Enalito presents

RFM BASED LIFE CYCLE MARKETING WITH US

BY PAUL NEWPORT

For more information visit www.enalito.com

TABLE OF CONTENTS

Enalito's AI-based platform lets you see which one of your clients is more inclined to buy goods or services from you. The platform analyses and displays data that may be used to boost sales while lowering marketing expenditures. Not only will we make this crucial information available to you, but we will also show you how to apply it.

We provide a set of Customer Behavior Models that you may use to conduct customer data-driven marketing with a high return on investment in your company. The Latency Model is the most basic. Following that, we'll go through the Recency and RFM Customer Models and teach you how to use them to develop your eCommerce business profitably.

Finally, we'll educate you about Customer Lifecycle Marketing and show you how to utilize Customer Behavior Models to make your customer acquisition and retention marketing efforts more profitable.

We'll model and anticipate your customers' behavior to assist you in understanding what they're likely to do before they do it. You'll utilize this predictive knowledge to create a series of lucrative customer marketing campaigns that will increase your client base and revenues while maximizing your marketing budget ROI.
These Customer Lifecycle Campaigns will enable you to send the right message, to the right people, at the right time.

THE CUSTOMER BEHAVIOR MODELS

Enalito can assist you in creating customer models for each of your consumers and categories. While these models will include apparent demographic data that will benefit your marketing efforts, we also construct and display complete customer behavior models, which are far more essential for developing deep and lucrative connections with your consumers.
The customer's activity is tracked and recorded by the behavior models. It's all about consumer interaction.

- How frequently have they accessed the website?
- When was the last time they bought something? When was the last time they went to the website? Is it probable that they will return? When? When was the last time they bought something?
- Will they buy from you again?
- When do you think they'll purchase again?
- What was the total cost of their most recent order? What was the entire amount of time they spent with you?
- What is the most reasonable amount they will spend on their next order? How much do you think they'll spend in the coming year?

You get the picture.

These are just a few of the numerous questions that behavior may help you solve. Customer behavior is a far better indicator of your future connection with a customer than any demographic data. By carefully examining customer data, you may learn a lot about individual consumers, particular client categories, and your whole customer base. It can inform you whether a consumer is dissatisfied with your service. It might indicate whether or not a consumer is ready to buy again but only needs a slight shove. It can inform you which clients are unsatisfied with your service or product offerings.

These in-depth Customer Behavior Models are essential for increasing sales to current clients. Rather than being static, they are action-oriented. Instead of telling you, "This client is 40 years old and lives in Auckland," they tell you, "If this customer does not purchase in the next 30 days, they are unlikely to return and make any more purchases."

As a result, the Customer Behavior Models look at your customers who engage in specific behavior and identify similarities between them. A behavior model may, for example, examine a list of your most significant customers and a list of your defective best customers to spot any behaviors or acts that indicate a client is likely to defect. You can use this information to predict which of your best customers are likely to defect and pre-empt the defection by communicating with them prior.

As a solution, Enalito was created to assist you with this. It provides Customer Behavior Models that you can use to communicate with the appropriate consumers at the right time with the right incentive or product, allowing you to develop deep and strong connections with all of them.

You may build an even more comprehensive and valuable overall picture of each client by integrating these Customer Behavior Models with additional demographic and psychographic data you have. However, the behavior comes first because it is the customer's behavior that you seek to influence, encourage, or alter.

LIFECYCLE MARKETING CAMPAIGNS BUILT FROM BEHAVIOR MODELS

MANAGE AND ACHIEVE YOUR KEY BUSINESS OBJECTIVES THROUGH LIFECYCLE MARKETING CAMPAIGNS BUILT FROM BEHAVIOR MODELS

As an e-commerce firm, you should concentrate on two primary goals:

1. Keep your most valuable clients.
2. Increase the value of fewer valuable clients.

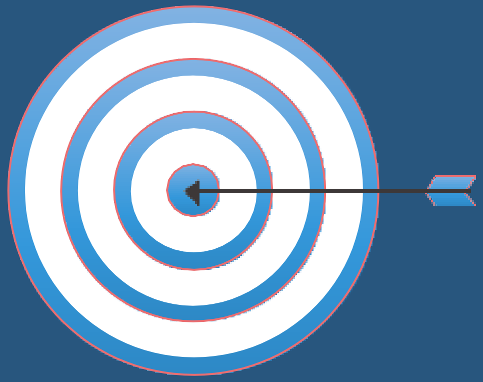
To fulfill these two primary goals, you'll need to create and operate a complete Customer Lifecycle Marketing Program based on your customer behavior models.

This implies you'll need to know your customers' worth and how likely they will respond to the different communication initiatives that make up your Lifecycle Marketing Program. These efforts have the same overarching goal: to persuade the customer to do or not do anything. For example, to spend more on their next purchase or to avoid defects.

And you must know ahead of time for each communication campaign:

1. WHAT DO YOU PLAN TO SAY?
2. TO WHOM are you going to say it, and
3. WHEN are you going to say it?

TARGETED MARKETING FOR HIGH RETURN ON INVESTMENT



TARGETED MARKETING FOR HIGH RETURN ON INVESTMENT

And you'll want to make sure that you spend as little money as possible on each of these campaigns to get the best potential return - i.e., the highest Return on Investment. You won't get there by sending the same message to everyone in your database simultaneously. Instead, the objective is to spend money exclusively on those consumers who are most likely to engage in the desired activity. It's pointless to spend money on those who are unlikely to respond to your message.

So, the first step is to figure out precisely what you want this particular set of consumers to accomplish. What ACTION are you looking for them to take? And, presumably, once they've done it, you'll want them to repeat the action and so continue to accomplish the things you desire. And, more significantly, you'll want to spend less money to convince those consumers to do what you want a second and third time. The data you have about these consumers (behavioral Models) will teach you how to do it effectively. You'll know what actions to take to reach your marketing objectives, whatever they are, once you learn to read and comprehend what the data is saying to you. You'll also spend less time doing it.

The data you have about these consumers (behavioral Models) will teach you how to do it effectively. You'll know what actions to take to reach your marketing objectives, whatever they are, once you learn to read and comprehend what the data is saying to you. You'll also spend less time doing it. So, if you have something to offer them that is very relevant and perhaps enticing, chances are they will miss it since they are no longer paying attention to you. And, of course, the more irrelevant messages a client receives, the more likely they are to unsubscribe from your communications.

CORE PRINCIPALS
OF
BEHAVIORAL
DATA DRIVEN MARKETING

CORE PRINCIPALS OF BEHAVIORAL DATA DRIVEN MARKETING

The "rocket fuel" clients are those that have a present high value as well as a high potential value (upper right corner of the chart); they are the 10% - 20% of your customers who generate 80% - 90% of your profits. You want to keep these clients pleased and should pay extra attention to them; these are your top purchases, most frequent visitors, and so on.

The scenario in the lower-left corner of the chart is the inverse; these consumers have imperfect present and potential value. Most of your 1X purchases, unintentional website visits, and so on are likely members of this category. Though it's good to have these clients, and they may help cover overhead costs, you shouldn't go out of your way to invest a lot of resources in attempting to maximize their potential. Every consumer you've previously spent too much money marketing to – those who never react – is likely to be included in this category. This is also where group customer "win back" campaigns frequently concentrate their efforts.

Customers with a combination of present and projected values are held in the chart's top left and lower right corners. Customers with a present high value but a low prospective value can be found on the top left. This region is primarily occupied by defecting best customers — they were best customers at one point (by current value) but have decreased their profit-generating activities with you for whatever reason and are most likely destined to defect towards the lower-left corner the chart. You'll come up with programs that pull them back across to the upper right corner if you're clever. Customer retention initiatives should be targeted towards this group, although they are rarely targeted at any group in particular, and that is why they have a high failure rate.

Customers with high prospective worth but low present value can be found in the lower right corner. Who are these individuals? It's probable that they're new clients who haven't had an opportunity to add much value yet, but who are anticipated to do so in the future. If they do, they'll climb to the top of the chart's upper right-hand corner and become "rocket fuel" clients. If they don't, they'll revert to the lowest left corner of the graph and contribute very little.

Customers in this corner should be the focus of programmes aimed at increasing customer value, however, as with retention programmes, these “grow the customer” initiatives are frequently not focused on them.

The Enalito method divides consumers into four quadrants based on their actual spending or value-generating activity.

CORE PRINCIPALS OF BEHAVIORAL DATA DRIVEN MARKETING

This data-driven customer behavior-focused retention strategy is based on four central ideas:

1. The best indicators of future consumer behavior are past and present customer behavior.

You may anticipate future behavior and utilize that information to better your marketing initiatives based on previous and present behavior. Actual conduct has indeed shown to be a far stronger predictor than any demographic variables.

Past and current Customer Behavior **Future Customer Behavior**

CORE PRINCIPALS OF BEHAVIORAL DATA DRIVEN MARKETING

1. Customers control the customer relationship today

They also want to make informed decisions and feel good about their actions. If you want your consumers to accomplish something and feel good about it, the emotional reaction to your advertising is critical. Customers want to know "what's in it for me," whether it's a discount, a special offer, improved service, or anything else that appeals to them as individuals.

Keep in mind that you're communicating to promote and alter behavior. You must do something for your consumers if you want them to do anything, and if it makes them feel good, they are more inclined to it.

2. Allocate your resources where they will generate the best return

You're working with a tight budget. A marketing effort must return multiple investments in PROFIT for every $1.00 spent (not sales). The value of that multiple may vary depending on your specific circumstances, but you should aim for a profit of $2-$3 for every dollar spent on marketing. You must, at least, break-even, so if you can't make back $1.00, the dollar isn't worth it. And, given that you may spend your marketing dollar in various methods and channels and get a $3 return on one campaign but only $1 on another, isn't it clear where you should put your money?

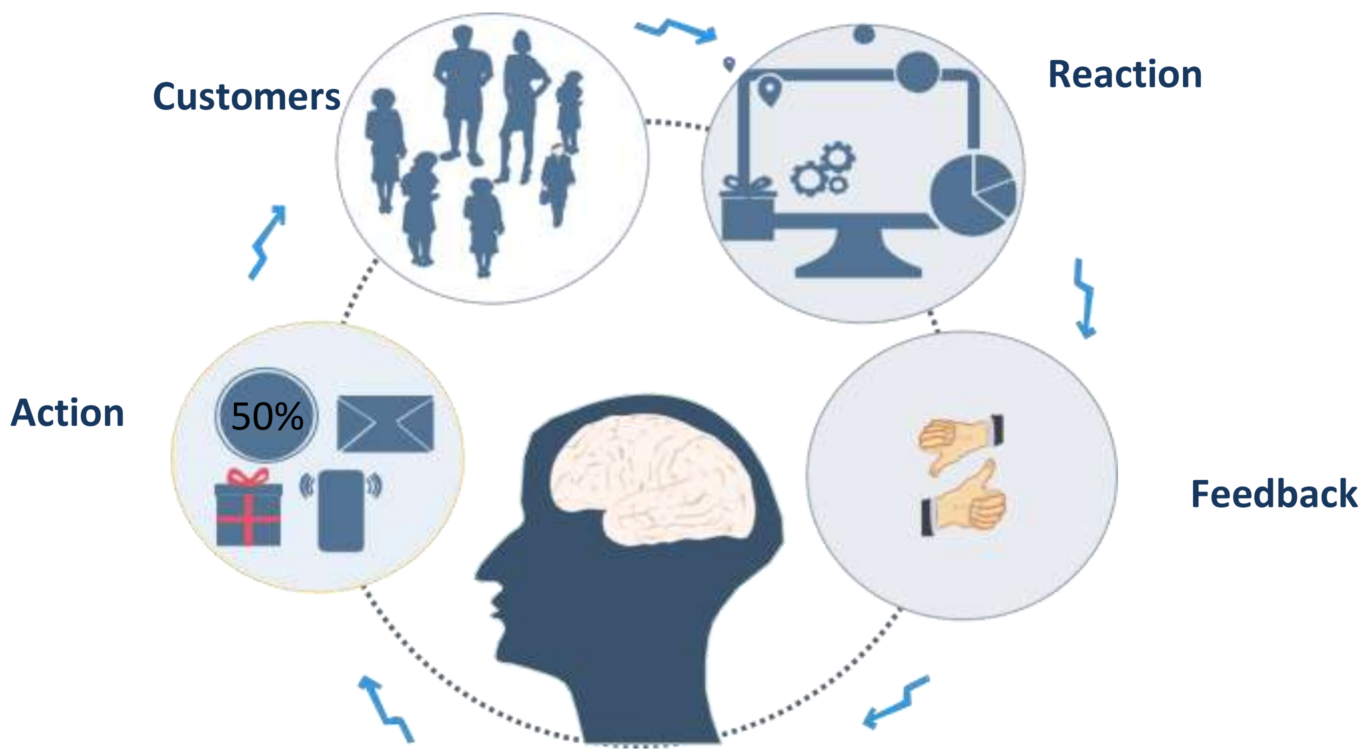
That’s why being able to forecast the return on all of your initiatives is critical: it helps you decide where to spend your limited marketing budget and attention.

