Global CRM software spending was $7.8 billion in 2007 and is projected to reach $8.9 billion in 2008. Further, CRM software sales will touch $13.3 billion by 2012. These software and processes have made it possible for companies to gather and analyze large amounts of data on their existing and prospective customers. This article shows how customer-level data can lead to increased customer profitability through (a) selection of the right customers by using the Customer Lifetime Value (CLV) metric, (b) the nurturing of those right customers and, (c) re-allocation of resources to the profitable customers. Due to this approach profitable management of individual customers is the basis for growth in firm profitability. A case study will show how IBM used CLV as an indicator of customer profitability and allocated marketing resources based on CLV.

Management Framework using the Customer Lifetime Value (CLV)

The selection of the right customers through the measurement of CLV, the realignment of marketing resources to the most valuable customers and the nurturing of the most profitable customers form the core of the management framework, as illustrated by the roadmap in Figure 1 (Refer to Figure 1, see next page).

As provided by Figure 1, the roadmap integrates all the three strategies and charts the course for companies to increase their profitability. While CLV is gaining popular acceptance as a metric in marketer’s toolkit, the metric’s judicious use depends largely on a manager’s ability to identify and work with the desirable customers. The customer selection process helps managers in identifying the customers who are the most profitable. These are the most desirable customers to work with and this identification forms a critical step in the road to increased profitability. This step calls for calculating the individual CLV by predicting (a) future customer activity, (b) future marketing costs and (c) contribution margin from each customer. Once the “right” customers are identified, they need to be nurtured, defended and retained. This step is important because, it is very likely that the competition is also interested in a firm’s most valuable customers. Therefore, by building a customer segmentation scheme based on the CLV scores, firms can select the right customers to nurture, defend and retain. Among the selected customers firms can then identify avenues for optimal resource allocation for each individual customer (and possibly across customers), so as to maximize CLV. The resource re-allocation is accomplished by considering each customer’s responsiveness to marketing contacts and the unit cost of such contacts. The resource re-allocation strategy facilitates the incorporation of long-term customer profitability effects into firm-level managerial decision making.

Customer Selection

The first step in implementing a successful customer management framework is selecting the right customers. Why is customer selection an essential ingredient for profitable customer management? There are two important reasons for this. First, given the limited marketing resources available to the managers, a challenge of choice as to where and on who companies should spend the limited resources arises. Second, not all customers are equally profitable. As shall be established later, a greater part of profits is generated by a small percentage of customers. Therefore, it is crucial that only those customers who are highly profitable be targeted by the marketing managers.

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So how do we select the right customers? Traditionally, firms rank order customers based on their historical purchase activity and prioritize their resources based on this ranking. Some of the popular metrics are RFM (Recency, Frequency and Monetary value), SOW (Share-Of-Wallet), and PCV (Past Customer Value). While these metrics are adequate in predicting customer value based on historical purchase behavior, they perform poorly in predicting a customer’s future activity and future profitability. Therefore, managers will have to use a forward-looking metric such as CLV to predict future customer profits. Further, the performance of the traditional metrics versus the CLV metric have always resulted in CLV offering higher levels of profitability. So CLV is a better indicator of future customer profitability.

Therefore, it is clear that in order to select the right customers, we need to determine the individual lifetime value of the customers. So how do we calculate CLV? This calculation involves predicting three parameters. They are: (a) future customer activity (frequency), (b) contribution margin from each customer (CM) and, (c) future marketing costs (MC).

The CLV components can be expressed through the following mathematical formula:

\[
CLV_{it} = \frac{\sum_{t=1}^{T_i} CM_{i,t}}{\left(1+r\right)^{t/\text{frequency}_{i}}} - \sum_{l=1}^{n} \frac{\sum_{m} MC_{i,m,l}}{\left(1+r\right)^l}
\]

where,
- CLV = Customer Lifetime Value
- CM_{i,t} = Contribution margin from customer i in purchase occasion t
- MC_{i,m,l} = Marketing cost, for customer i in communication channel m in time period l
- frequency_{i} = \frac{12}{\exp\text{print}_{i}} (where, \exp\text{print}_{i} = \text{expected inter purchase time for customer i})
- \(r\) is the discount rate for money,
- \(n\) is the number of years to forecast, and
- \(T_i\) is number of purchases made by distributor i, until the end of the planning period

