Using Customer Profitability in Targeted Marketing Campaigns in Communications Industries

An Oracle Business Intelligence White Paper

ORACLE

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THE ADVANTAGE OF CUSTOMER PROFITABILITY

Customer segment and individual customer profitability analysis provide communications companies with the decision power needed for targeted customer acquisition and retention programs. Customer profitability is a very fundamental decision strategy that few firms have performed well, but should.

The challenge has been the mountain of data from myriad sources, complex calculation rules and logic, and clear understanding of the methods. Those issues are addressed in this paper along with a discussion of tools and tactics that can be employed to harness the power of the cost and customer behavioral information scattered across a communications enterprise.

INTRODUCTION

The ability to understand and utilize customer profitability enables a host of management decisions and provides a basis for confidence in those decisions. The ability to take action on customer focused initiatives in marketing, selling, support and pricing provide the core value proposition for a large scale customer profitability solution. Understanding product purchase and usage across the customer base is not enough to measure impacts to business profitability. What is needed is to calculate the value contribution of these customers when shared infrastructure and assets are used to provide different types of products or services.

Customer profitability is certainly an attribute that you cannot get from a customer survey. In most cases, customers will have no idea how profitable they are to you, and would certainly use it against the firm if they knew. This suggests the value proposition of cross-referencing customer survey data with customer profitability segmentation. Ideally, the customer segments have their own specific survey responses, so that behavior of the customer is assigned directly to the cost-to-serve from the point of view of a particular company. Once market forecasts and propensity to buy (future revenue prediction) is linked to cost-to-serve at the segment level, detailed forecasts of customer segment profitability are achievable, which deliver the ROI decisions for future product and marketing initiatives.

What is unique to communications services is the large and intermingled infrastructure of technology, networks, customer support, IT and administrative

support that are applied to a changing base of products and services. Because these service assets are highly shared, there is a tendency to ignore the differences in usage across the customer base. Additionally, there is little or no marginal product cost and most costs appear to be 'fixed'. This results in accounting distortions that lead to inaccurate decisions, political jockeying to control cost allocations, and inaccurate strategies for maximizing future profitability. These two central issues are discussed below.

Additionally, the growing installed base of *operational* CRM (Customer Relationship Management) software provides the ability to utilize customer profitability results when receiving individual service calls; whether they are for trouble-shooting, new service requests, or billing inquiries. Customer Profitability knowledge increases the ability of frontline staff and management teams to put into action the primary goal of the firm: maximize profitability. Individual frontline customer-facing decisions can now be aligned throughout the company influencing a gamut of daily operational behaviors that distinguish the value of customers, and give the ability to link customer care actions to increased future profitability.

This is resource allocation at its finest granularity. For example: which customers receive waiting queue priority? Which customers are offered which premium messaging, data or voice services? Which customers have the shortest wait for new DSL provisioning installations? Because all customer service has cost and all customer waiting time has loyalty risks, this prioritization is an important way to make tradeoffs across customers and segments. It provides fine-tuning that will influence customer loyalty, retention, acquisition, customer profitability, and thus firm profitability.

A granular understanding of customer profitability enables resource allocation, priority servicing or response, and specific promotional offers that mobilize this new 'asset' of customer profitability knowledge. It allows these decisions to be decentralized as required by the firm's policy. This 'pushdown' of responsibility provides a powerful way to maximize profitability at every *frontline* decision. By recognizing the unprofitable customers or segments and scripting options for product offers, and terms and conditions, companies can take specific steps to reduce the percentage of unprofitable customers.

In banking, it is widely believed that 80-90% of the customers are unprofitable, and the remaining minority are very profitable but barely cover the cost of all the unprofitable customers. Since this type of analysis is so new to communications firms, there are no rules of thumb on these percentages for this industry. This also means that leaders in this industry can innovate in their usage of this solution for competitive advantage.

