

## Managing the “good customers” for new business realities



Telecommunications will undergo a major change within next two to five years. In all probability, the business model will move from voice connectivity to virtually every aspect of communications you can imagine. Customer intelligence will enable telcos to thrive – focusing their resources on gaining and retaining the customers they really want.

Organizations in any industry want to hold on to good customers, but it's unlikely that it's a bigger issue anywhere than in the telecommunications industry. So much so that telcos have their own word to express just how dangerous life is: *churn*. Think about it. In more sedate industries like financial services, commentators talk about customer attrition or erosion – suggesting a gradual loss of customers over a long period of time, like the sea eating away at the shoreline. It's still a challenge, but a manageable one, if you build and maintain the right defences.

But look up the word churn and you'll find it means something altogether different. Telecommunications folk take it for granted that they are right out there on the high seas, violently agitated by the seething and unpredictable movements of the market, and with little visibility over what lies ahead.

In telecommunications it is now routinely assumed that many customers are tempted to move from one operator to the next, looking for the best possible deal. How things have changed. Not long ago the industry consisted of a club of big national and regional operators who plied their trade in safe, familiar home waters. But over the past 10 to 20 years the industry has been tossed about on the rough seas of rapid deregulation, changing customer demands and technical innovation. In most countries around the world, former government monopolies, which once had all the agility of supertankers, have been forced to sail through the uncharted waters of globalized markets while being attacked from all sides by unforgiving – and often unseen – competitors.

For the recent market entrants, life can be even tougher. They lack the financial stability of the incumbents, and they themselves are vulnerable to even newer, sleeker market entrants.

Latest market research figures confirm that customer churn is still on the rise. In Asia Pacific the annual rate of churn has more than tripled in just one year, rising from three and a half percent at the end of 2004 to a high of nearly 11 percent in 4Q 2005. In Western Europe, churn increased to

3.59 percent at the end of December 2005, up from 2.52 percent the previous year.<sup>1</sup> This is not surprising – the more saturated market the greater the churn. Fast-changing offerings mean customers are more likely to be enticed by competitors.

Convergence and the evolution from connectivity to content increase the need for excellent churn management. But it also raises the question about increasing customer value despite decreasing margins. Telcos are desperately looking for new sources of revenue and as far as we can see there is only one serious answer – selling content rather than connectivity and broadband.

### Things can only get tougher

Like it or not, this is the way things are going to stay for the foreseeable future. In fact, new challenges are going to make life even tougher. Many mature markets are already saturated and decreasing prices, combined with increasing traffic, result in constantly falling margins. At the same time, operators are making major investments in new technologies without any clear visibility over ROI and without any guarantee that these investments are going to have any impact on market share, revenue and profit. We saw a

lot of premature UMTS investments in situations where EDGE (Enhanced Data rates for GSM Evolution) would have been way cheaper and easier to implement and would have given virtually the same results. New players such as VoIP and cable operators are changing the rules of the game, indeed the nature of the industry. Investment analysts understand that the traditional telecommunications industry – selling voice communications and network capacity – may not be a good industry to be in unless change happens, and pretty quickly.

Other industries have also travelled from being a safe bet for investors to being very troublesome, and then managed to turn things around by rebuilding customer loyalty or cutting costs. Think of the airline industry in the early eighties, before air miles and segmentation between budget and premium carriers. However, for airlines the basic product is the same: getting people safely from A to B. The problem for telecommunications is that the entire business proposition needs to change, and everyone is fearful of the big costs and risks that go with being a first mover. Telcos are not quite ready to move into the content business – there are many new and different business rules that telcos do not yet fully understand – specifically in terms of understanding changing customer needs and how to respond. Fixed to mobile convergence (FMC) is already providing enough headaches and the introduction of non-traditional content offerings will take some time.

These difficult times call for cool heads: people who are capable of steering their organizations to the next level of sophistication and innovation while also focusing on improvement in the classic customer intelligence disciplines such as customer segmentation and profiling, intelligent acquisition and retention strategies aimed at building up long-term loyalty.