This strategy focuses on increasing your Return on Investment, or ROI, which is why you want to undertake Data-Driven initiatives in the first place.

You can effectively assess ROI using data-driven marketing.

3. The Action – Reaction – Feedback – Repeat Cycle

Data-driven marketing entails developing and implementing a series of messages and interactions with your consumers, as well as evaluating the data from those interactions to evaluate the relationship's potential and problems. Simply put, you're LISTENING to what your consumers are saying you through their actions and the data generated by those activities. You then respond appropriately. The data generated by the customer's activity or inaction catalyzes your response.



CORE PRINCIPALS Of BEHAVIORAL DATA DRIVEN MARKETING

4. The Action – Reaction – Feedback – Repeat Cycle

The consumer is asking you to pay attention, and your response confirms that you are doing so and that you are concerned about their requirements. Something has happened, for example, if a client buys from you every week and suddenly ceases. They might be on vacation, dissatisfied with their last order, or have discovered a new provider. You must keep an eye on the data and comprehend what it could be telling you so that you can respond correctly. This inactivity on their part is a signal or a flag that something has transpired to cause this customer's behavior to alter. It would help if you didn't dismiss these warning signs. To clarify the issue and the customer's perspective, you should respond to the modification and seek feedback. For example, you may send a brief satisfaction survey to the client, offering them an easy method to express any present discontent. If they finish the survey, you will have gotten their input (positive or negative) and will be able to resume weekly purchases. The cycle is now complete until the data reveals a significant shift in behavior, and you must respond once again.

Or perhaps a client who has visited your website numerous times but has never purchased does so today. This is critical information since it indicates a substantial shift in behavior. The client has progressed to a higher degree of interaction with you, and you must respond and await feedback. Sending a welcome email thanking them for their purchase and faith in you is a natural reply. You might even include a discount for a second purchase or a free delivery coupon. Then you wait for the response, which is usually favorable (a second purchase), but it can sometimes be wrong (the customer contacts you to say there is an issue with the delivery). As a result of this input, you make a decision, feedback and continue the cycle.

Now let's look at how to use Enalito to transform these four data-driven marketing concepts into practical campaigns that will increase your sales and marketing ROI.

IDENTIFYING CHANGES IN BEHAVIOR

IDENTIFYING CHANGES IN BEHAVIOR

The principle of identifying consumer behavior and searching for variations in it underpins any form of customer relationship marketing (CRM). The principle is the same, whether it's termed Customer Lifecycle Marketing, Relationship Marketing, or "Predictive Modelling": usual behavior is established, and any deviations are recognized and responded to with relevant message. When you understand how "typical" consumers act, you can:

1. Now let's look at how to use Enalito to transform these four data-driven marketing concepts into practical campaigns that will increase your sales and marketing ROI.

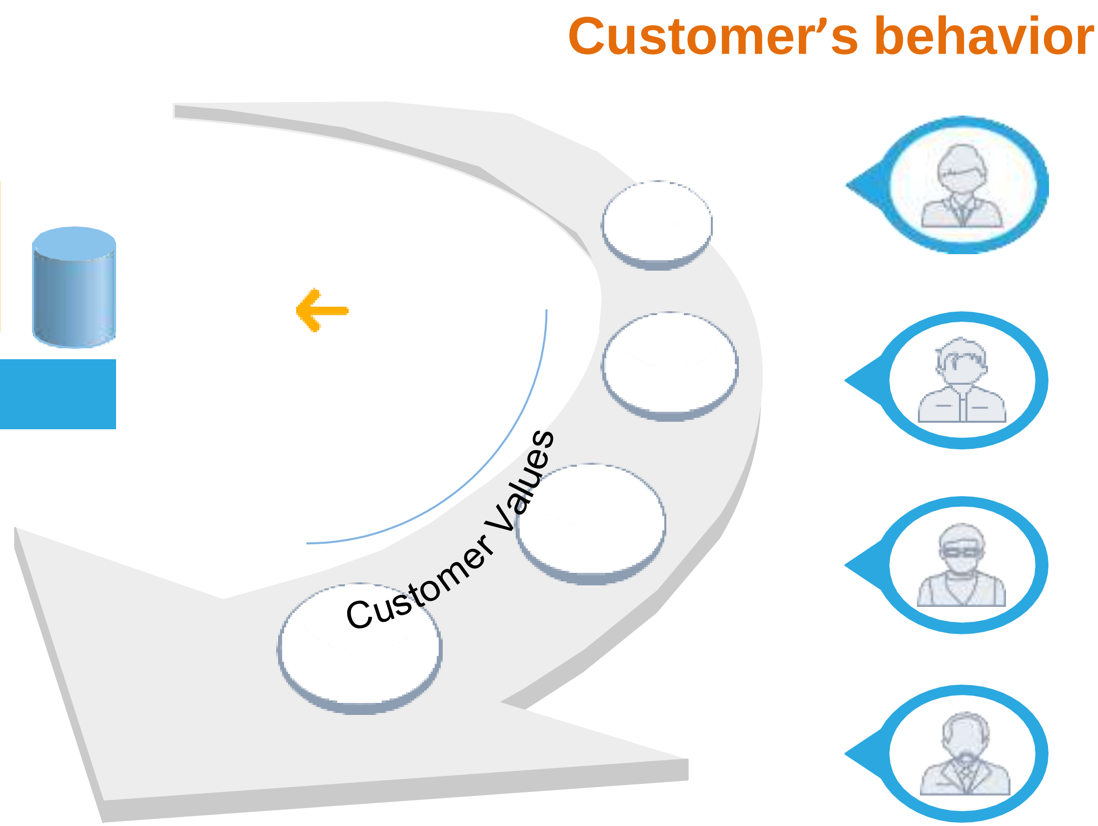
2. Create "triggers" to alert you to any consumer behavior that differs from what you've already recognized and documented as "normal." This difference in behavior is significant because it reveals explicit chances to respond to the change in behavior with particular, targeted communications to connect with the customer and develop the relationship, or at the very least avoid the relationship from deteriorating.

The essential thing to remember is that the change in behavior matters the most, and it should be observed and responded to regularly. Avoid putting too much emphasis on absolute metrics such as LTV. That isn't to argue that LTV isn't necessary. As we'll see later, it isn't crucial, but behavioral changes are simple to spot and respond to.

"Relative" numbers are used to show change. So, while knowing a customer's average order value or average time between purchases is essential, understanding how these figures have changed over time is far more significant. Is the AOV growing or shrinking? Is the average time between purchases getting longer or shorter? Each positive or negative change in the number informs us something essential about that client and our present and future connection with them.

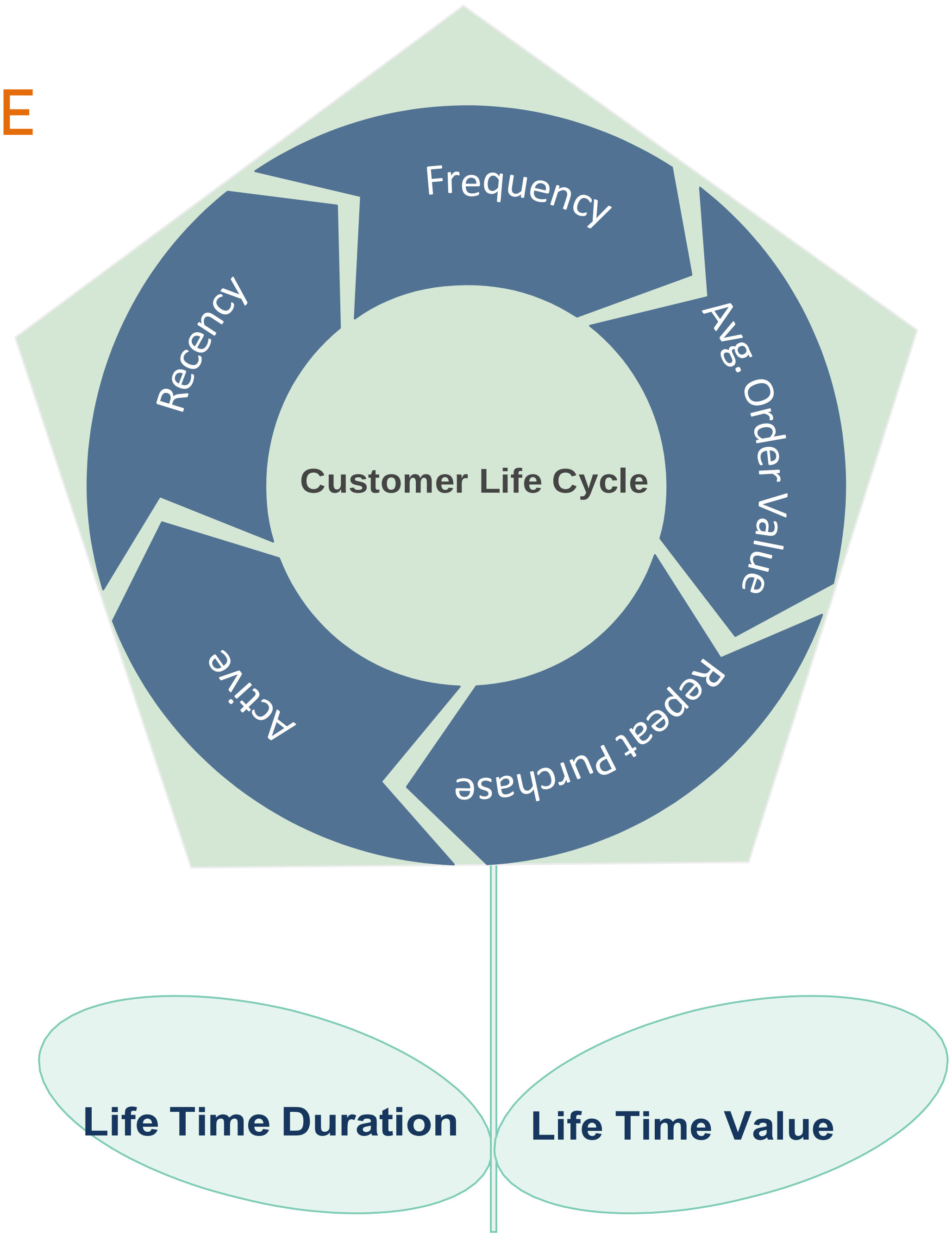
CHANGES IN BEHAVIOR REFLECT CUSTOMER VALUE

These shifts in data corresponding to changes in underlying behavior. And these shifts in behavior indicate that the customer's value is about to shift - either up or down. As a result, you can evaluate and forecast changes in your customer's worth by carefully measuring and monitoring changes in their behavior. This is significant because the total value of all of your clients equals the full price of your company. It's also significant because, by anticipating a potential shift in customer value, you may prevent it by launching a focused campaign to shift the client's behavior in the desired direction.



THE CUSTOMER LIFECYCLE

The Customer Lifecycle refers to these fundamental shifts in customer behavior and value across time. And we refer to our ideas and methods for influencing the Customer Lifecycle as Customer Lifecycle Marketing. The Enalito platform's entire purpose is to assist you in better monitoring, tracking, and understanding the Customer Lifecycle to improve the ROI of your customer marketing.