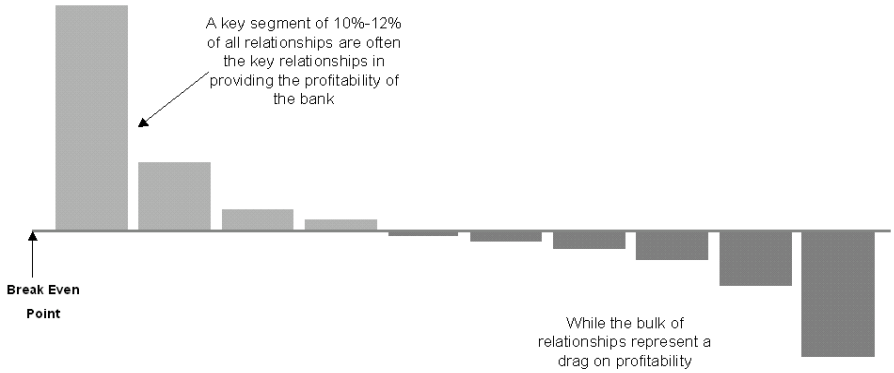


Figure 1. Typical profitability distribution of customers in retail financial services. Each of the ten blocks represents a decile of customers (10% of the total number of customers) and shows profit contribution for each decile. The amount of profit or loss is illustrated (here showing visually about zero profit overall). This information is a compilation of the analysis of millions of banking relationships worldwide

These profitability measures when combined with proven customer retention strategies will allow communications firms to improve profitability by focusing retention tactics on their most profitable consumer and business customers. As an example, within long distance carriers an annual customer churn rate of 25% or more is the typical experience with consumer households. An unfocused CRM strategy without the benefit of precise customer profitability data would result in retention strategies being identical for both profitable, marginally profitable, and unprofitable customers. Conversely, armed with profitability data a communications firm can reduce program costs and boost profits by focusing retention only on those households or relationships revealed to be the most profitable for the firm. Further CRM tactics such as predictive defection modeling, closed-loop testing, and targeted acquisition efforts will further enhance the bottom line and are discussed later in this whitepaper.

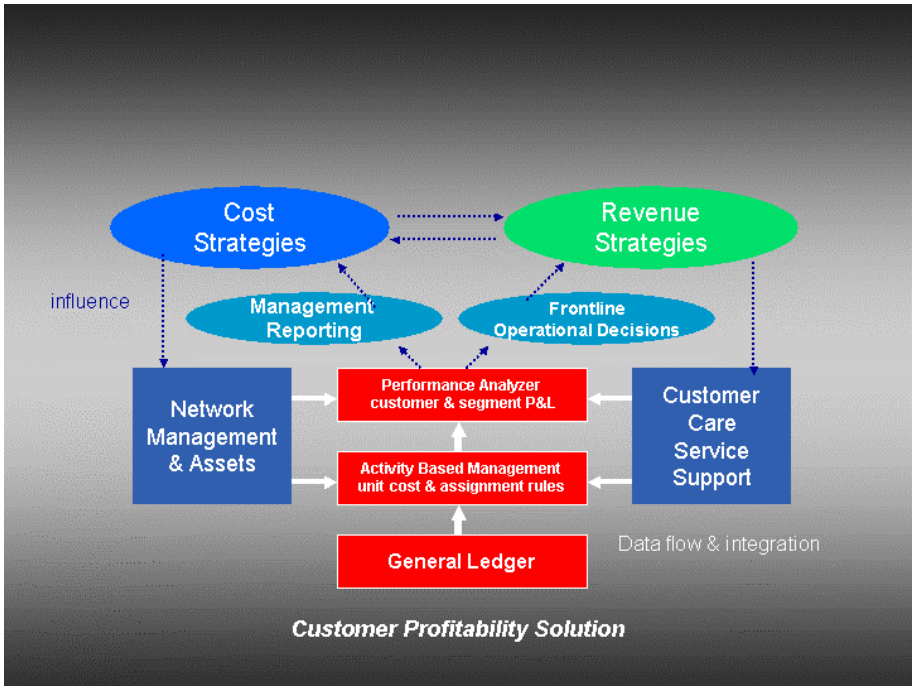


Figure 2. The decision environment for using Customer Profitability.

ORACLE'S CUSTOMER PROFITABILITY SOLUTION

Oracle's Customer Profitability solution provides the scalability, reporting flexibility and integration necessary to model customer costs at any level of segmentation or aggregation. The Oracle General Ledger chart of accounts segment structure can be used (optionally) to directly populate an Activity Based Management (ABM) model. Multiple activity or business-process hierarchies can be used to provide alternative rollups of costs as categorized into departmental or cross-functional processes, such as: distribution, training, support, network management, installation, repair, customer-facing, or customer-serving. Finally, these activity costs are integrated into Performance Analyzer, which provides large-scale, multidimensional customer profitability reporting and drill down (Figure 2).