### Acquisition strategies

Churn should be seen as a great market opportunity. Come again? Well look at it this way. Churn is affecting all players on the market, so if you can control the exchange of subscribers in your favour, you win. To do this you need to invest heavily in retention programmes to protect high-end customers while allowing low-end (low ARPU and low expected LTV) to leave. At the same time, with intelligent below-the-line acquisition telcos can collect churners from the competition. The net result could be the same or roughly the same number of subscribers, but with higher value. To win, you need a cool head.

Real penetration rates at the start of 2005 were 48 percent for France, 56 percent for Germany, 61 per cent for Spain, 68 percent for Italy and 77 percent for the UK. These figures are significantly lower than the official penetration rates of those countries, which are above one hundred percent

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in Italy and the UK. Real penetration figures are based on a recent market study that assumes an addressable market of nearly 70 percent of Western Europe's population (discounting people who are unlikely to subscribe to a mobile service because they are either too young – under 16, or too old – over 65). By contrast, official penetration figures are based on the number of subscriptions in a country relative to the population rather than individual users, which is difficult to determine without knowing how many people have more than one subscription. Mobile operators

themselves are supposed to have some idea of how many of their users have multiple subscriptions. Once the number of multiple (mostly double) subscribers in a country is arrived at, it is possible to work out the number of individual mobile users. This enables the country's real penetration to be reasonably estimated.<sup>1</sup>

Such information could be valuable because it helps operators to decide the right balance between acquisition and retention activities, and make them complementary techniques to maintain the customer base and constantly grow its value. Operators in France and Germany, and to a lesser extent Spain have considerable room for growth, whereas British and Italian operators would do better to focus their efforts more heavily on customer retention.

Nonetheless the high level of saturation means that acquisition efforts must be very effectively targeted, so the analytical and predictive approach is

essential if campaign efforts are going to generate sufficient return on investment. The role of analytical modelling is to optimize the start-up offering (similar to the way banks evaluate credit/loan applications) by running credit-scoring procedures from the very start to manage risk and reduce fraud. Analytical tools should also be used to improve understanding of customer trends to help decide what would be the best offer for each customer segment. In short, on top of the classic “let's blow the competition out of the water” acquisition strategies and above-

<sup>1</sup>Source: Informa Telecoms & Media

the-line campaigns, telcos need to seriously adopt stealth strategies based on superior intelligence and below-the-line promotions. For example, an analytical approach might use a blend of external and internal data to identify active customers (or competitors' active customers) who are opinion leaders within narrow communities and peer groups. You can then approach these individuals with interesting offers such as members get members incentives that not only help you to acquire loyal customers, but more interestingly, help you to develop loyal customers into active advocates of your service.

Today there is no good reason to separate or even choose between acquisition programmes and retention activities. There's been a tendency to hand new customers over to the retention specialists once they are on board, or even to forget them until they are identified as potential churns. A more sophisticated approach is actually to reduce the number of customers going into retention programmes and kick loyalty programmes into action before the ink is dry on the contract. Moreover, encouraging churn within the worst segments can be an easy – and quick – way

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to increase ARPU and average margins. But the only way to do these things sensibly is to know and understand the customers' behaviour, needs and expectations as early as possible – and to do that you need to be able to exploit internal and external data very cleverly.

### **From ARPU to AMPU – a new challenge**

Convergence is one of the most frequently discussed topics in the contemporary telecommunications industry. When telcos began offering more than just voice communications, it was easy to predict that they would soon grow into multi-service vendors, providing everything from voice to data and mobile services. The traditional sources of revenue are either declining or growing only marginally, which by itself presents big problems (for example: for how much longer can telcos still market themselves on the basis of per-minute voice charges?) In the near future we will witness a three-way industry convergence between fixed and mobile telecommunications (FMC itself is already a very hot topic), retail business (including retail banking, insurance, airlines and other service providers as well as high street retailers) and various content producers (news and entertainment providers).

