UNIT-13 Dealing with Unprofitable Customers

Learning Outcomes

By the end of this unit the learner will be able to:

- ✓ Evaluate customer behavior and identify unprofitable customers
- ✓ Understand database and value analysis.

Unit 13

Dealing with Unprofitable Customers

Every business will have a mix of profitable and unprofitable customers. The most profitable customers will represent only ten per cent of the client base, but a hundred and twenty per cent of the profit. Sixty per cent of the customers will represent no profit or loss and the remaining thirty per cent of your customer base will effectively cost you money. Assessing whether it is worth actively ridding yourself of the thirty per cent is an important exercise. While they may not be adding to your profit, they may be integral to your economy of scale. If a customer uses a rail network for one station only, provided he/she is not stopping a lucrative customer who is an annual season ticket holder from using the service, then chances are he/she is not worth measuring or actively trying to offload as a customer.

If, on the other hand, you have a set of customers who are habitual bad payers, they may indeed impact directly on your accounts because of the cost of communications with them. These particular clients may well be worth offloading. In order that a business can deal with its client base effectively, it needs to segment that client base, break it down into behavioural patterns or geographic locations, or even age groups that are more manageable and predictable. If this can be achieved effectively, then it makes dealing with your customers a much more structured process. Customer analysis must take the form of a strategic plan, which must look at both the savings and the costs.

Another important factor to be considered is how your organisation is measured by its stakeholders. If your organisation is measured by customer numbers, then it might be important to retain customers - even if they are unprofitable. If you are assessed as an organisation by product volume, then a reasoned judgement can be made with regards to the unprofitable customer and how much product volume they consume. Like many things in the customer service environment, it is not always as clear-cut and straightforward as it first appears.

Customer Behaviour and Customer Behaviour Database

Customer Behaviour

Understanding customer behaviour is the first step towards better customer value management. Customer behaviour is so complicated that each company should define which kinds of behaviour will be added to its information system. By extension, customer behaviours to a particular company involve any contact that the customer has with the firm.

Repeat purchase is the most obvious behaviour that can increases the firm's revenue, and it is also easy to record. Although cross-buying customers are not focussed on one product, they also belong to the organisation's product line – so it also can be recorded. Recommendations or effective word -of-mouth brings indirect revenue, and can be seen as customer value, but is hard to calculate. Nobody can

accurately evaluate the word-of-mouth effect. As such, this paper only focuses on customers' repeat purchases and cross-buying behaviour.

After defining what kind of behaviour should be recorded into the database, we also need to decide which detailed information should be included. Reach, frequency and monetary are the most common variables in the customer's lifetime value field.

Customer Database

Enterprise information management is becoming more and more popular. Most modern companies have already bought and begun using software, such as CRM, ERP, and so on. There are two problems, however, with the abovementioned systems designed to improve enterprise information management. First of all, most of the software is not customised. It therefore cannot be used directly, or cannot play an effective role in real management. Secondly, CRM is great, but when everyone in the industry is doing the same things, all the companies are back at the same starting line. In turn, companies should ideally develop their own information systems to store customer data and do relative analysis.

How long is your product or service life cycle? When analysing customer value, deciding on a proper time period is necessary. Different products or services have different proper purchase frequencies. For example, an automobile company may calculate its customer value within the past five years, while a milk company may only need to consider value in the past three months.

How do you effectively collect your customers' data? Consumers are worried that personal data might be compromised, so often customers may choose *not* to share their purchase information with the company. Because of this, membership is a good method of obtaining information. Kroger, for example, is a supermarket chain in the U.S. and it is very easy to become a Kroger member. The only thing you need to do is fill in a form and it is totally free. Kroger members enjoy a cheaper price for all promotional products - they only need to scan their membership card first when they check out. Customers like to get cheaper products and so using this method can help companies get customers' purchase information more easily.

Customer Value Analysis

Qualitative Analysis

Companies with lots of unprofitable customers may sometimes spend money on bringing in customers who are reducing the value of the firm. When you have already got your customer purchase information, it is easier to identify your unprofitable customers. These kinds of customers have certain characteristics. One of these, for example, could be that they always buy products that are on sale at reduced prices. In order to increase cross-buying or reduce storage, companies always have certain products on special sale. Products on sale are, unfortunately, always less profitable or even non-profitable.

Customers who only buy products on sale therefore are typically unprofitable customers.