Different sets of cost assignment rules allow quick creation of alternative scenarios of cost assignments from expense accounts to activities or other departments. For example specific expense accounts such as: equipment, leased-line, repair, maintenance or outside contractor costs can be optionally enabled or disabled and recalculations can occur instantly. Furthermore, the customer-identified revenues and fees (recurring or non-recurring) can be matched to costing information, bridging the crucial gap between the dimensionality of revenue (defined often by order management, invoicing or billing systems) and dimensionality of costing systems. By building models which use the appropriate cost drivers (volume of calls, orders, etc) we can measure cost in terms of the events that *cause* cost. This barrier prevented detailed customer profitability models in the past. What services the firm bills customers for and what capital equipment and activities create operating costs are entirely different in Communications firms.

Oracle's solution allows the aggregation of individual customer behavior upwards to ensure accurate accounting through multiple layers of rollups. Additionally, top-down distributions can be made to bring business process costs out to the correct customers or segments. The combination of top-down and bottom-up control allow any costing policy to be implemented and combined with revenues to form profit and loss statements at the individual customer level that rollup consistently to higher levels of business analysis.

To close the loop using analysis to support marketing campaign focus, Oracle Marketing Online adheres to the Oracle's Trading Community Architecture (TCA). Oracle has the ability to push customer profitability information for marketing campaign management. TCA is defined as one single uniform common dimension for every member of the user's trading community: for customers, employees, suppliers, and business partners. TCA enables several Oracle applications to share a common definition of these trading community members and avoid systems integration problems of connecting various applications that would otherwise have distinct customer tables.

In the Oracle architecture, when the user of any application performs an action that does a database update, the update is made to the relevant table or tables in the central database; the updated information is then available at once to any other application that may need it and which share the common dimensions. In short, TCA enables a single version of the truth throughout the operational and analytic applications from Oracle.

Some of the key features of the Oracle Customer Profitability solution are:

1. It will handle all company data from all sources, with no proprietary file formats
2. A simple integrated data model based on Oracle Relational Database
3. Web-based deployment
4. User-defined dimensions, named sets of mapping rules, named sets of activity rates (unit costs)
5. Fast server-based calculations for millions of customer-account combinations and hundreds of thousands of mapping rules, accounts and activities. No performance impact on application usage experience.
6. Ability to chain separate allocations and calculations together in groups
7. Integrated with Oracle GL; and also Discoverer and WebDiscoverer which allows wide deployments based on web portals of selected reports
8. Effective-range dating on all structures: account hierarchies, activity hierarchies, bills of materials and activities, Mapping rules.

9. Ability to copy and delete data sets, no need to copy or delete entire models that would destroy referential integrity. Alternatively, you can accumulate all data sets in one place, with no need to trim the database.
10. Ability to evolve models over time with a complete audit trail to past data and past calculations, even though re-organizations and rule changes occur.
11. Visual trace-back shows all source costs for any number displayed
12. Most flexible mapping rule control available, instant copy of sets of rules, on/off switches for individual or groups of mapping rules.

The Customer Profitability reporting structure allows drill-down, slice-and-dice dimensional pivoting all based on the standard Oracle Discoverer tool. Oracle Portal, part of Oracle9iAS allows customized configuration of HTML based portals to hold multiple reports or graphs for individual needs and provides the ability centralize them for deployment throughout an organization. These same tools are the basis for all Oracle Business Intelligence applications and can be used as a standard set of tools for any other legacy RDBMS reporting needs. The Customer Profitability solution allows monthly reporting on tens of millions of individual customers that hold multiple products, accounts or services rolling up to geographic regions, demographic groups, or other forms of market segmentation, through line of business up to corporate.

Furthermore, Customer Profitability is an important part of the Oracle Analytical Relationship Management (ARM) solution that provides integration into Oracle Marketing Online for complete closed-loop campaign execution management and measurement across multiple channels. This is described in a separate paper, 'Oracle Marketing, Marketing with Insight'.

MANAGEMENT REPORTING GOES BEYOND GAAP ACCOUNTING

Changes in communication, production and distribution technology over the last several years make historical GAAP accounting insufficient for decision support in the new economy. The purpose of GAAP is report accurate company results to outside stakeholders, not to support internal resource allocation or optimization decisions for maximizing profitability. Management accounting systems were created during the industrial revolution and were developed in the early 20th century to account for the railways, manufactured goods, retailing and machine tools.