This in itself is going to be a painful process, but to make the telcos' outlook even worse, it is expected that within the next couple of years we will see the start of major changes in the industry's

structure as newcomers join the market using new technologies and new business models. These changes will be every bit as exciting (for the winners) and dangerous (for the potential losers) as what has been going on in the IT world since the advent of the Internet. Three forces will force the pace of change:

- The Internet and the digitization of content
- Exponential growth in bandwidth
- New entrants to the market and new business models

These changes are creating a new type of industry, in which traditional measures of success are inadequate to the task.

The industry is no longer one in which costs are overwhelmingly fixed and therefore you only need to measure ARPU. Leading telecommunications companies are already using insights into individual customer profitability (both private and business segments) to drive profitable growth, capturing both revenues and costs at the level of each specific customer for each specific service.

For example, SMS usually generates high margins because of its simplicity and the fact that it requires no new network technology, whereas other data services may be money losers even if they generate additional revenues. Costs and revenues generated by a service may also differ depending on the end-user group, whether prepaid or post-paid, business users or consumers and so on: some customers are more demanding of the operators' time and resources. The AMPU (average margin per user) for each of these segments is different.

Of course, continuing investment is a must and almost by definition, investment does not usually generate short-term profits. However it is very important that any decision regarding product development, marketing programmes or investment in new technologies can be made based on detailed and accurate analysis of expected revenues and costs, ideally down to the customer level.

To support an AMPU-based strategy, telcos must be able not only to understand and measure profitability and customer lifetime value, but also to integrate that intelligence into better

decision-making and execution. Underpinning this capability are models based on experience and best practices of activity-based costing and management (ABC/M) and network cost modelling – topics addressed by other articles in this magazine.

### **Cross and up-selling**

In a market that has been (as we have seen, sometimes erroneously) characterized as saturated, cross and up-selling have been the Holy Grail for many telcos. Again, if you are measuring customer value based on ARPU you could be making more trouble for yourself: a customer who delivers high revenue but at a loss might be equally or more of a loser if you sell him other services. Incomplete modelling might deliver poor results in other ways, too. Traditionally, telcos have gone for the “low hanging fruit” when cross-selling and up-selling. In other words they have gone for the customers that they believe are easy to activate with campaign activity. On the face of it, that is the path to high return on investment. However it could be that the ones that are most resistant to marketing activities are the ones that will deliver greatest AMPU – though they just need a more individualized approach. It's only when you can integrate customer intelligence with financial intelligence (for example, using ABC) that you get a true picture of how much it is worth investing to secure the cross or up-sell.

We were discussing an integrated approach to customer acquisition and retention – as a matter of fact, truly coherent customer value management requires the integration of all aspects of marketing activities. Very sophisticated segmentation followed by customer profiling should be a starting point to make decisions about how to target subscribers for different marketing actions. It is not surprising when the same customer has high scorings for more than one campaign. When the choice is between (for example) collec-

tion and retention campaigns, usually collection will get a clear priority. The difficulties arise if we need to decide between different cross and up-sell campaigns and/or retention campaigns. It's not easy to decide how to plan long-term activities in a coordinated way and

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keep margins under control. Moreover, we must not forget about the broader financial impact of marketing: a campaign that sells heavily discounted minutes and product packages might end up requiring expensive new network capacity. If the additional operating expenses outweigh the increased revenue, the campaign won't look quite so successful from the CFO's point of view.

### **Customer intelligence and churn management**

What telcos must avoid is running churn management in panic mode. Some might argue that the market is already saturated and that it is too wasteful and expensive to invest money in acquisition activities. But that is classic panic mode thinking. In fact, recent investigation offers new insights into the penetration levels of key European mobile markets, confirming that many are far less saturated than operators' official subscriber figures suggest. This means that, on top of churning customers from one network to another one, operators in at least some of these countries still have considerable room for growth, provided they can accurately identify segments of the population that do not yet subscribe to a mobile service.

You cannot possibly retain all of your customers in today's competitive environment, and if you tried to keep all of them, you would go broke in the process. Intelligent churn management is about identifying the high margin customers, and focusing your resources

on ensuring that they don't churn.

