to determine each customer's total value path in the category, not just in a single organisation with which he does business. As any marketer who has gathered and maintained accurate customer data knows, this is not a trivial exercise.

VGM requires survey data

While some industries, such as financial services, benefit by their nature from sources of secondary information, like credit bureaux, marketers in other categories will need to work harder to estimate future customer value. Customer surveys or market tests can help track patterns of behaviour. Analytic model simulations that measure propensity to purchase and value migration can be executed. And mining information

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Internet data gathering

directly from existing customers about their spending habits in a particular product or service category can drive the successful adoption of value gap marketing. With the advent of the Internet and electronic POS, these data can easily be gathered on individuals and companies and not just for sample groups.

A better way to allocate marketing resources

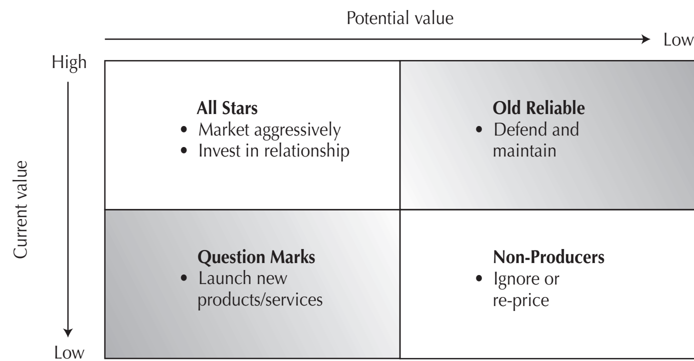
Perhaps the greatest benefit of VGM is that it helps marketers invest their budgets wisely.

Target promotional expenditures on those actively spending in the category. The ability to build on this relationship is a critical key to closing the value gap. The goal should be to develop a usable segmentation strategy that reflects both current and potential value and allows us to test methods for creating greater customer intimacy, retention and revenue.

Customer value matrix

Figure 3 is a matrix illustrating a simple four-part segmentation based upon VGM potential. A variety of marketing strategies are possible depending on the category, competition, etc, but the compelling notion behind such analysis is that some customers and prospects are more worthy of investment than others. Thus we would aggressively market to All Stars, defend Old Reliables, test and research the Question Marks and most likely eliminate, ignore or re-price the Non-Producers.

Figure 3: Customer value potential matrix



Marketing capital budgeting

Unfortunately most companies are not organised to market in this way. They have boundaries of budget and responsibility by product and region, by location or channel, and moving to a VGM approach is more difficult to execute than to understand.

Eight steps to bridging the value gap

Not all organisations can implement a rich VGM segmentation and effective marketing accordingly, but since the interactive world will undoubtably create more opportunities to do this, the best way to approach VGM is through a comprehensive eight-step process. Following this approach may also be the best insurance that a new

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company, launching through new channels such as the Internet, doesn't siphon off the top category spenders and leave you with low-value customers and high-cost channels. Certainly an element of the high valuation for Internet companies such as Amazon.com is predicated on the chance that this will indeed be the case. It is highly likely and well proven that high category spenders are more knowledgeable, more flexible in channel selection and very often more sensitive to price given their heavy usage. These eight steps will at minimum help to locate the best potential customers so that you can protect them as well as increase your share of their category spending.

Baseline economic analysis

1. Establish a baseline of customer activity, considering factors such as customer flows, RFM (recency, frequency, monetary) statistics, purchase history and cross-sell ratios. At this point, trends are identified and benchmarks are established to gauge future marketing programme success.
2. Calculate customer value. Each customer's current value to an organisation is measured, enabling consistent comparison across all business units and product lines. These scores are tracked in the customer marketing database.
3. Establish customer potential in the product or service category by building qualitative models that predict category behaviour, or by testing marketing programmes in specific regions or with a sample of customers.

Segmented marketing approach

4. Quantify the value gap and segment customers. Unlike traditional static snapshots, this approach measures both the current and future value gap that will evolve as customers' total category spending changes over their life cycles. The goal here is to predict how the gap will change over time, and segment customers into groups based on life-stage demographics, channel preferences, and other characteristics.
5. Define marketing alternatives for each customer segment and the expected pay-off. Offers, media, channels or promotions are determined for each segment. An associated return on marketing investment is estimated based on past experience or on programme testing.
6. Select the marketing actions with the greatest business gains. Matching business goals to the expected return, the most appropriate marketing action is implemented for each customer segment.
7. Measure programme results after an acceptable tracking period, and reassess value gap to determine progress.

Marketing asset reallocation

8. Evaluate marketing actions and reallocate resources. Careful results' analysis will ensure that return on investment is continually maximised and that progress is maintained against the value gap.