The change in methodology is simple but far reaching

To determine customer profitability companies would normally look to their existing costing systems. These systems, which are based on the standard accounting rules, will only look at profits, usually dimensioned by product only, for the current year. Traditional accounting systems do not focus on the potential profits or losses attached to individuals, customer segments or the range of

products and services they utilize. Cost assignment is focused on cost centers or departments with the addition of profit and loss reports that eventually roll up to the firm's overall profit and loss statement. This type of accounting system is not focused on customers or firm performance but on cost allocation.

GAAP notion of fair allocation destroys decision power

A lot has changed since the time of introduction of GAAP accounting rules. For example "fair allocation of overheads to products" assumes that there are a small number of similar product types, and that differences are not important. Fair in this sense means "even or average" and a lot of companies assume that is valid. In addition to the proliferation of products and services, automation technology and communication networks, from a customer-value standpoint, companies support the goals of individuality, not commonality now. Mass Customization and One-to-one marketing are popular management trends that focus on customer differences, not the averages. Standard costing destroys differences by spreading overhead and infrastructure cost evenly across products and by then treating customers as interchangeable in their consumption of products. This destroys decision power that is available to improve business results and achieve goals. Properly executed upon, knowledge of customer differences can lead you into differentiation of your product or service.

Difference between product and service cost

In Communications, the product is really a "service" in that each instance has variations in paths and therefore differences in cost. In the simple case of a cell phone call, it has a sender, receiver, and a path through the network, possibly access fees, and total number of minutes. Contrast this to a widget like a manufactured cell phone. In costing applications, each separate cell phone manufactured at the same location or plant should have the same cost (barring changes over time).

Difference between traditional and ABC methods

In traditional (standard) accounting, overhead costs are evenly spread over the range of products, services or transactions. This made sense historically with manufactured widgets since the majority of the cost was in the parts and the direct labor to make the widget. This was the birth of cost accounting.

Now, infrastructure is global, networks and technology are ubiquitous. A large centralized organization supports this network and technology through which many types of transactions and communications and entertainment content flows. If the analysis ignores the correct costing of the shared infrastructure than we destroy the decision power that comes from marketing segmentation. Pricing, contract terms, cross-selling, up-selling and loyalty programs depend on a complete understanding of the customers and segments. But if the company ignores cost-to-serve of customers, then how should they enable this decision power? How do they compete more aggressively? How do they grow more profitable? Utilizing Oracle Customer Profitability, any firm can now fully assign SG&A costs appropriately

into customer and segment costs. Furthermore, because this solution uses cost drivers throughout, the unit costs provide the basis for economic decisions on capacity, cost, and budgeting. This goes beyond both GAAP reporting and traditional cost methodology.

Gross margin excludes customer Cost-to-Serve information

Most companies still use today's antiquated accounting principles, and thus they don't know which customers generate profits and which do not. These companies only understand gross margin. Activity-based costing provides part of the solution that goes beyond gross margin and penetrates the real economics of all aspects of cost and profitability, including that of serving customers. Customers use differing resources, and this usage provides clues as to their current value to the company, their future value, and their propensity to buy other products and services.

Marginal cost thinking

Many people believe that as long as the revenue of an incremental sale exceeds the marginal cost, it makes a contribution to fixed cost and overheads. This is only true if fixed costs are *really* fixed, but many people know that they are not: it's just a convenient label. In fact, a good activity-based costing model will illuminate which costs you thought were fixed, and are not. Using Oracle ABM, arbitrary user-defined attribute values for example: Fixed/Variable Accounts, Core/Non-Core activities, etc, can be added to all models simultaneously, before, during or after model construction.

With standard costing, incremental sales volume yields favorable overhead recoveries and positive variances. Ideally, the cost application allows the firm to tailor the cost analysis to the question, being able to move from standard to marginal to average cost decisions -- as well as select in or out the appropriate accounts or cost codes that flow costs into activities. Oracle ABM allows this using separate data sets and distinct version options for model structure.

'Fixed' costs are misleading in Customer Profitability results

The term 'fixed' implies that these costs are not variable, relative to changes in short-term sales volumes. However, they do go up when the business is growing. In service organizations (especially communications and banking) where there is no direct product cost as such, people discuss fixed cost and overhead as though these service businesses were involved some kind of factory operation. One reason for this rationale is the need for financially-oriented accountants to try to 'correctly' match revenue with costs and to apply a GAAP principle of "fair allocation of costs to products." This principle is often misunderstood, because it is driven primarily by the need to "close the books." Its value in providing actionable management business decision ability is suspect for the reasons described above.