Further, the decline in the frequency of purchase is either due to splitting of loyalty between companies or due to the customer ceasing to buy a particular product due to falling demand or outdated products. In one of the studies, the drivers of the purchase frequency for the customers of a B2B firm were identified as follows:

- Number of product purchase upgrades
- Cross-buying behavior of customers across product categories
- Ratio of number of customer-initiated contacts to total contacts
- Product return behavior
- Frequency of web-based contacts
- Frequency of customer contacts (in-person, direct mail and telephone) by the firm
- Average time between two customer contacts

### Predicting Future Marketing Costs
There are two methods to forecast the future marketing cost (MC). The first method assumes that the past cost will continue in the future, given that there is not much change in marketing costs at the customer level over the years. The second method considers the future marketing cost as a function of customers’ interpurchase times and purchase quantity. Therefore, by modeling these two parameters, managers can predict the future marketing cost to each customer. Such an advanced approach would yield a better customer selection process that would help managers identify their profitable customers more effectively.

### Predicting Contribution Margin From Each Customer
The contribution margin from each customer depends on: (a) customer’s contribution margin from the previous year, (b) total number of customer contacts across all channels and, (c) total quantity purchased across all product categories.

Based on the inputs derived from these parameters, the lifetime values of individual customers can be calculated. In this framework, CLV is measured by predicting the three parameters over a reasonable period (usually three years). The time period is three years because over longer periods of time: (a) customer needs change, their position in the family cycle changes, and hence may have different requirements; and (b) product offerings change due to technological advancements and customer needs.
**Nurture, Defend and Retain Profitable Customers**

With customer selection strategy as the base, it is now possible for managers to nurture and grow their most valuable customers. By performing the CLV computation as described earlier, firms can find that not all customers are profitable customers. While one set of customers of the firm do not contribute to the overall profitability of the firm, and cost more to be retained, there is another set of customers who not only add value to firms by increasing the revenues but also by helping the firm attract other customers through positive word-of-mouth. Therefore, it becomes obvious that the former set of customers is not worth pursuing, and more importantly, the latter set of customers should be nurtured, defended and retained so that firms can maximize their profits. This process of nurturing and growing profitable customers consists of two steps: (a) track the distribution of the CLV score, and (b) assess the customer segmentation scheme based on their potential value.

As described in Figure 1, the process of identifying the most valuable customers calls for finding the CLV distribution score and analyzing the segmentation scheme. Specifically, customers have to be rank ordered into distinct customer segments (for instance, High, Medium & Low CLV segments) by calculating the individual CLV scores and then grouping them within each segment into profitability deciles. Each decile will represent the mean CLV score of 10% of the customers in the segment. Therefore, such a decile chart would provide managers a sense of how customer profitability is distributed across customers within each of the three customer segments and thereby offer insights with respect to profitable customer management. Based on this segmentation scheme, managers can take informed decisions about their customer contact strategy (which customers to contact and which customers not to contact) and product message strategy for each customer.

**Resource Re-allocation to Selected Customers**

Apart from knowing who the profitable customers are and how to nurture them, marketing managers should also know when, what and how much resources to allocate in the communications channels so that they do not
overspend or underspend on customers. This will help the firm to invest on the most profitable customers in the most effective way. In this last step of the customer management framework, we leverage the information obtained from the first two steps by re-allocating resources to the most profitable customers. Why should companies spend only on the most profitable customers? This is because, when companies spend their marketing resources on all their customers they either invest in customers who are easy to acquire but are not necessarily profitable or try to increase the retention rate of all their customers irrespective of their profitability. This results in a waste of limited marketing resources and a decrease in potential firm profitability. So how should the resources be re-allocated?

As illustrated in Figure 1, the re-allocation strategy involves two steps. First, managers have to identify the most profitable customers by calculating their lifetime values and those customers who are most responsive to marketing efforts. Second, managers have to ascertain the optimum mix of different channel contacts for each customer. This is a function of how responsive each customer is to each channel of communication (response elasticity), and the unit cost of each communication channel.

Why should managers find an optimum mix of different channels? This is because, when the factors are optimized, it generates a comprehensive resource re-allocation strategy that can be used to maximize CLV. The resource optimization need can be understood using the CLV equation explained earlier in the paper.