Fig.9.1. Below is an example of customer profitability. Customers with high total purchase count and low percentage on sales/discounts are the most valuable customers. By contrast, customers with low total purchase but high percentage on sales/discounts are unprofitable customers.

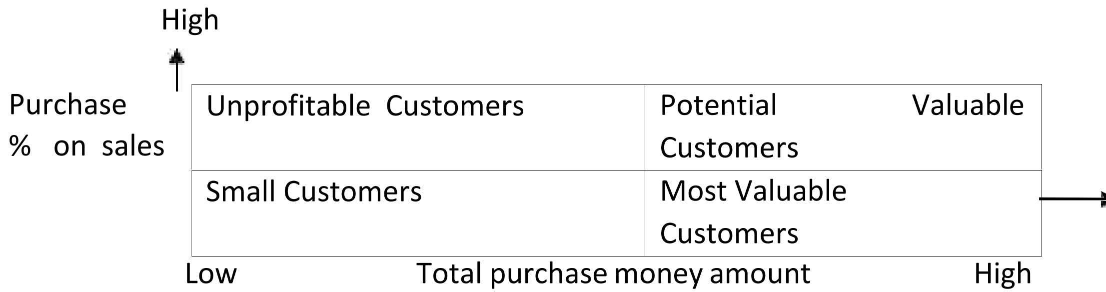

Fig 13.1: Customer Profitability Matrix

Always accept the return of products. In today's competitive market, more and more companies provide unconditional returns services. Customers with a high return rate should nonetheless be viewed as unprofitable customers. When something is returned to the company, the original revenue is also returned to the customer. Most returned products cannot be sold again at a regular price, so the total service cost increases as well.

Quantitative Analysis

The term 'customer value' can be understood in two ways. In this paper, customer value means the "value that the customer provides to the firm" instead of the "value provided by the firm to the customer."

Kotler and Armstrong define a profitable customer as "a person, household, or company whose revenues over time exceed, by an acceptable amount, the company costs of attracting, selling, and servicing that customer."

In general, customer value equals net present value of customer purchase minus net present value of company cost on acquiring and maintaining this customer.

Customer Value (CV) = Net present value of customer purchase minus net present value of company cost.

Marketing Actions

According to the three steps mentioned above, companies will calculate this customer value. This way, companies can identify their most valuable and unprofitable customers.

Maintain the most Valuable Customers

Believe it or not, it is entirely normal to find that just the best twenty per cent of a company's customers generate a huge portion of its share price - in some cases, all of it. When managers have found out who are their most valuable customers, the company should then allocate resources to these

customers, improve service quality and enhance the relationship between the company and its valuable most valuable customers.

Let your Unprofitable Customers Go

Managers must often make difficult decisions - letting go of unprofitable customers is one of them. There are several common methods of letting them go. Stop sending promotional advertising to unprofitable customers, for example. If they do receive the information, the frequency of purchase may lessen and the chances of them buying other valuable customers' recourses will be reduced.

You could also increase their waiting time. Managers should maintain a list of unprofitable customers. When they call for help, companies can put them in a long waiting line to deliberately make them impatient and take their business elsewhere.

Change Unprofitable Customers into Profitable Customers

A change in marketing promotion strategy is required to change the unprofitable customer into a profitable customer. Stop using a discount strategy - bundled selling is a better approach. With this method, if you want to buy something at a lower price, you also need to buy something else. "Buy one get one free" is also a better promotion strategy than direct discount. When companies change their promotion method, unprofitable customers will change their purchase behaviour or may adapt themselves to the new policy and become profitable customers. Otherwise, they may leave the company – though the company will become more profitable without them.

Another strategy is allowing customers to use a self-service system. Self-service can greatly reduce costs. If unprofitable customers switch to lower-cost channels, they become more profitable customers.

Evaluating Your Customers' Value, Segment by Segment

In order to effectively evaluate a segment (group) of your customer base, it is necessary to establish your segmentation methodology. The methodology and objectives should be in-line with your corporate strategy and take into account corporate culture. Having established the 'rules of engagement', you are faced with the task of establishing *why* you have undertaken the segmentation of your customer base. In short, this can be summed up by the rule that it is far easier to deal with a small number of segments than a very large number of individuals. Each individual customer's profile will differ from the next, but certain characteristics will stand out that enable groups to be established. These groups are referred to as segments. Segments when evaluating a customer base take into account elements such as behavioural patterns, trends, expectations and purchasing needs. From initial segmentation, it is possible to drill-down to sub-sections within a certain segment, for specific corporate or marketing purposes. An organisation will target a particular segment, such as the first-time buyer being a valuable segment for a mortgage company.