In the past, people have tended to ignore the actual composition of 'fixed cost'. If asked, they would say that fixed cost refers to rent and depreciation. However, as much as 70 percent of 'fixed cost' is related to human activities. Accounts consist of salaries, benefits, and facilities in which to house the people and the supplies to keep them going. To refer to the cost of people as being fixed is misleading. Without seeing the set of costed activities and their performance (unit cost) it is unclear what the firm has accomplished; and how much of that was wasted. Efficiency and capacity are now part of the decision process using Customer Profitability because volume information is linked to the activity costs and is usually updated monthly in conjunction with cost updates.

Centralizing distinct data sources

Oracle provides the Customer Profitability Solution enabling all costs to be assigned to customers and reporting to occur on multidimensional models of customers, channels, markets, products and regions.

Because we incorporate statistical cost drivers, the Customer Profitability Solution can reveal profitability along many dimensions such as divisional, segment, relationship manager, line of business, customer, channel and product. To achieve this, a communications firm could work towards establishing profitability by simply collecting the relevant data for a profitability model. Some of the historical challenges are based on the size and scale of applications and databases, which is technology and cost dependent and have changed markedly throughout the 1990s:

- Data warehouses were constructed in the past to provide customer analysis and profitability calculations, but the complexity of mapping rules, issues of versioning, range-dating and hierarchy changes for accuracy brought disappointing ends to large expensive data warehouse projects before the hopes and dreams were met. Oracle Customer Profitability is a well-defined data model with pre-defined calculations and reports. It has no requirement for extensions but does enable user-defined dimensionality.

Oracle is the only solution that leverages a multi-org GL, multiple currencies, and is available in 12 different languages. Calculations of millions of customers can occur monthly, weekly or nightly

- Different company departments have historically owned parts of the data comprising a 360 degree view customer, and hence coordinated efforts at a holistic view were hampered by difficulties and organizational goals being unaligned and shear effort at conceiving and building a single data model to bring it all together.

FIRST CONCLUSION

Customer Profitability provides a recognized strategic advantage using distinct data sources and an activity-based costing capability to create the most critical dimension to customer segmentation: "are they generating or draining profits?" Today, a single vendor, Oracle Corporation, provides this integrated solution. The Customer Profitability solution makes use of integrated Activity-Based Costing (ABC) to surpass the limitations of standard costing and GAAP reporting.

DEFINING CUSTOMER LIFETIME VALUE AND USING IT

Lots of companies want to have the lifetime value of customers as a starting point for customer retention and loyalty analysis programs. In order to get there, companies first need to understand customer profitability over time, and be able to recalculate that monthly or at least quarterly. Clearly customer profitability must be defined with revenues by customer, subtracting total cost per customer. But in service industries, in order to understand how profitable customers are, management must first make the hard decisions about cost assignment. But the customers do not *consume* product cost directly; they utilize activities and services of the company. Until these activities are costed and assigned by driver volumes to the various customers and segments, there is no real way to get customer profitability. Many companies today make simplifying assumptions to make progress on understanding customer profitability. But firms should be cautious about taking shortcuts, either you have accurate customer costing based on activity

consumption; or you don't. The problem to date is four fold:

a) The use of the methodology was unclear and did not fit with the tools
b) Data sources were scattered
c) Amount of labor to integrate and map the costs and cost drivers was prohibitive, especially for services businesses
d) No application could handle that size of problem with 20+ million customers with changing monthly usage.

The Oracle Customer Profitability solution provides the scalable enterprise application to solve all these issues. In conjunction with Oracle Alliance Partners or Oracle Consulting, the firm's model and methodology can be represented in the solution. The recent requirement to provide Customer Lifetime Value (CLV) can only work in the context of a real understanding of existing customer profitability across the range of products and services in the customer portfolio. Customers can now be treated in different ways relating to their different past, current and potential value to the firm. A book entitled 'Advances in Relationship Marketing' suggests:

> "…Companies should segment their market by level of profitability and identify which groups of customers the company wishes to retain and which are likely to provide the most profitable returns. This will help identify the type and frequency of the marketing activity which should be directed towards the different segments" (authors: Moira Clark and Adrian Payne).