The original equation is as follows:

$$\text{CLV}_{it} = \sum_{t=1}^{T_i} \frac{CM_{i,t}}{(1+r)^{t/frequency_i}} - \sum_{l=1}^{n} \sum_{m} \frac{MC_{i,m,l}}{(1+r)^l}$$

The first half of the equation represents the contribution margin the customer is likely to give the firm in the future. This is dependent on the revenue generated and the margin per transaction. Further, revenue is a function of (a) past buying behavior, (b) the number of contacts made by the firm in contacting the customers, and (c) customer characteristics. The second half of the equation represents the marketing cost to the firm, where $MC_{i,m,l}$ is the product of unit marketing costs and the number of contacts. Therefore, it is evident that when the number of contacts is increased, the revenue is bound to increase. However, increasing number of contacts also increases the marketing cost to the firm. So the challenge for managers here is to find that optimum point that balances the number of contacts and marketing cost, at the same time maximizing CLV. In other words, if a firm wants to optimize its marketing contact strategy to maximize profits from each customer, it has to consider how many contact channels ($m$) it has and how many times it wants to contact each customer in each channel ($x_m$). Managers can use methods such as genetic algorithms that can help them determine the optimal marketing contacts per channel per customer.

Our resource re-allocation strategy provides a comprehensive CLV-based framework to design an effective marketing strategy. This strategy suggests which customers to acquire and retain based on their predicted CLV. An optimal level of communication across the right mix of channels will ensure managers maximize profitability.

Therefore, measurement of customer profitability and a deep understanding of the link between firm actions and customer profitability are critical for ensuring the success of the above decisions.

Implementing the CLV-based Management Framework at IBM

We implemented our CLV-based management framework at IBM, a leading high-technology firm providing hardware, software and services to B2B customers. It intended to enhance their profitability by managing customer relationships profitably. Among a wide array of marketing factors determining the customer relationships, IBM aimed to customize the level of contacts to each customer which would ensure resource re-allocation to their most valuable customers, thereby driving up profitability. To identify their best customers, IBM had traditionally used Customer Spending Score (CSS). CSS was defined as the total revenue that can be expected from a customer in the next year. Based on this metric, IBM classified their customers into 10 deciles and targeted the top one or two deciles for targeting customers. However, IBM felt the need to move to a forward-looking metric such as CLV because CSS focused primarily on revenues (top line) and ignored the profitability (bottom line).
IBM wanted to implement the CLV-based management framework which would improve their profitability. Specifically, IBM wanted to test if an increase in contacts to the right customers can create high value from low-value customers, given all other drivers are similar. To accomplish this, our CLV-based management framework was adopted to design customer management initiatives, as illustrated in Figure 2.

**Which Customers to Target?**

As shown in Figure 2, we computed the customer value with the use of the CLV metric. The always-a-share approach was adopted for measuring CLV because of its relevance to the non-contractual setting of IBM. The always-a-share approach assumes that customers never “quit” their relationship with the company. Rather, they demonstrate only dormancy in their relationship with the firm. For instance, consider a case where a customer switches between Apple and Dell. In such a scenario, the customer continues to transact with both Dell and Apple. Hence, neither Dell nor Apple completely loses the customer but they lose/gain a share of the customer’s purchase. This assumption allows for a customer to return to purchasing from a firm after a temporary dormancy and when the customer returns to the relationship they retain the memory about their prior relationship with the firm. In this approach the customers’ transition probabilities associated with each firm is modeled, and not the time of defection.

In calculating the CLV, we accounted for the drivers of purchase propensity and contribution margin at IBM and categorized them as customer relationship characteristics and customer firmographics. The customer relationship characteristics include drivers such as past customer spending level, cross-buying behavior, purchase frequency, recency of purchase, and past purchase activity, and the marketing contacts by the firm. The customer firmographics include drivers such as sales of an establishment (a measure of the size of the establishment), an indicator for whether the establishment belonged to B2B or B2C industry category, and the installed level of PCs in the establishment (a measure of the level of demand for IT products in the establishment).