MONITORING SEGMENT BEHAVIOR

But it’s not just individual customer behavior that we want to track. Groups of customers (segments) often display similar patterns of behavior. When any single customer deviates from the segment norm, this can be a sign of trouble (or opportunity) ahead. For example, if the average new subscriber to your promotional emails makes their first purchase 60 days after subscribing, but a particular customer has not made a purchase after 60 days this may be a sign that this particular customer will have difficulty converting to the next lifecycle Stage - a repeat purchaser. And the greater number of days over 60 that pass without a purchase from this customer the less chance that there is that they will convert. Obviously, this is very important information that should be reacted to promptly and ignored at your peril.

As marketers we often talk about our “average customer”, but it’s important to understand there is no single average customer. Each business is made up of a collection of differing customer groups and each group displays their own “normal” behavior. This is exactly why it’s important to have tools you can use to identify customer segments that share the same or similar attributes that differentiate them from other segments. The Enalito platform monitors key behavioral data and uses these metrics to help you dice and slice your single customer database into as many segments or micro segments that make sense for your business at any point in time.

For example, the type of media or offer used to attract the customer can have a dramatic effect on long-term behavior, and customers who come into the business on the same media and offer at the same time will tend to behave in similar ways over time.

In the first customer purchase case above, the number of days from newsletter sign-up to the first purchase serves as the "trigger” and detects a potential signaling by the customer, which should say to you “Focus on me right now as I’m behaving differently" Once the customer alerts you through their behavior its then up to you to determine the next course of action and implement it. Enalito makes it easy to do this - in fact a significant portion of it can be automated and we will show you how to do this soon.
Triggering metrics like these provide the framework for setting up a series of targeted campaigns that will deepen your relationship with your customers, and build customer value.

DEVELOP AN ONGOING CONVERSATION WITH YOUR CUSTOMERS

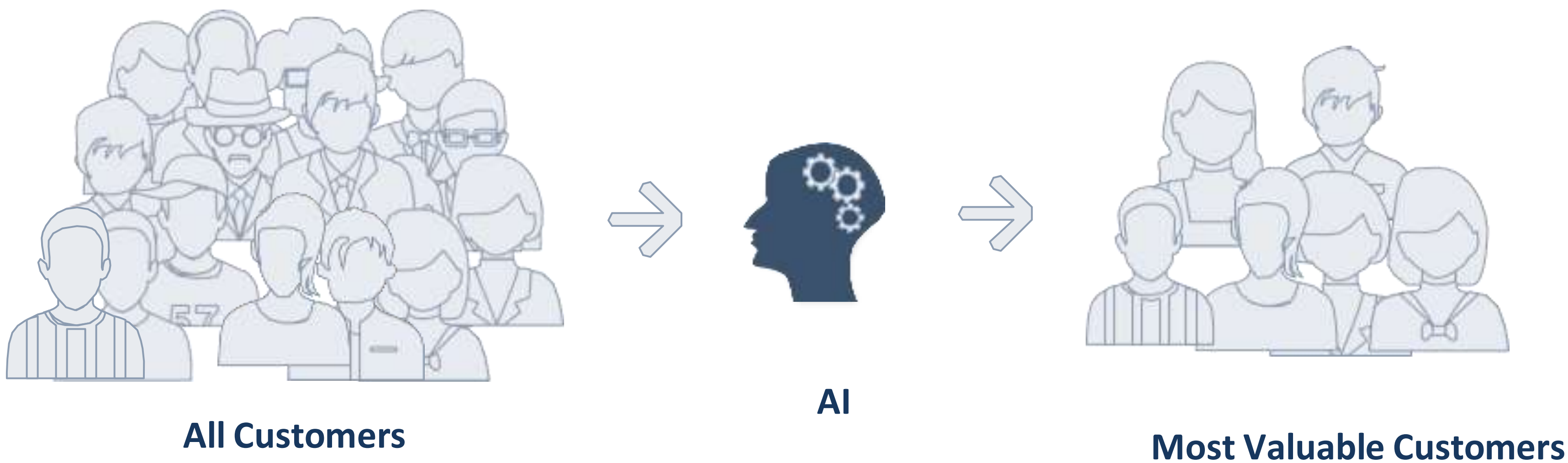
These customer alerts (actions) and your reaction to them is the feedback loop central to Lifecycle Marketing. It's an Action - Reaction - Feedback cycle that keeps repeating. Managing this cycle correctly is the key to strong ROI and business profitability. Your customer signals (alerts) you and you react. The customer then provides Feedback through another Action — perhaps they return a product, or perhaps they buy again. You react to this Action, perhaps with an apology note and gift card or with a thank you note or free gift with the new order. This is an ongoing conversation and it requires interaction to sustain the conversation. Once you or the customer stop interacting the conversation stops, value is lost and it's only a matter of time before the relationship ends. The customer moves to one of your competitors.

Each Customer Is Important

The whole point of this ongoing conversation is to demonstrate that you are responsive to each customer's specific needs, that you care about them and that they are important to you.

FOCUS ON YOUR MOST VALUABLE CUSTOMERS

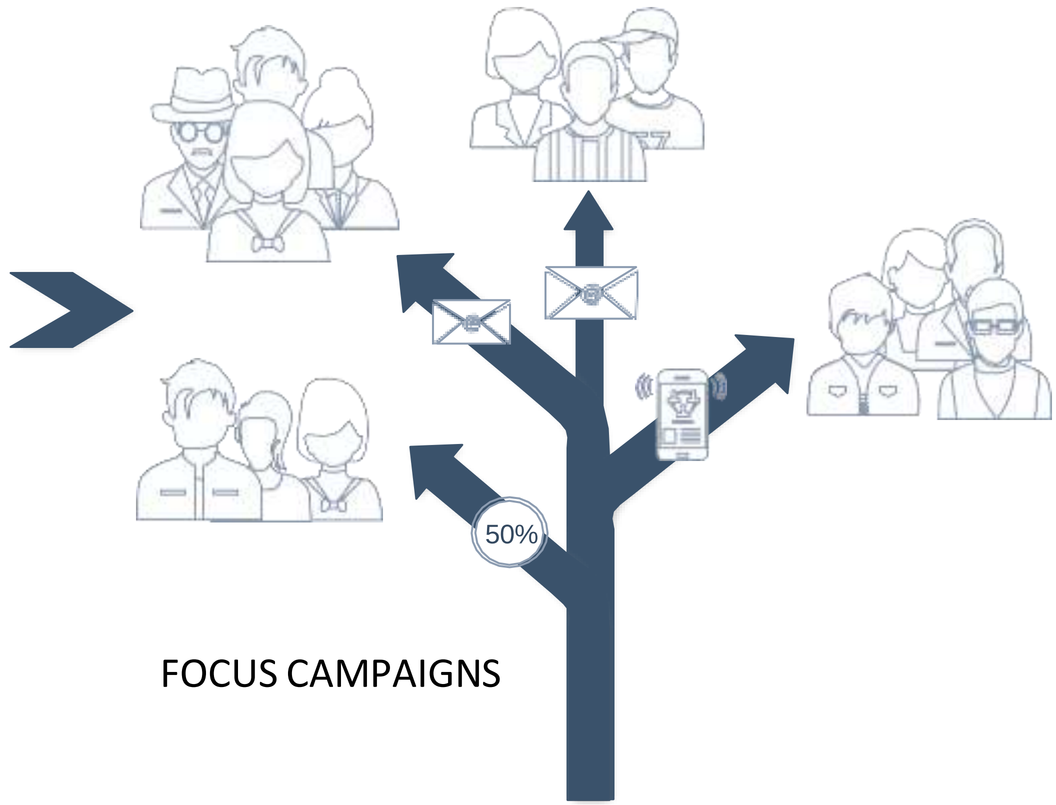
So, to the extent that all your customers are important, you need to initiate and continue the conversation. But not all customers are equally important so the trick is to be able to identify who your most important, most valuable or potentially valuable customers are and spend the majority of your marketing dollars conversing and converting with them while minimizing spend on your least valuable customers. And we are not saying you should ignore your least valuable customers. Every customer deserves some attention from you until its clear they are no longer a customer. Remember it's all about ROI. If you have a choice to spend a $1 on one customer returning $2 from the communication and another returning $4 - it's obvious which customer you should spend your money on. And it's important to also remember that for a different campaign at another time, the first customer above might return more from that campaign than the second customer. So it's all about being able to predict the campaign ROI for each customer or customer segment and knowing who to spend your money on and who not to. The majority of lost marketing profitability comes from spending budget on targeting customers who you can predict will respond poorly and not spending enough on customers who would have responded better.



FOCUS CAMPAIGNS ON SPECIFIC CUSTOMER SEGMENTS

A big mistake many marketers make is measuring campaign results overall instead of by specific identifiable segments. So while a particular campaign may
return say $2 for every $1 spent overall, if the results are broken down by segment you find that segment A returned $4 for every $1 and segment B actually lost $2 for each $1 spent. Clearly it would have been better to exclude segment B from this campaign. And thats the power of using customer behavioral data to predict response to future campaigns. You can identify those customers with the highest propensity to respond to your campaign with the desired behavior and target just them, leaving the other customers for a different campaign at a different time best suited to them.

ALL CUSTOMERS



FOCUS CAMPAIGNS

MEASURING AND MONITORING BEHAVIOR CHANGE IS IMPORTANT

At the time when customers are signaling a change in behavior via their customer data, they represent the highest potential ROI customers you have. And it doesn't matter if that behavior is signaling a positive move (relationship getting stronger) or a negative move (relationship weakening), both represent an opportunity to leverage your marketing dollars to achieve maximum impact.
Being able to identify a potential best customer or defecting customer and communicating with them to move their behavior in the direction you want is a much more profitable use of your marketing dollar than simply marketing to the "average" customer. You can identify these potential high ROI customers by monitoring their behavior and establishing triggers that alert you to important deviations from "normal" behavior and allow you to manually initiate campaigns or set up automated campaigns depending on the behavior change that tripped the trigger.

You want to focus your data driven marketing on customers whose relationship with you is trending up or down, not remaining static. This group potentially can represent 50% or more of your database. The question is how do you identify these customers and maximize your opportunity with them?

IDENTIFYING POSITIVE AND NEGATIVE CUSTOMER BEHAVIOR TRENDS

Recency, Frequency and Monetary (RFM) metrics presented in Enalito are the tools you use to identify changes in customer behavior and decide what reaction is required to respond to their change in behavior.

The key is to model normal customer behavior and then set triggers to alert you when a customer or segment of customers is departing from that normal behavior. You don't want to wait until a customer has defected and then try to win them back. Far better that you recognize the signs indicating a customer is moving towards defecting and intervene to prevent it. By analyzing the behavior of past defecting customers, you can detect a pattern in their behavior that you can use to identify potentially defecting customers and initiate communications to reverse their behavior. If you understand the Customer Lifecycle, you can predict the primary defection points and react to them before customers leave you. This is the highest ROI marketing you can possibly do; it's much cheaper than "win-back" (after the customer defects, response is much lower) and preserves the investment and profits you have in the customer already.

UNDERSTANDING
RELATIONSHIP FRICTION

UNDERSTANDING RELATIONSHIP FRICTION

Your customer base is your most important business asset. It, along with your other business assets (stock, staff, property, etc.) make up your portfolio of assets. Like all assets your customer base has a value and that value can change up or down, so it has both a current value and a future value. If your business is growing and making profits your customer base asset will be growing also and so its value in the future is likely to be higher than its current value. If your business is in decline the reverse is true - the future value of your customer base will be lower than its current value.

Actually, each customer has a current and a potential value. The current value is whatever the customer has created in value for the business as of today. Current value could be the cumulative profits for the customer since they became a customer, or the cumulative advertising value of all the visits made to a web site since the first one. Potential value is the future stream of profits expected from the customer as long as they continue to be a customer. If the customer terminates the business relationship, the potential value of the customer drops to near zero; this is the end of the customer Lifecycle, the defection by the customer.