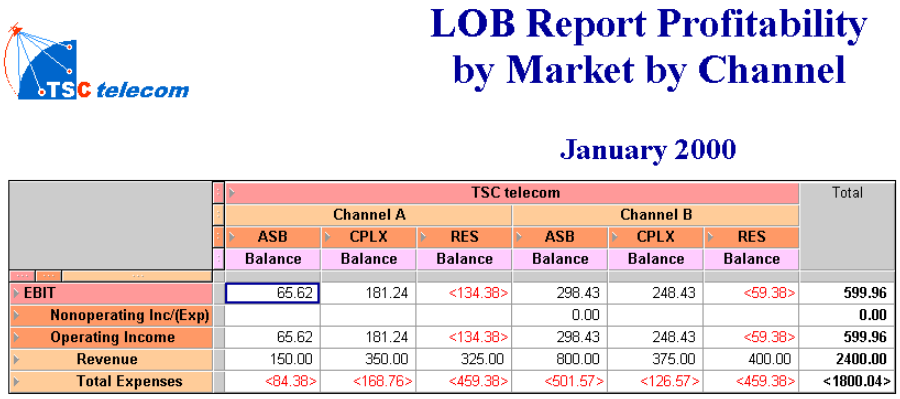
LOB Customer Segment w Channel View
Profitability by Customer Segment and Channel
January 2000

	Orphan	TSC telecom								Total
		ASB				CPLX		RES		
		Channel A	Channel B	PCS Radio Shack	Support	Channel A	Channel B	Channel A	Channel B	
		Balance	Balance	Balance	Balance	Balance	Balance	Balance	Balance	
EBIT		27,160	<39,414>	49,220	<13>	0	0	0	0	67,899
Nonoperating Inc/(Exp)			<3,000>							<3,000
Operating Income		27,160	<36,414>	49,220	<13>	0	0	0	0	70,898
Revenue		27,160	<5,250>	49,220	<13>	0	0	0	0	136,345
Total Expenses		0	<31,164>			0	0	0	0	<65,444
Total Expenses		0	<31,164>			0	0	0	0	<65,444
Customer Service		0	<12,600>			0	0	0	0	<26,460
Customer Setup			<18,564>							<38,984

Figure 3: Oracle Discoverer report showing customer-facing activities in Channel B, as part of Total Expenses.

By understanding profitability at a customer level, a communications company can deduce important information: fees charged, devices installed, support costs, acquisition and retention costs, channel preferences, and call patterns. By having access to the key profit drivers, the firm can then create clearly targeted strategies to reduce operating costs in service and support and increase revenue opportunities using the new understanding of customer profitability at the point of service contact. Oracle customer profitability supports CLV as part of a complete understanding of customers' value to the firm. Furthermore, Trading Community Architecture (TCA) from Oracle enables the results of customer profitability to be utilized in other Oracle e-Business Suite applications, making the knowledge

actionable.



	TSC telecom						Total
	Channel A			Channel B			
	ASB	CPLX	RES	ASB	CPLX	RES	
	Balance	Balance	Balance	Balance	Balance	Balance	
EBIT	65.62	181.24	<134.38>	298.43	248.43	<59.38>	**599.96**
Nonoperating Inc/(Exp)				0.00			**0.00**
Operating Income	65.62	181.24	<134.38>	298.43	248.43	<59.38>	**599.96**
Revenue	150.00	350.00	325.00	800.00	375.00	400.00	**2400.00**
Total Expenses	<84.38>	<168.76>	<459.38>	<501.57>	<126.57>	<459.38>	**<1800.04>**

Figure 4: Oracle Discoverer report showing EBIT calculation results drill-down structure across customer segments (ASB, CPLX, RES) and distribution channels A and B.

Service businesses have different cost models than manufacturers

In service businesses, it is quite typical to allocate all operating costs to lines of business, such as loan or insurance policy types, or residential telephone service. These categories are often perceived to be products.

The cost structure of telephone and communications companies is strongly influenced by the physical network architecture of the business. Telephone company employees often refer to their services as products, for example "data" or "long distance." As with the insurance organizations, these "products" are intangible and are, therefore, usually described incorrectly. However, most telephone company accountants routinely prepare "product profitability" reports that include massive allocations of shared network and cost center costs. These reports depict a fictional representation of the economic structure of the business, and contribute to a poor understanding of the dynamics of the profitability of the organization.

Even in a telecommunications company, a significant proportion of cost pertains to large numbers of people employed, in addition to the cost of operating the network. Activities are performed by people to sell services, process new service provisioning, process billings, as well as plan, configure and maintain the network. The network system itself consists of hardware and software that perform activities. A key dimension on activity costs is human activities versus system activities, because of the long-term productivity changes that it makes visible from automation using capital equipment and self-service using software for process improvement.