Moving forward, success in the industry will therefore depend increasingly on the ability to integrate all of the data that a telco generates – every bit of it tells you a part of the story on revenue and/or costs – and using it to analyse profitability at the level of the individual customer.

But the profitable operator will be able to go further and identify who will be the profitable customers in the future. It is not worth spending time and money on customers who are going to be unprofitable over the course of their lifetime: clearly, the money will never be recovered. Successful long-term customer relationships will be built by retaining the good customers – not necessarily the “important” high-spending accounts but the ones who can be developed through cross and up-selling activities, the ones who deliver revenue above costs year in year out, and the ones who will help to recruit new good customers.

Many telcos have been led to believe that the answer is to invest a lot of money in customer relationship management systems. Yet market research suggests that they are struggling to make a return. One recent survey, among 167 companies across 14 industries found that while the majority of

respondents considered CRM to be very important, few had achieved the results they had expected from their investment.<sup>2</sup> The fact is that without customer intelligence, CRM is blind, and a lot of effort is wasted, as with above-the-line advertising.

Customer intelligence enables companies to make more accurate strategic decisions on a wide range of customer-related issues; equally important, it enables them to do this rapidly. The dynamics of the current communication market forces telcos to introduce new services, tariff plans and loyalty programmes virtually on a weekly basis. It's not good enough to introduce new packages and then sit back to see if they are accepted by customers. It is essential to understand in advance what is the right product price, who are the target customers, and what will be the acceptance rate within certain customer segments. Package creation has moved from being a service-oriented activity to being customer-driven. But whereas some customers might enjoy telling telcos what sort of service they want, most will be even happier if telcos can offer them what they need, before they ask for it, or better still, before they have even stopped to think about it.

Customer intelligence has revealed that customers tend to change their behaviour just before they decide to switch to a competitor. The trick is to pick up on the clues that indicate change in behaviour, and to predict what sort of offer will entice the customer not only to stay on board, but to stay profitable. Such changes in behaviour are virtually impossible to identify without analytical software and the ability to bring together call detail records (CDR), billing, payment and other data. By systematically following the behaviour patterns revealed by this data, it is possible to determine the risk of a customer leaving within a defined time horizon.

In principle, predictive modelling is simple. You take information about similar samples of current and ex-subscribers to find out the differences in behaviour between the two groups. The model's task is to recognize churners and non-churners within the data, and to create scoring rules that can then be applied across entire segments within the customer database. These rules take the aspect of time into account and can calculate the likelihood of each customer to churn in a defined period of time in the future.

Armed with such information, the telecommunications operator can take preventive actions to "head off the customer at the pass", in other words before they have reached the point of no return. The telco will not waste additional time and resources on customers who are going to stay loyal anyway. An effective churn management solution has the following characteristics:

- Accurately reports who is leaving
- Provides insights into the major factors influencing the decision to leave
- Accurately predicts who is likely to churn in the near to medium future
- Scales up to report on the entire customer data base
- Pre-built analytical data and process models support rapid deployment and ROI

Because churn management is a business-critical activity, an effective solution must be able to drive not only customer but also product, channel, content and network strategy: in today's more difficult environment, the ability to move faster than the competition in these areas will be a vitally important factor in keeping valuable customers on board.

This leads to the new concept of revenue churn (as opposed to classic customer churn). Revenue churn much more accurately defines what the problem is, and how it should be addressed. If retention programmes were measured against revenue churn, and the only criteria for success was revenue retained, telcos would save a lot of money that was spent on retaining customers with no hope of a reasonable LTV.

### Calmer waters ahead?

For the next few years there will be even tougher times for the telecommunications industry. That is indisputable. The industry is in the process of redefining itself and customer intelligence will be part of that process, helping to redefine the industry as an exciting and profitable one that investors really want to be a part of. Those organizations that come through the tough times will emerge much stronger. Nobody can foresee what the environment will be like for telcos in the years beyond, but customer intelligence will be essential for any company seeking to stay on course in good times and bad. ■



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<sup>2</sup>ibid.