Current Value and Potential Value is equal to the Lifetime Value of the customer; it's the Total Value contributed by the customer to your business. If customers in your customer portfolio have both current and potential value, then you can set up a 2 X 2 chart describing the value of your customer base in terms of current plus potential value (Lifetime Value), shown below.

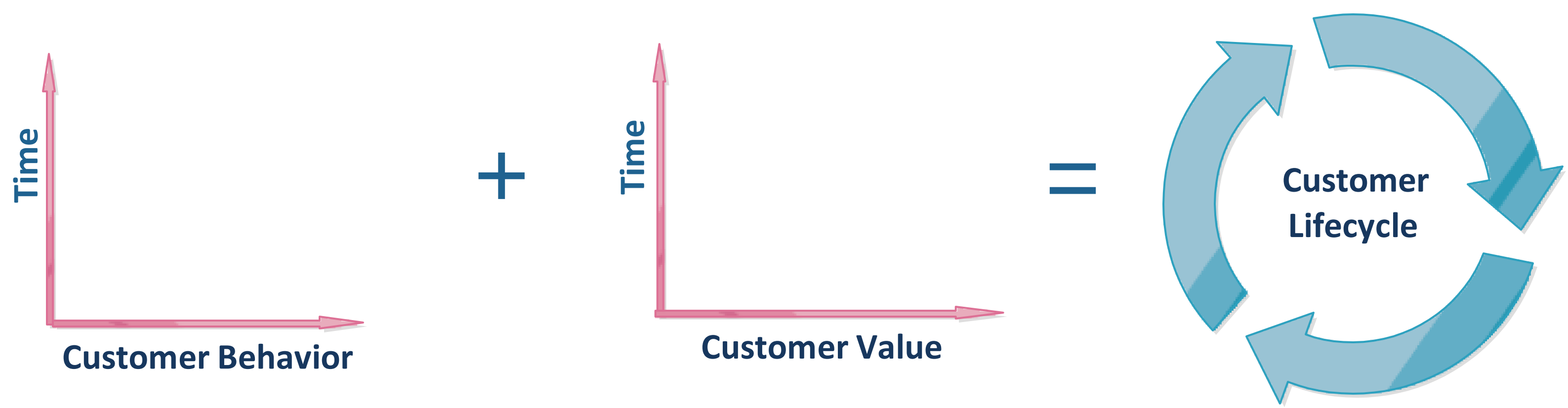
MEASURING AND MANAGING POTENTIAL VALUE

MEASURING AND MANAGING POTENTIAL VALUE

- But how do you measure potential value?
- What kind of behavior indicates the potential value of the customer?
- What metrics do we use to measure potential value and how do you use them?

Let's look at how to use potential value to grow your business and maximize your marketing ROI.

Remember, it's more important to know how a customer's potential value is changing over time. It can trend up or down. More importantly, a customer's behavior will change over time and often these behavioral changes precede a change in the value of that customer. That's why it's so important to track customer behavior. By tracking the customer behavior, you can forecast a change in value and create campaigns to pre-empt that change. These changes in customer behavior and value over time are called the Customer Lifecycle.



CUSTOMER ENGAGEMENT STRATEGY USING ENALITO

CUSTOMER ENGAGEMENT STRATEGY USING ENALITO

The vertical Current Value axis is Frequency of Purchase, with finer divisions for lower Purchase Frequency. The horizontal Potential Value / Engagement axis is made up of Days since Last Purchase (Recency) blocks of 30 days each out to 120-day Recency.

Current Value

	Days Since Last Action						
Frequency	181+ Days	121-180 Days	91-120 Days	61–90 Days	31–60 Days	≤ 30 Days	Totals
25 + Units	45	62	97	178	245	374	1001
10 – 24 Units	102	224	312	489	634	721	2482
4 – 9 Units	154	338	435	678	768	934	3307
3 Units	478	502	532	897	978	1217	4604
2 Units	1073	1156	1267	1543	1876	2389	9304
1 Unit	1578	1754	1971	2245	3543	4245	15336
Totals	3430	4036	4614	6030	8044	9880	36034
	Q1	Q2	Q3	Q4	New		

Potential Value

FOUR QUADRANTS

The four colors represent the Four Quadrants we must focus on:

•Q1 (Green) is our BEST CUSTOMERS quadrant – highest Current Value and highest Potential Value – they are best customers (Current Value) who are also the most engaged (Potential Value).

•Q2 (Yellow) are UP AND COMING CUSTOMERS with Low Current Value but are still Engaged and so have high Potential Value; the Blue square within the Yellow region contains brand new customers – a very Recent first purchase.

•Q3 (Orange) contains DEFECTING BEST CUSTOMERS.

•Q4 (Violet) contains the WORST CUSTOMERS – 1x or light buyers that never bought again. These are often the result of inappropriate or mis-targeted acquisition campaigns.

We need to devise a communications strategy for each quadrant.

Q1 CUSTOMERS love us and are ready buyers, with high likelihood to purchase again. We don't need to offer discounts to these customers. We must try to engage them across multiple product lines or invite them to participate in feedback surveys or other high engagement activities. At least we will know who we are talking to – as opposed to "random surveys" where we have absolutely no idea who we are getting feedback from.

The Q2 area (Yellow) contains up-and-coming best customers, brand new customers, and customers headed for Q4. We can tell which is which by looking at the chart – up and comers are top right of Q2, new customers bottom right of Q2, trending Worst Customers on the left side of Q2 on the border of Q4. Each of these sub segments of quadrant 2 need targeted communications and specific offers.

The **Q3** (Orange) quadrant contains our former best customers. This group requires special communications handling and depending on their Current Value, are worthy of further research. This is where a lot of our service problems, over-promising on Brand, and unfulfilled customer expectations lie. Since we know exactly who they are, we need to talk to them to identify the issues that are causing them to defect.

The **Q4** (Violet) quadrant needs to be closely examined and viewed by campaign source, product purchased, etc. Why are we creating these BAD customers? Are our offers too strong? Is our website or email campaigns creating negative experiences? Are we sourcing customers from the wrong channels?

If we can empathize with each customer based on their demonstrated behavior, we will be far more effective in our marketing. This is all about sending the "right message, to the right customer, at the right time".
Our response rate for a particular promotion to any one "cell" on our customer map is going to remain fairly consistent over time. This is because the population in that cell is replaced by customers with the same behavioral profile each month.

There is non-stop migration across the map from right to left through the columns each month. If a customer makes a purchase, they immediately move back to the right-most column and may move up a row. Then, customers start to move across to the left again each month. This pattern represents the Lifecycle of the customer.

Our job as marketers is to make sure customers don't move too far to the left, losing Potential Value as they move. We must try to re-engage them with each promotion and if they respond, the customer jumps back to the right and possibly up a row – increasing both their Current and Potential Value. The most profitable campaign for each customer is defined by which cell the customer resides in at the time the campaign is dropped. To maximize profits, the content offers for each customer would be defined by what cell the customer is in at the time the communication is sent.

The customers in any cell as a group generally respond at the same level for the same offer every time. So, once we figure out what the optimal campaign is for a cell, it doesn't really change much over time, unless we further sub-segment. As customers move through the cells, they are generally exposed to a lot of different campaigns (whatever is highest ROI for the cell) which maximizes the chance of response and reduces promotional burn-out.

With Enalito this campaign process is easily automated because the cells are well defined numerically – if customer has 3 purchases and no purchase in past 2 months, send "Campaign X", if customer has 3 purchases and no purchase in past 3 months send Campaign "Y", etc. This creates an automated stream of "right message, to the right customer, at the right time" communications that are tailored to the actual behavior of the customer.

So how do we act on this info? Let's say we have a group of customers who have just passed into Q3 from Q1 – these are best customers who are dis-Engaging. We know exactly who and how many there are – they are under the column "91 – 120 days" in the Orange Q3 Quadrant. There are 844 of them (97 + 312 + 435). What am we going to say to them, based on what we know of their value and current behavior? How much are we willing to invest to keep them Engaged? This is Driving More Sales.

To "drive more profits" we would create control groups and test our messaging to this segment as well as the one preceding it (10+ units, 60 – 91 Days) and the one after it (10+ Units, 121-150 Days) and find out where the highest ROI is. This type of behavioral targeting is the fundamental driving force behind the DISCOUNT LADDER profit optimization technique we will discuss and employ.

OTHER WAYS TO USE THIS QUADRANT SEGMENTATION:

1. When we initiate a large-scale acquisition campaign, we are going to see the blue square in Q2 “bulge” with all the new customers. Then, if we run this chart every month, we will see this bulge “pass through” the chart into the other quadrants. Will the bulge head up towards Q1, meaning the campaign is creating best customers? Will the bulge move to the left towards Q4, meaning you created a lot of Bad customers? Will the bulge “fork” and parts of it head to different Quadrants, depending on product of purchase or offer taken?

We can use this data to predict the long-term results of a campaign before it is over.

2. Let’s now take a look at how mapping the customer base using Current and Potential Value can help us in other ways.

Let’s say we have two product lines, wine and spirits. Further, let’s say our customer base is the one in the CV / PV model above.

All Customers

			Recency Days Since Last Action				
Frequency # of Actions	181+ Days	121-180 Days	91-120 Days	61–90 Days	31–60 Days	≤ 30 Days	Totals
25 + Units	45	62	97	178	245	374	1001
10 – 24 Units	102	224	312	489	634	721	2482
4 – 9 Units	154	338	435	678	768	934	3307
3 Units	478	502	532	897	978	1217	4604
2 Units	1073	1156	1267	1543	1876	2389	9304
1 Unit	1578	1754	1971	2245	3543	4245	15336
Totals	3430	4036	4614	6030	8044	9880	36034

OK, so let's take this customer base, and run our product affinity segmentation. Then we map each product segment by customer using the Current Value / Potential Value model, and this is what we get:

Wine Segment

	Days Since Last Action						
Frequency	181+ Days	121-180 Days	91-120 Days	61–90 Days	31–60 Days	≤ 30 Days	Totals
25 + Units	9	19	39	89	147	262	564
10 – 24	20	67	125	245	380	505	1342
4 – 9 Units	31	101	174	339	461	654	1760
3 Units	96	151	213	449	587	852	2346
2 Units	215	347	507	772	1126	1672	4638
1 Unit	316	526	788	1123	2126	2972	7850
Totals	686	1211	1846	3015	4826	6916	18500
	Q1	Q2	Q3	Q4	New		

Spirits Segment

	Days Since Last Action						
Frequency	181+ Days	121-180 Days	91-120 Days	61–90 Days	31–60 Days	≤ 30 Days	Totals
25 + Units	36	43	58	89	98	112	437
10 – 24	82	157	187	245	254	216	1140
4 – 9 Units	123	237	261	339	307	280	1547
3 Units	382	351	319	449	391	365	2258
2 Units	858	809	760	772	750	717	4666
1 Unit	1262	1228	1183	1123	1417	1274	7486
Totals	2744	2825	2768	3015	3218	2964	17534
	Q1	Q2	Q3	Q4	New		

Note the label on the first map is “wine” and on the second in “spirits”. What do these customer maps tell us?

Well, we have about the same number of customers in each segment – 18,500 in wine and 17,534 in spirits. Take a look at the totals along the bottom of the grid, representing the total number of customers in each Recency Engagement column. What do we see?

The wine segment has much higher Potential Value / Engagement than the spirit’s segment.

If we look at the 61 – 90-day column, we see both the wine and spirits segment have an equal number of customers. But the wine segment is clearly much more Engaged than the spirits segment, as evidenced by higher totals in the columns to the right of the 61–90-day column for wine than spirits. Conversely, in the columns to the left of the 61 – 90-day column, the totals for spirits are higher than wine – these customers are less Engaged.

In other words, even though the gross customer numbers in these segments are close, the composition of the segments is quite different. Wine has a higher number of very engaged best customers and potential up-and-comers (Q1 and Q2), where spirits have a higher number of dis-Engaged Best customers and bad customers (Q3 and Q4). Further, you can say with certainty that relative to the spirits segment, the average customer in the wine segment is going to create more value for the company in the Future.

This tells us something about the way we optimize marketing to each segment, and the way we should market within each segment, not to mention something about the products and / or service satisfaction in each segment.