After the individual CLV scores were calculated, some key observations with respect to the drivers were made:

---

**TABLE 1:**

CLV-based Management Framework at IBM

a) Customers who have spent more, have made a recent purchase and have purchased across a wider range of product categories are more likely to purchase in the current month.

b) Marketing contacts have a positive influence on customer purchase incidence, and for customers who have made a recent purchase; the influence of marketing contacts is enhanced.

c) Customers who have a greater cross-buying, and customers who have purchased frequently in the past provide a higher contribution margin.

d) While IBM allocates more marketing contacts for customers who have higher sales, the purchase incidence and contribution margin is lower for these customers. This is possible because customers who have higher sales in general split their purchases across several vendors.

e) Customers who have a large installed base of PCs have a higher purchase incidence and contribution margin and are contacted more by IBM.

After the CLV computation was performed, a comparison between the traditional customer selection metrics (such as RFM, PCV and CSS) and CLV was made. The traditional metrics and CLV were computed using the first 54 months of data and then rank-ordered. This was used to predict the next 18 months of purchase behavior for the four metrics. A comparative analysis of the customers in the top 15 percent of each metrics’ list was made, as shown in Table 1 (Refer to Table 1).

This analysis clearly showed the power of CLV to identify the best customers for future targeting. While prior research in contractual settings had found that current profit is a good indicator of future profitability, this study indicated that for selecting high potential customers for future targeting in non-contractual settings, current profit performs poorly than estimates of future profitability.

How many times to target?

After we decided CLV to be the best indicator of future profitability, we then developed an optimum contact strategy for each customer using a genetic algorithm. The objective of the algorithm is to find the optimal level of marketing contacts for each customer that would maximize the sum of expected CLVs of all the customers. The output from the optimal resource allocation model produced input into the decision making process regarding the number of contacts in each channel for each customer in various customer segments. As mentioned earlier, the firm was using CSS as a key metric for targeting customers and allocating marketing resources. However, when the CLV metric was used the contact frequencies, as decided by the CSS metric, changed. Table 2 provides the optimization strategies for marketing contacts based on CLV and CSS.

As provided in Table 2, the optimal contact strategy for customers was divided into four buckets along the CSS and CLV metrics. We recommended that contact interval through direct mail/telesales/catalog/email to the High CLV – Low CSS customers be increased to 1.9 days from the existing 4.8 days. This would provide an increase in gross value of around 63% from the current level. Similarly, an increase in the contact interval to the High CLV – High CSS customers and a decrease in the contact interval to the Low CLV – Low CSS customers was recommended, each generating an increased gross value. The biggest lift in gross value was realized with the Low CLV – High CSS customers, with a slight reduction from the current contact interval. The nearly 160% increase in gross value showed that by optimally contacting the low value customers (as decided by the CLV metric), it is possible to derive high value from those customers.

How To Reallocate Resources?

To optimally re-allocate marketing resources, we conducted a field test. A sample of 35,131 customers were divided into two groups – 7,670 customers who have not been contacted at all (the Not Reached group), and 27,130 customers who were contacted previously (the Reached group). The Reached group comprised of customers who were contacted through salespersons, mails, telesales, email, etc. in year 2004 whereas, the Not Reached group comprised of customers were not contacted until 2004. In each group, the customers were further divided into deciles, and the mean CLV computed for each decile is provided in Table 3 (Refer to Table).

From the Table, it is evident that the customers belonging to the tenth decile of the Reached group are not profitable. We recommended that marketing resources be allocated based on this rank order (i.e., higher CLV candidate customers were first allocated resources) until all the resources that were available from Decile 10 of the Reached group was exhausted. Therefore, marketing resources from 2,713 low-CLV customers in Decile 10 of the Reached group was re-allocated to the high-CLV customers in the top three deciles of the Not Reached group (totaling up to 2,301). The level of resources allocated to each candidate customer was determined based on the optimum contact strategy described earlier.
### Table 1
Customer Selection Metrics – A Comparison

<table>
<thead>
<tr>
<th>Value</th>
<th>CLV</th>
<th>CSS</th>
<th>RFM</th>
<th>PCV</th>
</tr>
</thead>
<tbody>
<tr>
<td>15% Top of Cohort</td>
<td>30,427</td>
<td>21,789</td>
<td>22,622</td>
<td>23,542</td>
</tr>
<tr>
<td>Gross Value</td>
<td>9,184</td>
<td>6,659</td>
<td>6,966</td>
<td>7,185</td>
</tr>
<tr>
<td>Variable Costs</td>
<td>107</td>
<td>114</td>
<td>110</td>
<td>104</td>
</tr>
<tr>
<td>Net Value</td>
<td>9,077</td>
<td>6,544</td>
<td>6,856</td>
<td>7,081</td>
</tr>
</tbody>
</table>

Source: Adapted from Kumar, V., Rajkumar Venkatesan, Tim Bohling, and Denise Beckmann (2008), “The Power of CLV: Managing Customer Lifetime Value at IBM”, Marketing Science, 27(4), 585 – 599. Notes: The reported values are in dollars (expressed as a multiple of the actual numbers) per customer and are cell medians. The values reported here have been adjusted by a constant factor of the actual figures.