Overall, the distribution of resource cost in a telephone company is heavily skewed towards product-sustaining, business-sustaining and customer-serving activities, rather than performing the service directly (which is automated). Of particular importance is the cost of providing service to remote customers in comparison to serving customers in densely populated geographic areas. Downtown-city and business district areas are often much more profitable than rural areas because the cost per dollar of revenue to serve low-revenue customers in a rural area is much

higher. By allocating all costs to products, the accountants are misrepresenting the economic structure of the business and, probably, severely impairing decision making. In telephone companies, profitability of customers varies by geographic area and population density. Cost impacts from weather deterioration, hills, pole types -- will influence crews and costs are tracked in a good activity-based cost model. Government regulation forces the large incumbent firms to use average pricing, and allows the new competitors to come into low cost areas, which are usually the high density areas. Effective competitive response in these low cost areas to respond to changing prices with a complete understanding of activity-based costs to avoid creating unprofitable segments.

Differences between segments drive different strategies

Service organizations perform a significantly higher proportion of customer-serving activities than do manufacturers of automotive parts, for example. This fact has potentially significant strategic consequences for the organization. For example, in a company that has a high proportion of customer costs previously allocated to products, management is informed that low-volume products are relatively more profitable than high-volume. It will also think that the biggest influence on the size of a customer's gross-margin contribution is primarily price. With ABC, management will discover that products may have significant cost differences but that there are three influences on customer profitability -- sales volume, price, and the amount of customer-serving activities used. In most service firms, a relatively few number of customers produce high levels of profits which subsidize losses on many small or demanding customers.

Specific actions that firms can now take with confidence

Firms can make what they consider to be a very conservative "what-if" analysis, illustrating the bottom-line impact of shifting some small customers or segments into a new distribution channel, and refocusing sales efforts on higher revenue generators, using monthly data trend reports available over the web. First the company would substantially reduce cost-impact of the number of its lowest-profitability customers by transitioning them into a cheaper distribution channel. The reduction in revenue from those direct customers would likely be offset by an increase in sales revenue from distributors who can then bring in additional customers at the same time.

The company pays a fee to the distributors that result in slightly lower gross margins. However, eliminating the low revenue and high cost-to-serve customers from the direct channel frees up resources to serve larger customers perhaps corporate accounts or business accounts. Another increase in revenue would be achieved by re-deploying marketing and sales resources previously focused on small-usage customers. Part of this comes from matching customer profitability to propensity to buy models for add-on services, such as DSL, cable modem, and pay per view TV.

The combination of information on existing profitable households served can have a very powerful impact on the bottom line when combined with targeted new customer and cross-sell efforts by following a simple series of steps to use the power of data already stored across the enterprise. First, all available data on product usage, customer tenure, customer buying sequence and demographic information on your most profitable customers is analyzed by a data mining engine such as Oracle 9i data mining. Next, Data mining provides valuable insight by

providing a statistical description of these valuable customers that can be used to mine a list of prospect customers for ones who share attributes with your existing profitable customers. Then third-party lists can then be culled for only your most desirable prospects, allowing you to eschew marketing efforts on ones that would hold a high propensity to prove unprofitable. The net result is that your marketing, sales and cross-sell efforts yield a higher concentration of profitable customers versus an untargeted mixture of profitable and unprofitable ones. Closed-loop marketing tools such as Oracle Marketing Online allow you to execute and manage these on-going direct sales efforts and measure and report on the results.

Meanwhile the average cost-to-serve for all customers would be reduced by some percentage. In industries selling a technical or customized product to numerous customers where capacity and sales force are at least somewhat constrained, there is usually a major opportunity to rationalize customers and customer-related activities and customer profitability is the natural starting point for that analysis.

- Ranking customers segments and Individuals with 'value indicators'
- Control & decide quality of service
- Encourage profitable loyalty by promotions and specials
- Discourage unprofitable loyalty by pricing and terms
- Create targeted programs and service responses by segment