Just by looking at these maps, we can tell:

1. The response rate for wine campaigns will be consistently higher, over and over, than the response rate to spirits campaigns – pretty much regardless of what kind of offer we make, as long as the offers are similar.

2. For the same dollar spent, the wine segment is driving our business, the spirit segment is dragging it down. We can either roll with that situation and reinforce it in our communications, or we can try to fix spirts. For example, when we choose to feature an item, all else equal, we should feature wine, because it has the longest customer legs and drives higher repeat purchase.

3. For the same dollar spent, we would focus more heavily on wine in new customer acquisition Campaigns because this segment generates better, higher value customers for the business.

We could do this same mapping using any customer segmentation scheme we think is meaningful and compare the value of the customer maps. Compare the results of Campaigns using these customer maps. Compare organic search versus paid search. Compare Geography. Compare average price points, order sizes, shipping choices, coupon usage, e-mail opens, whatever customer variable we want – and find out which variables drive the highest customer value.

Further, we can use this model across any kind of "action" we want to map – purchases, visits, downloads, blog posts, phone calls, whatever we want. We can use it to compare customer value across channels, and start building the knowledge we will need to optimize the business in an omni-channel world.

We now have a customer value model we can use to:

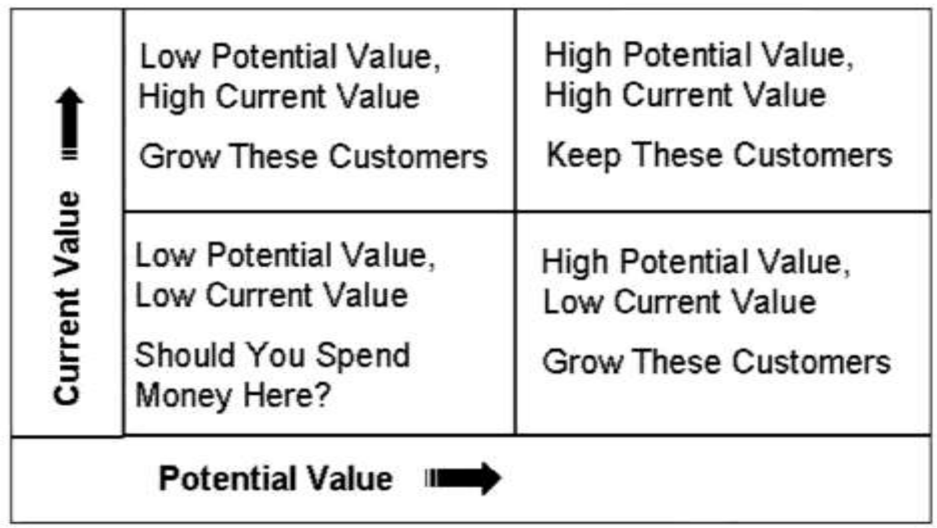
1. Objectively measure the value of content or products to a customer segment.
2. Predict the value of a customer segment to the company in the Future
3. Drive the allocation of content, design, or marketing spend towards highest ROI
4. Provide consistent, repeatable campaign targeting results, so we can actually predict response and ROI
5. Analyze any customer “action” variable, in any channel, across any segmentation scheme

Using this model will streamline our marketing decision making process, resulting in more accurate decisions being made, reduce campaign turn-around time, and result in higher profitability.

LIFETIME VALUE = CURRENT VALUE + POTENTIAL VALUE

One of the important things we do with Enalito is assist our customers to focus on measuring the Potential Value of a customer and changes in it. If we take care of Potential Value, Lifetime Value will take care of itself.

In Enalito we need to map the customer base into quadrants, and then recommend appropriate marketing actions based on which quadrant the customer resides in.



RECENCY IS HOW WE MEASURE ENGAGEMENT

We use RECENCY - the time since last event – to define “engagement”. The more Recently the activity (visited website, purchased, etc.) occurred, the more “engaged” the customer. (We use the Enalito recency score here)

And because more engaged customers have a higher Potential Value then we can use Recency as out Potential Value metric.

So, the more Recently a visitor has visited, the more Potential Value they have relative to another visitor. The more recently a customer has purchased the more Potential Value they have relative to another customer.

We can rank the Recency of any activity our customers engage in, online or offline. Visits, or purchases or downloads or telephone calls or emails to help desk, visits to shop. Whatever we choose as an indicator of value to can be measured as both Current Value and Potential Value to create the model and customer mapping.

ANALYSING THE QUADRANTS

Our customers with high Current Value and Low Potential Value are our Best Customers in the process of defecting. These need attention! They are becoming less likely to engage, they are losing Potential Value. They are moving from the “Keep these Customers” box to the “Spend Money Here” box.

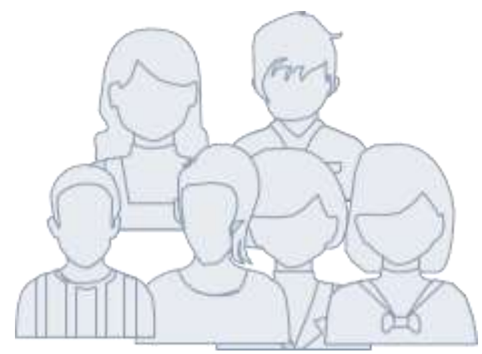
This highlights the fact that sales frequency (Current Value) by itself is not equal to engagement. A customer that has purchased 10 times and the last purchase was 5 years ago has much less Potential Value and is way less engaged than a customer who purchased 10 times and the last purchase was a month ago. Recency matters, it predicts Potential Value.

High Current Value

+

Low Potential Value

=



Best Customers

MAXIMUM ROI

WHAT DOES THIS MEAN FOR MAXIMISING ROI?

We need to:

1. Identify the most relevant value generating interactions with our customers; this allows us to map Current Value and Potential Value. Current Value is simply the Monetary Value or Frequency of these transactions to Date or in the past several years; Potential Value is the Recency of the last interaction.

2. Segment our messaging by Recency and measure performance; we are looking for the "sweet spot", the highest response or profit related to re-engagement. For example, we can segment our customers by number of weeks since last purchase, and then determine which of these segments generates the highest ROI or re-engagement relative to the cost of our campaign.

We will give each customer a quadrant tag between 1 and 4 so we know where they sit on the scale of current and future value.

Q1. High PV High CV. Our Best Customers. Retain.
Q2. High PV Low CV Our Future Best Customers. Grow.
Q3. Low PV High CV. Our Defecting Best Customers. Win Back.
Q4. Low PV Low CV. Our worst customers. Monitor.

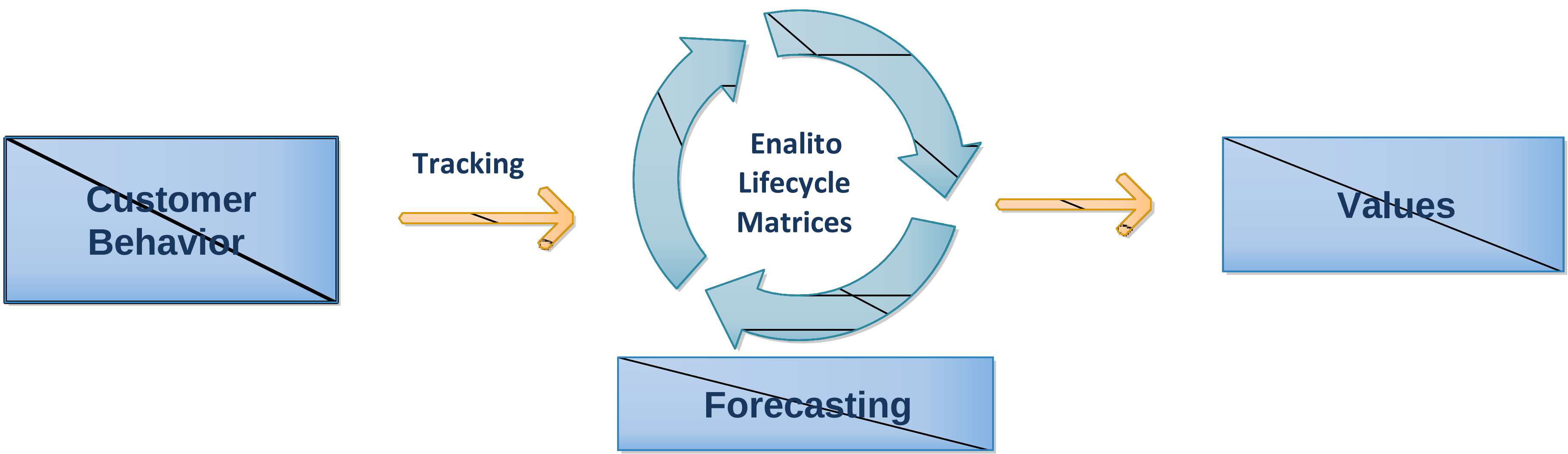
LIFECYCLE METRICS AND CUSTOMER FRICTION

LIFECYCLE METRICS AND CUSTOMER FRICTION

Lifecycle Metrics can be used to forecast future changes in value by tracking current behavior. They measure friction in the relationship with your customer.

The greater the friction in the relationship the less likely the customer will continue to do business with you. Reduce the friction and you increase the likelihood that the customer will continue to buy from you.

Friction is caused at the touch points of the customer with your business. They include things like the ease of use of your website, pricing policies, delivery experience, unboxing experience and after sales service and many more.



LIFECYCLE METRICS AND CUSTOMER FRICTION

Every bad experience increases friction and every good experience reduces it. If bad experiences outweigh good experiences with your brand and business then friction will increase until a point is reached where the customer will defect. The good news is that there are behaviors you can monitor and measure that will tell you if customer friction is increasing or decreasing and act accordingly.

And remember friction is directly related to customer value in that rising friction means reducing value and decreasing friction means increasing customer value. So, by measuring friction you are measuring value.

The Lifecycle Metrics we track for you in Enalito are measuring customer behaviors that signal increasing or decreasing friction and therefore are also measuring your customers Potential value to the business.

So clearly, it’s important for you to be able to measure and track rising friction so you can trigger communication campaigns to reduce that friction and increase customer value.

The Enalito Lifecycle Metrics will provide these measurements and tell you which customer segments or individuals need campaigns to reduce friction, when to trigger those campaigns and what the messaging should be.
And its not just existing customers who experience friction in their relationship with you. Potential customers (website visitors) do also. You can measure this potential customer friction by monitoring the visitor conversion rate of your website.
The structure, design and layout of your website will impact physical friction and the content will impact emotional friction. By continuing to improve and test your website layout you will reduce physical friction. Focusing on your content to match the needs of your visitors and customers will work towards reducing emotional friction. You can measure how well you are reducing visitor friction by monitoring the change in the visitor conversion rate of your website.

THE ENALITO LIFECYCLE
METRICS

THE ENALITO LIFECYCLE METRICS

The first two Lifecycle Metrics we focus on are Latency and Recency. These help us track potential value. We can use changes in potential value to trigger High ROI Customer Marketing campaigns or programs. We also look at the RFM model, which uses both Present and Future Customer Value metrics to trigger campaigns to drive higher ROI of your marketing budget.

LATENCY METRICS

Latency is simply the time between each customer event of interest. The obvious event for e-commerce stores is purchase so an important -commerce metric is the average time between customer purchases. We use these latency metrics to trigger certain campaigns. For example, if the average time between purchases of spirits on your website is 45 days, we can call this the Average Spirits Purchase Latency and use this average as a hurdle rate to trigger campaign messages. Every day past 45 days that a spirit buyer has not purchased, the less likely they are to purchase and the lower their future value.

You can also be more specific. Let's say the metrics indicate that the average time between the second and third wine purchase is 60 days. This is the "Third Purchase Latency" for the customer segment of Wine Buyers. Any customer who goes more than 60 days after their second purchase to make a third purchase is behaving differently to the "normal" behavior of wine buyers and is demonstrating increased friction. They are moving closer to defection each day that exceeds the norm.

The 60-day average time between second and third wine purchases becomes a trigger point for a specific communication campaign to alter the customer behavior in some way, ideally to make the third purchase. A key point here is that if you set up these trigger events you will spend more of your budget on campaigns necessary to reduce specific friction points with your customers and not waste that budget on customer who are behaving as you would expect or want - in this case wine purchasers who made their third purchase 60 days or less following their second purchase.