### Table 2
Optimization Strategies

<table>
<thead>
<tr>
<th>Customer Lifetime Value (CLV)</th>
<th>Low</th>
<th>High</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>High</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Interval is 4.8 days</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Optimum Interval is 1.9 days</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Value</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Value is $30,936</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Optimum Value is $17,809</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Low</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Interval is 9.7 days</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Optimum Interval is 12.6 days</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Value</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Value is $743</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Optimum Value is $1,203</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted from Kumar, V., Rajkumar Venkatesan, Tim Bohling, and Denise Beckmann (2008), “The Power of CLV: Managing Customer Lifetime Value at IBM”, Marketing Science, 27(4), 585 – 599. Notes: The values reported here have been adjusted by a constant factor of the actual figures.

### Table 3
CLV-based Resource Re-allocation

<table>
<thead>
<tr>
<th>Decile</th>
<th>Low Reached Until 2004</th>
<th>Reached by 2004</th>
<th>Customer Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$350,471</td>
<td>$2,124,483</td>
<td>Super High CLV</td>
</tr>
<tr>
<td>2</td>
<td>$993</td>
<td>$125,460</td>
<td>High CLV</td>
</tr>
<tr>
<td>3</td>
<td>$669</td>
<td>$43,681</td>
<td>Medium CLV</td>
</tr>
<tr>
<td>4</td>
<td>$638</td>
<td>$23,624</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>$623</td>
<td>$17,449</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>$611</td>
<td>$13,675</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>$534</td>
<td>$10,513</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>$444</td>
<td>$8,051</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>$369</td>
<td>$5,023</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>$80</td>
<td>($35)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted from Kumar, V., Rajkumar Venkatesan, Tim Bohling, and Denise Beckmann (2008), “The Power of CLV: Managing Customer Lifetime Value at IBM”, Marketing Science, 27(4), 585 – 599. Notes: The values reported here have been adjusted by a constant factor of the actual figures.
» Nearly 160 % increase in gross value showed that by optimally contacting the low value customers (as decided by the CLV metric), it is possible to derive high value from those customers. «

This process of resource re-allocation resulted in some customers in Deciles 1, and all the customers in Deciles 2 and 3 in the Not Reached group being allocated marketing resources for 2005.

As a result of an improved targeting strategy, the revenue of the Not Reached Group increased ten times in 2005 compared to revenues in 2004. The lift in revenues for the Not Reached until 2004 but Reached in 2005 group of customers was about $19.2 million. The incremental revenue due to resource re-allocation (after adjusting for the annual growth in customer revenue) among the Not Reached until 2004 but Reached in 2005 group of customers was about $19.1 million. This incremental value is derived from two sources – (a) $7.6 million (nearly 40 %) was obtained from the increase in purchase amount from customers who were active in 2004, and (b) $11.4 million (nearly 60 %) was obtained from the reactivated customers (about 273 customers) who were dormant in 2004. Therefore, the average increase in revenue from reactivating dormant customers was about $41,758, and the average increase in revenue from existing customers was about $4,160. The effectiveness of our model was reflected in the superior performance of the sales revenue metric. The improved profitability was made possible by the successful implementation of our CLV strategies.

IMPLEMENTING THE CLV-BASED MANAGEMENT FRAMEWORK AT A FASHION RETAILER

We have also implemented this management framework in a B2C setting for a fashion retailer. The retailer, which sells apparel, shoes and accessories for both men and women, has a chain of 30 stores across the USA with relatively larger concentration of stores on the east coast and west coast. Through this study we showed that the retailer’s profitability is maximized through the use of the CLV metric. Specifically, we developed a model to compute the lifetime value at individual customer level and showed that this forward looking view of customer profitability is more efficient than other traditional metrics in designing and implementing CRM programs. Using this CLV score, we performed profitability analyses both at the customer level and at the store level.