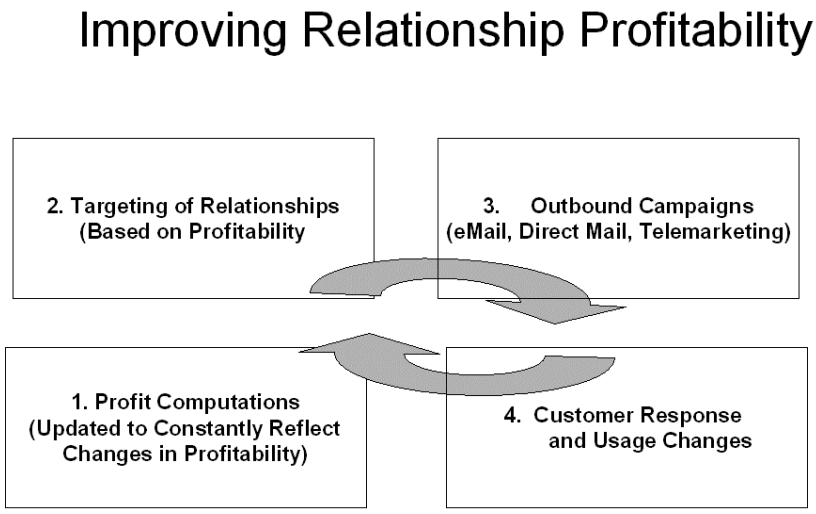


Figure 5. Influences of analysis results and operational uses of Customer Profitability information to add focus and power to future customer and market development activities.

Marketing Lift definition

Marketing lift is generally described as the additional response rate or performance of a marketing campaign (email, telemarketing or direct mail) generated by using targeting or data mining tactics versus untargeted efforts at a randomly drawn

audience. For example, if a direct mailing to owners of two or more telephone lines in a home generated a 1.7% response rate for a DSL offer and one using a response model for the same offer generated a response rate of 2.5% the modeling would be said to have attributed to a 0.8% lift, or a nearly 50% increase in the performance of the marketing effort.

Telecom Profit Lift Chart		
Example if No Retention Program in Place Today		
Total Households Served (000)		4,000
% Most Profitable Households		10%
Profitable Households (000)		400
Customer Churn Rate		25%
Profitable Households Lost Annually (000)		100
Average Monthly EBIT from Profitable Segment	$	63.00
At Risk Annual Profit ($000)	$	75,600
Retention Rate of Successful Save Program		9.00%
Annual Gross Impact of Save Program ($000)	$	6,804
Focused Marketing to Retain Most Profitable ($000)	$	(3,200)
Annual Net Income from Retention	**$**	**3,604,000**
Example to Improve Performance of Existing Program		
Total Households Served (000)	$	4,000
Annual Marketing Expense/Household	$	3.00
Annual Retention Program Budget ($000)	$	12,000
Unprofitable Households Served		40%
Reduction in Program Costs	**$**	**4,800,000**

Figure 6. Market Lift example defined for telecommunications campaign. Chart shows two profit lift examples; the first is for a company which today has no retention program in place, at the line "Annual Net Income from Retention". The second example in the chart is for a company who already has a retention effort and is using our solution to reduce the cost of the program so here the lift is in line "Reduction in Program Costs".

Supporting new management decision capabilities

Decisions that are shaped by allocated product-cost information are often inadequate and potentially risky. Customer-service and support costs are highly influential in many organizations where there are a high proportion of resources dedicated to activities other than producing tangible products.

Communications firms' financial staff can add value by moving past financial accounting requirements, and make a concerted effort to provide meaningful operational information to business managers. Understanding the dimensions of cost associated with all of the dimensions of a business is fundamental to good management.

Customer profitability is a very fundamental decision strategy that few firms have performed well, but should. It is in the firm's best interest to focus the organization on economic reality, as opposed to bureaucratic and redundant financial accounting practices of the past that do not support revenue increasing and cost reduction

decisions. By developing cost-to-serve models across the customer base, firms pave the way for decisions that impact market penetration, customer mix, retention and customer acquisition programs that maximize long run profitability for the firm.

SECOND CONCLUSION

Customer Profitability is required for Customer Lifetime Value. Gross margin analysis is not sufficient for product or customer profitability decisions -- especially in Communications. Oracle's Customer Profitability Solution provides the scalability to calculate P&L statements for millions of customers as frequently as required. It provides the modeling and flexibility to incorporate direct costs (such as one-time and recurring fees) as well as any assigned indirect costs. Business processes as well as departmental activity costs can play a role in the performance-based reporting for improving operational efficiency in addition to dynamically segmenting customers into profitability groups. The decision power and confidence that comes from this solution provides a basis for business focus and growth in profitability into the future at time when industry consolidation and a renewed focus on operating earnings are changing the communications industry.

Using Customer Profitability in Targeted Marketing Campaigns in Communications Industries
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