FINE TUNE LATENCY METRICS BY CUSTOMER SEGMENT

Different customer segments will have different Latency characteristics, and the more you fine-tune a Latency campaign, the more profitable it will become.

It’s important to create different latency metrics for each customer segment of importance to your business. You might measure second purchase latency for wine buyers separately from second purchase latency of spirit buyers and find the Latency is quite different for each specific segment. Whiskey buyer second purchase Latency might be quite different to Gin buyer second purchase Latency. This means you should have different campaigns for whiskey and gin buyers each triggered at a different number of days since the first purchase.

The more you refine these customer segments the more specific your campaign content and trigger times can be and the better your response rates.

This is simple, but effective Lifecycle based marketing. You are using your customers behavior to signal the best time to market to them. The trigger points you establish are based on expected behaviors of each customer segment of interest. If any particular customer falls outside the expected behavior targeted marketing campaigns relevant to that customer are triggered. Remember, it’s the customers behavior (actions or lack of actions) that signals they deserve your attention at that specific time. It’s an action - reaction mechanism. The customer takes or doesn't take an action you are monitoring and you react.

USING LATENCY METRICS TO MONITOR YOUR BUSINESS

By analyzing your customer base, you can come up with a series of Latencies that are important to monitor for your business. Time between first and second website visit, time between second and third purchase, time between contact with the help desk, time between returns, time between email opens, and so on. This whole collection of latencies helps you build a Latency model of your customers LifeCycle.

This Customer LifeCycle Latency Model allows you to predict customer behavior and therefore customer value. Once you know the predicted future value of specific customer segments you can direct your attention towards the highest value segments and away from the lowest value segments. The end result is higher ROI of every marketing dollar spent.

CUSTOMER LIFECYCLE AND CUSTOMER VALUE

CUSTOMER LIFECYCLE AND CUSTOMER VALUE

Every customer has a Life Cycle and a Lifetime Value. But you must understand your customers lifecycle and how to manage and leverage it before you worry about LTV.

Customer generally go through a LifeCycle starting from Prospect to First time Buyer to Repeat Customer to loyal Customer to Defecting Customer to Lost Customer to Recovered Customer and so the Cycle Repeats. Of course, not all customers will go through each stage of the Cycle. For example, many first Time Customers will never become a Repeat Customer - they go from First Time Buyer to Defected Customer. These are your one-off buyers and every business has plenty of them - up to 50% and more for some businesses. It's important to understand the LifeCycle of your customers and in particular the path to defection. Preventing Customer defection is an important goal of any marketing strategy. The overall goal of managing your customers lifecycle is to increase the value of that customer.

There are two ways you can do this:

1. Extend the life of the customer (LifeCycle). The longer the customer remains an active buyer the greater their value to you. The focus here is to increase the time it takes the customer to defect. Or put another way, we want to RETAIN the customer for longer. Loyalty programs are one of many tools available to extend the LifeCycle.

2. Increase the value of the customer within the existing LifeCycle. Here the time to customer defection is not reduced but the value of the customer during their lifecycle is increased.

TO HELP ACHIEVE THIS REMEMBER THESE TWO RULES TO HIGH ROI-MARKETING

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

So don’t spend money on customers who are behaving as you would expect them to (like an average customer). Rather focus your attention and marketing budget where you expect to get maximum impact. This is generally on those customers who have exceeded the threshold of your modeled “normal” behavior and are trending towards defection. Better to spend double the amount on influencing the behavior of potential defectors and none on customers who are behaving as you would expect than applying the same spend to all customers equally.

Let’s say you have a retention budget this month of $5000 to spread across 10,000 customers. Instead of spending 50 cents per customer and communicating with them all, identify say 2500 that are most likely to defect and spend $2 on each. This concentrates your budget where it will have the maximum impact and greatly improve your ROI.

HOW TO EXECUTE A LATENCY-BASED PROMOTION IN ENALITO

1. Time your promotion close to the trigger event

Let's say the average latency between 1st and second purchase is 90 days. As each customer rolls past 90 days without making a second purchase the likelihood of them doing so decreases each day. You would want to set the trigger point for a second purchase campaign somewhere between 90 and 120 days.

2. Create the offer

This can be whatever you think will work best for the particular segment you are targeting. It could be as simple as a discount offer or a gift with purchase offer. And remember not all customers need to receive the same offer. You may want to divide the segment into high value first time buyers past 90 days and low value first time buyers past 90 days. The former sub group are potentially more valuable to you so you could offer them a greater incentive to make their second purchase. Remember - spend where you are likely to get the maximum impact.

3. Create your control and active lists

Select all your 90 day / no 2nd purchase customers, and then randomly select 10% of them. These will not be contacted and will act as your control group. If you created two sub-groups of "high" and "low" value then create a control list for each sub group.

4. Define and set up report to measure success

In this example, revenue per customer for each group would be appropriate. To do this take the total revenue from each group and divide by the number of customers in each group for both control and test groups.

5. Deliver your promotion to the test group

6. Monitor the spend

Out of both test and control groups each week and compare the revenue per customer for each group. If the campaign is having a positive impact you would expect to see a higher revenue per customer from the test group.

7. Calculate ROI

We want to compare the revenue per customer from both the test and control groups after costs of the promotion are deducted from the test group. We are looking for a significant difference in net revenue per customer between the groups. Let's say the test group returned a gross margin of $1000 and the control group retuned a gross margin of $600. If the promotion cost $100 then the test group retuned $300 more revenue after costs than the control group. The ROI for the promotion is therefore 300% ($100/$300)

This type of promotion will help reduce defection by focusing on those customers the data tells you are most likely to defect. You are effectively retaining more customers and the profits from those customers. The results of the example promotion show the promotion has successfully kept customers from defecting. The promotion added value to the Customer LifeCycle rather than extending it.

THE HALO EFFECT

THE HALO EFFECT

However, if we were to continue to track the purchase activity of both groups for another 90 days past the end of the promotion chances are the data will show us something very interesting. A greater percentage of customers in the test group went on to make a further purchase than did those in the control group. Put another way, there were more defections in the control group than in the test group. This indicates that as well as adding value to the Customer LifeCycle, the promotion also extended the LifeCycle of the test group.

This is called a Halo Effect. The promotion stimulated purchases even after the promotion was over. Some of your customers may have thought about participating in the promotion but wait too long and missed it. But the promotion has increased their awareness of your company and as a result, they are now more likely to make a purchase from you given any positive stimulus to do so. The promotion has created a situation where customers became more likely to purchase from you in the future.

RECENCY METRICS

RECENCY METRICS

Simply put, the recency rule states that a customer who has transacted with you Recently is more likely to transact with you again relative to a customer who has not transacted with you in some time
So, by ranking your customers by their Recency (number of days or weeks since the last transaction) you effectively are ranking your customers by their likelihood to transact with you in the future. It's a simple but powerful concept. Those in the top 20% of the Recency ranking are far more likely to transact with you than those in the bottom 20% of the Recency ranking.

So, if recent customers are more likely to transact than non-recent customers, we can also predict that:

1. The more recent the customer the more likely they are to respond to promotions. This is common sense in that a customer who is more likely to
transact is more likely to respond when receiving a promotion from you. They are predisposed to purchase.

2. The more recent the customer the higher their potential value to you. A customer who is more likely to transact and respond to promotion is going to make more transactions than the customer less likely to transact. More potential transactions from a customer means they have a higher potential value to the company.

So, for whatever action you are measuring (website visits, sign ups, purchases) the number of days since a customer completed that action (the Recency metric) is the most powerful predictor of the customer repeating this action. The more days that pass since completing that action the less likely the customer will repeat it.

Recency is the number one most powerful predictor of future behavior

RELATIONSHIP BETWEEN LATENCY AND RECENCY

RELATIONSHIP BETWEEN LATENCY AND RECENCY

By combining latency and recency metrics you can learn whether customer friction is increasing or decreasing.
Say the average latency of a customer segment is 30 days. This means that on average this segment purchases every 30 days. If the average recency of that same customer segment however is 45 days the data is telling you that customer friction is increasing in this segment. The latency metric tells you to expect a purchase every 30 days but the recency metric indicates this segment has not purchased for 45 days. - 15 days later than expected. Something is causing friction with this segment and you'd better find out what it is before customers start defecting.

Had the recency metric indicated this group last purchased on average 20 days ago, then they are purchasing 10 days sooner than expected which tells you friction with this segment is reducing a sure indication that your promotions to this group are having a positive impact. They are buying sooner than expected and so you are moving their behavior in the direction intended - towards more frequent purchases.

This comparison between latency and recency metrics is a powerful tool to determine where to spend your marketing budget. Say you have two previous email campaigns each with the same conversion rate to purchase, you can compare the difference between latency and recency metrics for each campaign to see which campaign reduced friction more.

So, bear in mind that while Latency metrics can tell you when something good or bad has already occurred, Recency metrics are much better at predicting the likelihood of future events. Whatever activity you are measuring customers who are more recent for that activity are more valuable than customers who are less recent on it. Customers who last visited your website 10 days ago are more likely to visit again and are therefore more valuable than customers who visited 60 days ago. Customers who purchased 30 days ago have a higher potential value than customers who purchased 90 days ago. Simple, eh?

USING RECENCY - EXAMPLE

Let’s use Recency to compare the potential value of customers coming from two different ad words ads that ran at the same time and for the same duration with the goal of stimulating a purchase.

1. Identify the groups you want to compare for potential value. In this example, it's the customers who clicked on either of two ads, Ad #1 or Ad #2 (two groups).

2. Decide which activity is most important to you for these groups. In this example, we are interested in purchases.

3. Separate the purchase records including date and amount of purchase of people who clicked on Ad #1 or Ad #2 into separate segments.

4. Pick a time frame to look at Recency. The exact length is not critical, because we are interested in comparing the two groups. We will use 30 days for this purchase activity.

5. Sort the purchase records for Ad #1 from most Recent to least Recent and find out what percentage of the people who clicked on Ad #1 and made a
purchase have made at least one more purchase in the past 30 days. Let’s say it is 20%.

6. Run the same analysis for people who clicked on Ad #2 and made a purchase. Let's say only 15% of these people have made at least one purchase in the past 30 days.

7. The results show that a higher percentage of people who clicked on Ad #1 are Recent - active and purchasing - when compared with Ad #2. This means Ad #1 generates customers with higher potential value. You need to take this into account when analyzing the success of the ads.

This is a powerful concept to understand. You could for example, do the same analysis above but this time by customers grouped by product they bought first. This will tell you which products generate new customers with highest potential value.

Or run the analysis on customers segmented by which area of the website they visit most, and you will find which areas generate highest potential value customers.

Run the analysis on customers segmented by their demographics and you can determine which demographics define customers with the highest potential value.

All you have to do is segment your customers and compare their Recency. The group with the highest percentage engaging in the activity you are measuring over some time period is the group with the highest future value to the company.

The most Recent customers for any particular activity are always the ones most likely to repeat that activity, and so have a higher potential value.

You can track multiple activities for the same segments. In the example above we compared the purchase activity of two customer segments based on which of two ads they clicked on. We could also have compared their frequency of visits to the website or any other activity of interest to us.

Measuring the actual behavior of your customers is the most accurate way of identifying their future value to your business. Enalito will help you organize all your marketing activities around the potential value of the customers they generate. It will help you spend your precious marketing dollars on campaigns generating high value customers and away from campaigns generating low potential value customers.

LIFETIME VALUE

The LifeTime Value of a customer is the net profit the customer generates over their LifeCycle. Calculating the LifeTime Value of a customer can be a difficult task, but luckily Enalito can do this for you.

As a marketer, you use LifeTime Value to make decisions about allocating more resources to campaigns that generate high potential value customers. It stands to reason therefore that you need to be able to predict the relative LifeTime value of the customers generated by each proposed campaign activity.

By analyzing the recency data on ads, PPC keywords, newsletter links, and so on, you should be able to compare the relative potential value of the customers generated by each approach and easily decide where your ad budget is most profitably spent.