Profitability Analysis at the Customer Level

At the individual customer-level, we predicted the purchase frequency, the contribution margin and the marketing cost to calculate the CLV score for each customer of the retailer, as expressed by Equation (1). The CLV scores were then used to rank-order all customers in descending order and aggregated into deciles. Based on the distribution of average CLV across deciles, we divided the customer base into 3 segments – High, Medium, and Low CLV segments. For instance, we observed that the top 20 % of customers accounted for 95 % of profits, and the retailer was actually losing money with 30 % of customers! Next, using the drivers of CLV we analyzed their impact on the high and low CLV segment of customers.

Finally, we also identified the impact of customer-specific variables such as demographics, lifestyle and shopping behavior on the High and Low CLV segments. We observed that these variables varied significantly between the two segments. This study showed that the most profitable customers, i.e. High CLV customers, were professionally employed and married women in the 30 – 49 age group. They had children and a high household income. Further, they were members of the store’s loyalty program, lived closer to the store, and shopped through multiple channels. Whereas, the typical low CLV customer was a low income unmarried male customer in the 24 – 44 age group, primarily a single channel shopper, lived further away from the store, and did not own a home.

Profitability Analysis at the Store Level

At the store level, we observed that customer purchases varied significantly between the retailer’s 30 stores. This enabled us to assign customer value weights to each store. We repeated this procedure to distribute customer value weights for all stores. The lifetime value of a store was then calculated as the weighted sum of the net present value of the lifetime value of customers that shopped from that store minus the net present value of the rent for the store. In our CLV computation methodology, we calculated the lifetime value at the lowest level (for each customer) and aggregated it as a weighted sum to arrive at the store value.
After computing the store's lifetime value, we assigned ranks to the stores based on past profitability (based on past revenues of the previous 3 years) and future profitability (based on net present value of customer profitability for the next 3 years). Each of the 30 stores was more or less of the same size and located in regions having similar demographics. Then, we computed the spearman's correlation coefficient between the store's past and future profitability ranks. While one would expect a high correlation between the two rankings, we observed that the rank-order of all 30 stores of the retailer based on the CLV differed significantly from the rank-order of the stores based on the historic store revenue and historic profits. Similarly, we observed a divergence when comparing the past and future revenue of a customer. The findings showed us that it is not prudent on the part of retailers to rely on historic performance of their stores. Instead, they need to be sensitive of their customer portfolio and the future value of that customer portfolio. Given the finding that the retailer was losing money on 30% of their customers, a re-visit into the stores' customer acquisition and retention strategy was needed.

In order to retain profitable customers, we suggested that the store manager can look up the CLV score of its current customers and use that as a decision support tool to prioritize direct marketing initiatives such as promotions and special discounts. In order to acquire profitable customers, we suggested that the store manager can look at the profile of the customers in the prospect pool and prioritize customer acquisition resources in favor of customers whose profile is similar to a typical high CLV customer. For a relatively new customer (who does not have any transaction history), we suggested that the store manager can look at the customer's profile and estimate the future profitability and map it to the profile of a typical high CLV customer (or a typical low CLV customer). These strategies provided the store managers with decision choices on when and how to cultivate relationships with the customers in the future.

While the above results were particular to the fashion retailer, this study also provided us with two key generalized results for all retailers. First, the study identified the presence of low correlation between measures of loyalty used by the retailer in our study and future profitability of its customers. Second, the study helped us to recognize and emphasize drivers of CLV that are generic to any retailer, such as cross-buying, product returns, purchase of specific product category, multi-channel shopping behavior and relationship duration. Overall, the study highlighted the importance of CLV metric in retail setting and how it assists in ensuring a paradigm shift in doing business by migrating emphasis from managing customer relationships to managing customer value.