Value gap marketing in practice: Case studies

A not-for-profit example

A major charitable organisation turned to value gap marketing to identify value pockets within their current donor base. After building a

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donor marketing data warehouse, the organisation took to segmenting its donors by demographics and giving history. With an eye to a bigger picture, the charity also used donor surveys to determine the behaviour of their donor base within an overall philanthropic giving context. It inquired about each donor's attitudes and behaviour toward the charity as well as annual donations in general. The non-profit organisation also relied on surveys to provide insight to each donor's lifestyle interests and consumer behaviour.

Customised segments

With survey results in hand, the charity mapped donor segments along a customer potential matrix, where segments fell into four value gap quadrants. These included (1) high philanthropic giving/high charity-specific giving; (2) low philanthropic giving/high charity-specific giving; (3) high philanthropic giving/low charity-specific giving; (4) low philanthropic giving/low charity-specific giving.

Customised appeals stratgey

With an understanding of where the value gaps were, the charity was able to restrategise and prioritise marketing treatments to maximise results. The high potential donors who fell into the first quadrant, or the 'bleeding hearts', could theoretically represent large donations. They are best suited for multiple programme treatments including major gift appeals and planned giving programmes.

Since donors falling into the second quadrant probably have given all they can to charitable causes (with the majority of their money directed towards this particular charity), they are best targeted with loyalty programmes that possibly encourage one more annual gift.

More exciting, however, is the opportunity to increase revenue from these donors through cause-related marketing. Since the charity used surveys to gather consumer behaviour data, it can work with companies these donors purchase from to gain a share of the purchase towards their cause. This opens up an entirely new revenue stream for the charity, creatively extracting additional value from donors who had previously appeared tapped out.

Donors falling into the third and fourth segments are best candidates for limited programmes and may also represent additional revenue from cause-related marketing.

A retail bank example

A major retail bank, upon adopting a value gap marketing focus, embarked on building its customer data warehouse. This data store included client-specific facts, demographic data and financial services behaviour data (collected by survey) for each of its customers. The bank further improved its customer view by applying analytics to the data, estimating customer retention scores, constructing cross-sell models, and running tests of their predictions in the marketplace.

Bank customer matrix

This enhanced customer understanding resulted in a multi-dimensional segmentation of the customer base. The three dimensions included potential value, current value and lifestyle attributes. To understand each segment's value gap, the customer segments were then mapped on to the customer value matrix across the following four quadrants: (1) high potential value/high current value; (2) low potential

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value/high current value; (3) high potential value/low current value; (4) low potential value/low current value.

The retail bank was able to refine its marketing focus by funnelling money into programmes that maximised return. For the segments falling into the first quadrant, the bank embarked on a rewards programme that marketed to these customers heavily, leveraging cross-sell strategies and enhanced customer service benefits. For customers in the second quadrant, the bank launched on marketing programmes that defended these customers against the competition.

Customers in the third quadrant were targeted with cross-sell programmes that motivated spending. The bank also invested in strategies to motivate these customers to utilise lower-cost channels in an effort to improve their profitability.

Finally, the low potential value/low current value customers were slated for increases in banking fees and other re-pricing efforts that would drive up their bottom-line worth to the bank.

A credit card marketing example

A credit card issuer in the early stages of VGM adoption built a customer database that included client-specific data, as well as credit bureau attributes. To round out each customer's profile, the issuer determined share of wallet as a percentage of total credit card balances, and also calculated historical customer profitability. Using all of these data, the credit card issuer developed a potential profitability model and assigned each customer with a resulting score.

Today, the credit card issuer is in the process of segmenting its customers and mapping them on the customer value matrix. Their customer segments are falling into the quadrants based on total credit card balances and balance with the issuer.

Rewarding best and re-pricing worst customers

Early strategies for the 'high potential/high balance' customers include a best-customer programme with attractive balance transfer perks and premier product/service offerings. In a defensive action, 'low balance elsewhere/high balance with issuer' customers will be targeted with a retention programme with limited service benefits.

The credit card issuer is planning further analysis and research to determine why the 'high potential/low balance with issuer' customers are going elsewhere to complete their credit card business. And finally, to improve the worth of the 'least profitable/low potential' customers, the credit card issuer intends to develop additional fee and merchandise add-on strategies.

Conclusion

VGM unlocks hidden category potential

Value gap marketing provides marketers with a strategic framework for growing and managing their business. It is information-driven customer marketing, providing marketers with the power to discover untapped potential in the existing customer base. However, only those marketers who are committed to the critical competencies required of any customer marketing strategy — marketing, analytics and technology — will successfully implement VGM as a growth strategy.

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