Let's say you have run 20 campaigns and you know your cost per new customer from each of them. You want to run the top 10 (lowest cost per new customer) but you only have the money for 5 campaigns. With Recency and LifeCycle tracking on the 10 campaigns, all you have to do is choose the top 5 campaigns generating customers with the highest potential value based on Recency. If you allocate your budget to those and away from the bottom five, you are maximizing your budget ROI, regardless of the actual LifeTime Value in dollars of the customers generated.

Length of LifeCycle is important information to have when determining the true value of a campaign. For example, let’s say campaign 1 generated new customers with a cost per new customer of $10 and campaign 2 generated customers with a cost per customer of $15. Campaign 1 clearly has a lower customer acquisition cost and so we may decide it’s the better of the two campaigns and indeed may have a better short-term ROI. But if Campaign 2 generates customers with a longer customer LifeCycle it may produce a better ROI in the longer term. That’s why it’simportant to know and track the Lifecycles of your customer segments.

LifeTime Value is hard if not impossible to determine without knowing what constitutes a LifeTime. Is it 1, 2 or 5 years?

If we track the relative lifecycles of different customer segments however we don't need to know absolute LTV in dollars. Instead, we simply focus our attention and resources on those segments that have Longer LifeCycles (higher potential value) and away from segments with shorter LifeCycles (lower potential value). This is how we maximize our marketing ROI.

USING RECENCY METRICS TO INCREASE PROFITABILITY

USING RECENCY METRICS TO INCREASE PROFITABILITY

Return on Investment has to be measured over time. If you run a campaign today the return on investment depends on what time frame you measure the return over. A campaign run today may return $100 profit after 1 week but $500 profit after one month so the return in investment depends over what time frame you measure that return.

This is why it's important to track the LifeCycle of various campaigns. If we compare two ad campaigns 30 days after the end of the campaign, we might find that Ad 1 returned the greater number of purchases and revenue and so determine that ad 1 was the better ad. However, if we continue measuring the additional purchases generated by each ad group at say 60, 90, 120 and 180 days after the promotion ended, we may discover that now Ad 2 has generated the greater number of purchases and revenue. So, once we consider the LifeTime, we now find that ad 2 rather than ad 1 generated the highest value customers to the business.

So clearly estimated ROI by measuring conversion to first purchase is not as robust as adding LifeCycleto the equation and getting a truer estimate of LifeTime value.

RECENCY IN PROMOTIONS

RECENCY IN PROMOTIONS

Its normal to see response rates to any promotion decline over time. That is to say as Recency increases (the number of days since last response) response rate decreases. This decline is predictable and can be graphed.

- **Customer inactive for 31-60 days Response rate = 20%**
- **Customer inactive for 61-90 days, Response rate = 10%**
- **Customer inactive for 91-120 days, Response rate = 4%**
- **Customer inactive for 120+ days, Response rate = 1%**

The relative response rates will follow a decelerating curve as shown above, that is, the less Recent the customer, the more dramatic a drop-in response rate you will get to your request for an action.

In terms of using this information for promotions, you will find some point along the curve where you will hit "breakeven," meaning the cost of the campaign will equal the profits or benefit generated. For example, let's say you offer a discount, gift, or other incentive in your retention / lapsed customer campaign and need a response rate of at least 4% to pay back the campaign cost. This is your breakeven point.

The implication for this 4% breakeven campaign contained in the Recency information above is this: don't bother to promote to any customer who hasn't engaged in the activity you are trying to encourage for over 3 months, because you're wasting your money. Response will be too low to pay back the cost of the campaign with any customer who has been inactive for over 3 months.

This Recency effect is very stable over time, allowing you to predict in advance what response to a campaign will be, once you do an "establishing" campaign to see what your response rate is for any particular offer. Recency will predict average response rate for any specific combination of offer and media used.

You can save a tremendous amount of money by forecasting your response by using Recency, and not promoting to customers unlikely to be profitable.

PERFORM A RECENCY TEST

1. Classify customers in 30-day Recency segments by the last date of purchase, for example:

- **31 – 60 days ago**
- **61 – 90 days ago**
- **91 – 120 days ago**
- **120+ days ago**

2. Take a 10% random sample of customers from each segment (every 10th person in the segment), and send all of them a promotion with the same offer, say 20% off any purchase in the next 30 days. Look at the response rate by these 30-day segments. You will find response falls off significantly as you look at Recency segments further back in time.

If you repeat the test using the same offer to a different sample of each 30-day segment, the response rate by segment will be very close to the response rate by segment in the first test. This kind of stability allows accurate predictions of marketing ROI before promotions are even sent out to customers.

The response rate in any one of the 30-day segments above will be influenced by the value of your offer, and both response rate and cost of the offer have significant impact on the profitability of your campaign to any segment. As offer value increases, so does response rate, and so do costs. Ideally, you want to find the ideal mix of response rate and offer value creating the highest profitability for each segment you promote to.

USING A DISCOUNT LADDER TO INCREASE CAMPAIGN ROI

USING A DISCOUNT LADDER TO INCREASE CAMPAIGN ROI

You can use Recency to "ladder" the promotional discount, gift, or incentive value offered in a promotion, boosting overall response while cutting expenses by minimizing discount or other incentive costs.

Let's use purchases as an example, and say you usually e-mail all your customers a 10% discount when you do a promotion. If you were using a Recency ladder approach for this purchase incentive, you might apply your discount strategy this way:

Customer inactive for 31-60 days, Response rate = 20%, discount = 5%
Customer inactive for 61-90 days, Response rate = 10%, discount = 10%
Customer inactive for 91-120 days, Response rate = 4%, discount = 15%
Customer inactive for 120+ days, Response rate = 1%, discount = 20%

Using this approach, you are allocating the most "bang for the buck" discount wise where you need it most - the least Recent, lowest response customers, and pulling back on some discounting where you don't need it as much - the most Recent, highest response customers.

Since your most Recent customers are most likely to respond, you can back off on their discount and you reduce the cost of giving discounts to customers who “may have bought anyway without a discount.” You then reallocate this discount money to where it is needed most – boosting the response rates of those much less likely to respond - the less Recent customers.

Your response rates will vary depending on the offer, media used, and your business. You have to test these ladders with different combinations of offer and media to find the optimum profitability for each Recency segment.

The interesting and quite useful benefit of this approach is the "automatic" overall customer retention effect discount ladders have.
Using a ladder of this type means your promotional discount budget is automatically working harder and harder to keep a customer active with you as they drift further and further away from you. The less Recent a customer is, the less likely they are to buy or visit again, and by using a discount ladder you are counteracting the customer LifeCycle (the tendency of customers to leave you over time) with stronger discounts as the defecting customer behavior plays out. If a most Recent customer does not respond to the 5% offer, as they get less Recent, they automatically get offers rising in value, and at some point, many will take advantage of an offer. The customers who run through this system without taking any offers were likely lost to you as a customer already, and not worth the extra expense to try and keep promoting to them.

SETUP A DISCOUNT LADDER
TEST IN ENALITO

SETUP A DISCOUNT LADDER TEST IN ENALITO

Pick any one of the segments from your Recency test above and now test discount level for the segment. Let's say you used a 20% discount in the first test. Pick a segment (say 91 – 120 days), and create a 20% random sample of the segment (every 5th customer) divided into 4 equal test groups. Send each test group a different discount - say 5%, 10%, 15% and 20%. Look at your response rates and calculate the profitability for the 91 – 120-day segment at each discount level. You will find your result looks similar to the following:

Customer Sample	1000	1000	1000	1000
Discount Offer	5%	10%	15%	20%
Response Rate	2%	4%	6%	8%
Responders	20	40	60	80
Average Price	$80	$80	$80	$80
Totals Sales	$1600	$3200	$4800	$6400
Gross Margin	30%	30%	30%	30%
Gross Profit	$480	$960	$14,40	$19,20
Discount Cost	$80	$320	$720	$12,80
NP before Expense	$400	$640	$720	$640

As you can see, the most profitable offer to the 91 – 120-day Recency segment is 15% off. If you offer 20%, you get a higher response rate but lower profits; any offer under 15% significantly diminishes response rate. Repeat this test for each Recency segment, and you will find the most profitable discount rising as the customer becomes less Recent, creating your discount “ladder.”

When you implement your promotions based on a Recency / Discount ladder, as customers become less Recent and therefore less likely to respond to a promotion, they will be automatically offered a higher discount – one that maximizes profit for each Recency segment the customer passes through. Discount ladders create in effect a "lights-out" customer retention program suitable for automation.

There is a subtle but important side benefit to using a Recency / Discount ladder approach to manage e-mail efforts. Instead of blasting out indiscriminate offers to the whole customer base, taking a ladder approach more closely matches the offer value to the "attitude" or point in the LifeCycle a customer has reached. Following the mantra of Permission Marketing, this is called being "relevant,” and will tend to increase open rate and response as customers begin to put a higher value on your e-mail relative to another offer, they may get.

In addition, as e-mail clutter and execution expense increase, response will fall and profits will decrease, as customers get tired of receiving multiple promotions. Over time, you will find it is simply more profitable to e-mail customers less often, because you know for a fact the most profitable offer to make and when to make it, based on the Recency / Discount Ladder. Using this approach will generally help you rise above the clutter by sending fewer, higher impact promotions. The Recency / Discount ladder approach to creating a customer retention program is clean, simple, and easy to implement. And if you don't have any formal customer retention program in place, much better than what you're using now!

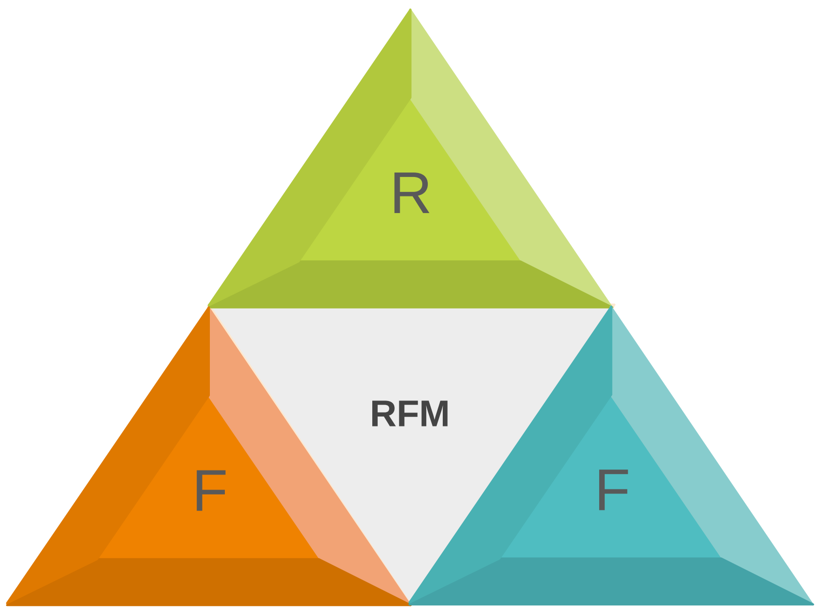
RFM MARKETING

RFM MARKETING

RFM stands for Recency Frequency and Monetary and is an extension of the Latency and Recency models we have just talked about.

Customers who purchased RECENTLY are more likely to buy again versus customers who have not purchased in a while.
Customers who purchased FREQUENTLY were more likely to buy again versus customers who had made just one or two purchases
Customers who spent the MOST MONEY in total were more likely to buy again. The most valuable customers tended to continue to become even more valuable.

Mail order catalogue companies discovered that by promoting offers to the highest scoring customers on all 3 parameters produced significantly higher response rates and sales than those customers scoring low on RFM. It's one of the most basic of all the behavioral models ever developed, and yet one of the most powerful. The more Recently someone has engaged in an activity, the more likely they are to do it again. The more Frequently someone has engaged in an activity, the more likely they are to do it again. And the more Monetary Value someone has created by purchasing, the more likely they are to continue to purchase. These concepts are central to high ROI Data-Driven marketing.



RFM AS A PREDICTOR OF CUSTOMER LIFETIME VALUE

RFM AS A PREDICTOR OF CUSTOMER LIFETIME VALUE

Remember the portfolio approach for managing customers we looked at earlier?