ORGANIZATIONAL CHALLENGES IN IMPLEMENTING THE CLV-BASED MANAGEMENT FRAMEWORK

The research results from IBM provide us with valuable insights on profitable customer management. However, companies have to incorporate certain managerial changes of operational and workforce elements to prepare themselves for implementing this management framework.
Changes in Operational Elements

This type of change encourages companies to revisit their business dimension and tailor its offerings that focus on the customers rather than products. The underlying philosophy of focusing on the products, or the product-centric approach, is to sell products to whoever is willing to buy. Such an organizational position aims to solve the needs and problems of customers the world over by developing appropriate product solutions. This type of approach aims to build on the product line of a company and develop a comprehensive portfolio of products. However, the pitfall of such an approach is that companies tend to ignore customer-specific needs that are crucial in determining their relationship with the firm. When the products so developed do not address the specific needs of the firm, customers are likely to defect to competition. Of course, it would not be prudent or viable for companies to continue producing products that satisfy every single need of the consumers. So what can companies do to remedy this issue?

The answer lies in the change from a product-centric approach to a customer-centric approach. Figure 3 illustrates how the customer-centric approach compares with the product-centric approach.

From Figure 3 it is clear that the customer-centric approach suggests firms to focus their strategy on serving customers rather than selling products. Several new firms have moved away from the product-centric approach and have gained huge profits by adopting a customer-centric approach. Wells Fargo, a leading financial institution has realigned its organizational structure by creating a two-tiered sales structure wherein a relationship manager manages externally-focused relations with the customers and a product manager who is internally focused and provides input for the product development and helps the relationship manager to sell the products more effectively. Similarly, while record labels such as EMI, BMG, and Sony opted to concentrate on their product offerings, Apple iTunes unleashed a new business model by focusing on customers.

So what does it take for firms to adopt a customer-centric approach? By focusing on Interaction Orientation, firms can successfully migrate from a product-centric to a customer-centric approach. When firms adopt Interaction Orientation, it results in customers being viewed both as a source of business and as a potential business resource for the firm. This helps a great deal in customer empowerment and in harnessing the network effects of customer-to-customer linkages. Specifically, by (a) making decisions on a per customer point of view, (b) providing rapid responses to customer needs, (c) creating a rich customer experience, (d) allowing customers to exchange information and reviews about product and experiences with other customers, and (e) encouraging customers to connect with the firm and design the nature of transactions, a firm can ensure that the focus is on customers and not the products.

Changes in Workforce Elements

Re-aligning operational or business elements to fit the customer-centric approach is only part of the solution. For a complete adoption of this approach, the workforce should also be tuned to this philosophy. To enable a complete transformation, some key initiatives on the human side of business have to be undertaken. They include: (a) creating awareness of the need for change through employee-targeted communication messages, (b) arousing employees’ interest in participating and supporting the change by communicating the initiative’s effectiveness and potential benefits, (c) establishing transparency in sharing information and insights about the change process, (d) facilitating stakeholders to implement the change on a daily basis, and (e) emphasizing to keep the change in place through constant change monitoring and evaluation.
When companies align themselves on these elements, the goal of profitable customer management now seems more attainable. Other factors that help in implementing effective CRM are: (a) understanding the data requirements and collecting customer-level data, (b) communicating the change process and CRM implementation to both internal and external users, (c) ensuring accountability in execution, and (d) creating metrics dashboards containing customer-focused metrics such as CLV and CSS.

**Conclusion**

As shown in this article, IBM and an apparel retailer migrated from a customer spending metric to a CLV metric. In both the B2B and B2C worlds, this transformation involved following these three steps sequentially:

1. Rank-order existing customers based on CLV to select which customers to target.
2. Identify high-value customers by understanding the drivers of CLV.
3. Develop an optimum contact strategy for the highly valued customers, in terms of how to communicate and how often to communicate.

By selecting the right customers and by optimally re-allocating resources IBM was able to nurture both existing customers and re-activate dormant customers (with a slightly higher emphasis on re-activating dormant customers), and thereby improve their profitability. To the apparel retailer, the CLV framework offered important managerial implications on designing customer promotion programs, enabling multi-channel shopping, initiating direct marketing efforts, marketing resource allocation, up-selling and cross-selling efforts by the retailer, customer acquisition and retention strategies and managing store level marketing mix.

The evidence offered in this paper suggests that adopting a CLV based framework to manage customers can be a profitable strategy for businesses in both the B2B and the B2C world. The proposed methodology allows firms to devise customer centric strategies that harness the data available in CRM systems.

**FURTHER READING**


**KEYWORDS:**

Customer Relationship Management, Customer Lifetime Value, Return on Marketing Contacts