[The Customer Value Portfolio quadrant goes here]

When we were looking at Latency or Recency (or both), we were looking exclusively at the Potential Value part of the equation. When you add Frequency and Monetary, you are now also addressing the Current Value part of the equation. RFM integrates both the Current Value and Potential Value concepts into a single, standardized method of ranking the value of customers to the business – now, and in the future. For this reason, the RFM model can be used as a predictor of the LifeTime Value of the customer.

RFM works everywhere, in virtually every business. And it works for just about any kind of "action-oriented" behavior you are trying to get a customer to repeat or not repeat, whether it's purchases, visits, sign-ups, surveys, games, calls to a service center, complaint management, error detection – just about anything where a human decision has to be made and an action (or non-action) taken.

HURDLE RATES

HURDLE RATES

Just as Latency and Recency can be used to evaluate a single customer or segments of customers, so can RFM. One application of RFM is Hurdle Rate Analysis, where “hurdles” are selected for R, F, and M, and the entire customer base is evaluated against these hurdles as a group. A Hurdle Rate is simply the percentage of your customers who have at least a certain activity level for R, F, and M. It's the percentage of customers who have visited since a certain date, have bought or visited a certain number of times, or have purchased a certain amount. Understanding this Hurdle Rate application will help you understand the overall concept of RFM.

Let's say you know some things about your good customers from looking at their sales records. From comparing a few good customers, you see the following patterns in behavior:

Good customers who haven't visited or purchased in the past 30 days seem to start slipping away. They tend to stop buying or visiting. You decide to use 30 days as the Recency Hurdle.

Good customers have purchased 10 times; you decide to use 10 orders as the Frequency Hurdle. Good customers have spent around $500; you decide to use $500 as the Monetary Value Hurdle.

You then check to see what percentage of the customer base is “over the Hurdle” for each of the variable’s R, F, and M. What percent have purchased or visited in the last 30 days? What percent have purchased over 10 times or visited over 10 times? What percent have spent over $500 in total?

Once you establish these baseline Hurdle Rates (% of customers over the Hurdle) you simply re-check the customer base each week or month, and determine the percentage over each Hurdle. Over 8 weeks a healthy business would look like the following:

RFM IN ACTION: INDIVIDUAL CUSTOMER SCORES

RFM IN ACTION: INDIVIDUAL CUSTOMER SCORES

How is RFM scoring at the individual customer level implemented? Customers are scored, they receive a ranking based on each of the attributes of RFM. Simplistically, you need a customer's last purchase or visit date (Recency), total units of activity (orders or visits) you want to measure, (Frequency), and the total dollars sold to them (Monetary Value). Let's just call them R, F, and M. R = Recency, F = Frequency, M= Monetary Value.

You then sort customers from highest to lowest on each of R, F, and M, then assign a numeric rank to them. These rankings are combined in some way to produce an overall "score" for the customer.

Let's say you have 100 customers. For R, you would sort all your customers by last purchase (visit) date, most recent to least recent in descending order; then you would label the top customer "100," the next customer "99," the next customer "98," and so on to the bottom customer labeled "1."

For F, you would sort all your customers by total instances of action (visits, orders, downloads, log-ins), most frequent to least frequent in descending order; then you would label the top customer "100," the next customer "99," the next customer "98," and so on to the bottom customer labeled "1."

For M, you would sort all your customers by total dollars spent, highest to lowest; then you would label the top customer "100," the next customer "99," the next customer "98," and so on to the bottom customer labeled "1."

Using this rather tedious process, (but don't worry because Enalito will do this for you automatically) each customer ends up with 3 numbers identifying how they ranked compared to all the other customers on R, F, and M. The customer with a rank of 100 in Recency (the most recent buyer), 100 in Frequency (the most actions taken), and 100in Monetary Value (the most dollars bought) would be your best customer.

This customer would have a score of 100-100-100. A 50-50-50 customer is the "average" customer in terms of R, F, and M out of these 100 customers.

If you don't have an "M" (Monetary Value) for your customer action because you're not a commerce site or are focused on service issues, don't worry; you can use just R and F very effectively by themselves. The important thing for you to understand at this point is how customer RFM scores are created — it's a ranking of each customer on R, F, and M compared to all your other customers. These separate rankings are then combined to produce an overall RFM score for each customer in the database.

Once scored, it's easy to look at the customer base (and your business) in terms of the scores. These scores, or changes in scores, become the trigger points for your highest ROI marketing activities. High scoring customers tend to repeat the action being profiled; low scoring customers tend not to. A customer with a rising score is (usually) becoming a better customer and you want to encourage them, let them. A customer with a falling score is beginning to lose interest, and if it's a valuable customer, you should hit them hard with a marketing or service program before they stop purchasing / visiting.

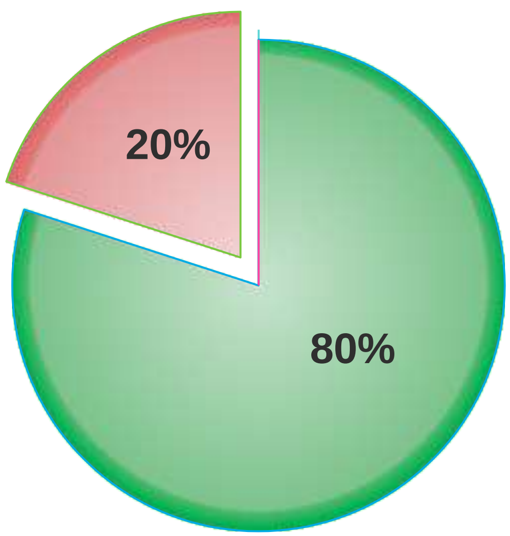
THE PARETO PRINCIPLE

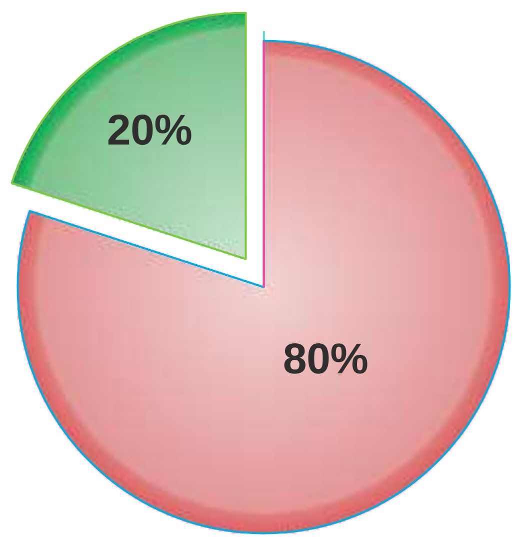
THE PARETO PRINCIPLE

Have you heard of the 80 / 20 rule? In many businesses, 20% of the customers generate 80% of the sales or service activity. Well, guess what? The 20% of your customers that represent 80% of your sales or activity are likely among the most recent (R), most frequent (F), and highest Monetary Value (M) customers you have. If you can identify your high RFM customers, you will know who is most likely to respond to your request for an action, to order, visit, or sign-up for something at the site.

But here's the big secret and where much of the money is made: Think about a high RFM customer who all of a sudden stop buying or visiting. This customer's R (Recency) would begin to drop, relative to other customers who continued to buy or visit. These customers are getting ready to defect (or already have). So RFM can be used not only to target customers most likely to repeat, but also, and more importantly, to target people likely to stop an activity completely.

This means RFM scores can be used to assess the potential value of your business. The best 20% of your customers all have high RFM scores, and your weakest customers have low RFM scores. Just looking at the scores, and how the scores change over time, can tell you whether your business is moving in a positive or negative direction.





HURDLE RATES, RFM SCORES, & LIFETIME VALUE

HURDLE RATES, RFM SCORES, & LIFETIME VALUE

Why are Hurdle Rates and RFM scores important? Because RFM is closely LifeTime Value (LTV). LTV is the expected net profit a customer will contribute to your business as long as the customer remains a customer – the sum of Current and Potential Value.

If a customer has a high RFM score, they are already a “best customer” and are likely to continue contributing to your revenues and / or visits; they're a satisfied customer, and visit and/or purchase often. For this reason, consistently high RFM score customers will tend to have high LifeTime Values; consistently low RFM score customers will tend to have low LTV.

RFM techniques can be used as a proxy for the future profitability of your business. If the percentage of customers as a group over the RFM hurdles is shrinking, the current and potential value of your sales and visits is shrinking.

If the percentage of customers over the RFM Hurdles as a group is rising, the current and potential value of your sales and / or visits is growing.
If a customer with a high RFM score begins to drop in score, the potential value of their sales and / or visits is shrinking.
If a customer with a low RFM score begins to rise in score, the potential value is of their sales and/ or / visits is growing as well.

This makes sense because high RFM score customers are already valuable, are most likely to continue to purchase and visit, AND they are most likely to respond to your marketing or service promotions; these customers likely have the highest LifeTime Value. The opposite is true for low RFM score customers; they currently have low value, are the least likely to purchase or visit again, AND the least likely to respond to marketing promotions, so these customers tend to have low LifeTime Values (LTV).

High scores represent future business potential, because the customers are willing and interested in doing business with you, and have high LTV. Low scores represent dwindling business opportunity, low LTV, and are a flag something needs to be done with those customers to increase their value.

And let's not forget customer Friction. As with the Recency metric, falling RFM scores indicate rising friction, and rising RFM scores indicate falling friction. What is the implication when you see a high RFM score customer drop in score like a stone? Rising Friction, and a red flag for defection. It's a trigger for taking action with a customer retention program, you are about to lose a best customer. What is the implication when you see a low RFM score customer rise in score like a rocket? Falling Friction, and a green flag for “future best customer.” It's a trigger for taking action with value creation and enhancement programs like up-sell / cross-sell, VIP Service, and introduction into a higher loyalty program “tier.”

It is possible that a high RFM score customer will not have high LTV. RFM is all about activity and the revenue implications of that activity, whereas LifeTime Value goes a step further and nets out all the costs of the revenue generating activity. If the cost to acquire and maintain a customer is higher than the revenue generated, the customer has a negative LTV. Examples of these types of customers would include customers with a high return rate, customers who were very costly to acquire, and customers who are “high maintenance” and require a lot of after-the-sale service and hand-holding.

SUMMARY

SUMMARY

RFM (Recency, Frequency, Monetary Value) is a customer scoring model used to assign a score to each customer representing his or her current value and likelihood to continue any particular type of behavior (potential value) – orders, visits, etc. – compared to all your other customers. The higher the RFM score, the more likely it is the customer will repeat a behavior and respond to promotions or encouragement to continue the behavior. RFM is about “top line” activity and doesn't take into account any costs of doing business, like how much it cost to acquire the customer.
LTV (LifeTime Value) is the sum of current and potential net value of a customer to your business, and takes into account both revenue and expense considerations. High RFM customers tend to have high LTVs, but this is not always true; it depends on the cost of selling to the customer and maintaining the customer relationship.

The ideal customer is one who has a high RFM score (current and potential value are high) and has a high LTV (expenses to acquire and service the customer are average or lower than average). These customers are already “best customers,” have a high propensity for revenue generating activity in the future, and are inexpensive to acquire and maintain.

Because of the link between a high RFM score and high LTV for a customer, Hurdle Rate percentages on a group of customers, or RFM scores on individual customers, can be used as a measure of the future profitability of a business.
When the percentage of customers over the Hurdle for R, F, and M is increasing, future revenues will also increase, and marketing or service programs will have higher response rates. When it's dropping, future business will decrease, and response rates to marketing or service programs will be lower.

In some service programs, the relationship of RFM score to LTV could be reversed, and high RFM scores will mean low LTV (e.g., Help Desk calls). For example, if you are scoring trouble call activity, high scoring customers may be both already costly to the company (low current value) and highly likely to repeat expensive service requests (low potential value). These customers could end up with very low LifeTime Values. As with the other earlier service examples, the interpretation of when “high score” = “good” depends on the activity being scored; if you are scoring activity that is costly to the company, “high score” probably equals “bad,” as in the customer is already very costly and likely to get even more costly.