The specific driver behind this philosophy is that the first-time buyer is likely to remain with the same mortgage company for the lifetime of his/her house purchasing activities.

Targeting specific segments of customers highlights a belief in the organisation that a particular segment is valuable to the overall goals and aims of the business. Having targeted them and enlisted them as your customers, the next phase of segmentation is likely to take place. This is where you look at that particular segment and break it down further, splitting those that are profitable to the organisation and those who are less profitable.

It is important for the organisation to establish its most profitable and least profitable customers. It is then necessary to evaluate whether or not it is worth actively seeking to retain all these customers. You need to look at the cost of their retention against the cost of rejecting them to one of your competitors. There have been cases where the rejection of customers to a competitor enables the competitor to reach critical mass. They are then able to implement an economy of scale that makes the rejected customer a valuable resource to them. This, in turn, gives your competitor a competitive edge over you. So the very fact that a customer may not be the most valuable in your own customer segmentation does not always mean that they are worthless. It may be worth retaining them, simply to ensure that your competitors are not in a position to exceed your own levels of service.

Before targeting a specific segment, you need to establish how long it will take for that customer segment to become profitable. In terms of a first-time buyer in the mortgage market, it may take three years to break even and five or six years before he/she actually becomes profitable to you. You must have in place a strategy to keep the customer for the required length of time. (Mortgage companies are a particularly good example, because they may include an indemnity that states that if the customer switches mortgage supplier within a set period of time, they must pay a substantial amount of money to the original supplier. Which in turn means that having attracted the first-time buyer, the mortgage company has then locked him/her in, effectively, to a lengthy relationship.)

The end result is that the strategy must be in place at the outset of making the service offering. Your customers provide you with a huge amount of knowledge - this knowledge will enable the company to make various predictive assessments. A particular segment will be seen by the organisation to behave in a certain way. This enables the organisation to assume certain needs are being dealt with, and can aid the smooth communication by tailoring fewer messages. Why do organisations segment their customer base? The main reasons are:

1. To target new customers
2. To retain existing customers
3. To provide better service
4. To reduce the risk of customers defecting to competitors.

Once a segment has been defined, it is important to assess how representative that segment is to the precise segment you were trying to target. You will then need to see how you can physically reach them as a segment, along with the method of communication you will use. Segmentation can only give you potential worth. Until the particular segment becomes customers, you will not know its true value. The strategy to retain them needs to be flawless, if you are to pull it off long-term.

Should you continue to serve unprofitable customers?

There will undoubtedly come a time when the cost to serve unprofitable customers exceeds the income value of that customer. This, however, does not always mean that it is viable to let that customer go to your competitors. Each instance must be carefully evaluated and it must form part of the overall strategy of the organisation. Again, it will depend on whether the organisation measures performance by customer numbers or consumption of products. An ethical question also presents itself: Are you duty -bound to serve the unprofitable customer? In regulated industries, such as a water company, there is no choice. The water company must serve the unprofitable customer, not in exactly the same way as it must serve its top ten per cent, but it must continue to supply at least a basic level of service. It cannot withhold its services. It cannot disconnect the water supply so it has little choice. An organisation that is not regulated has to decide whether or not it *should* deal with this particular customer or client segment, perhaps in a different way to how it would deal with the rest of its customers.

Some of the key factors in making the decision about unprofitable customers will inevitably be whether a company can afford to let those customers defect to competitors, and whether the number of customers that are being let go will affect the economy of scale. It is necessary to calculate whether the unprofitable customer is likely to remain unprofitable forever, or whether that customer could become profitable in a given timeframe.

How to Offload the Customers that Cost you Money

The first step is to calculate not your own cost to serve these customers, but your customers' worth to your competitors. Once the decision is made and the strategy approved, let the culling begin!

The simplest and most cost-effective way of letting unprofitable customers go is by doing absolutely nothing. If a competitor is offering special incentives to your customers to switch, only counter the offer for the segments of your customer base you wish to retain. Another method is to allow for natural slippage of service levels to the chosen segment you wish to offload and accept that there will be a certain amount of wastage (customers threatening to walk away and being allowed to do so, by your inactivity).

When a client calls to say that they are thinking of moving, instruct your service personnel to show a certain amount of empathy, but not enough to change that particular segment's decision. This may all seem very calculated, cynical and harsh, but the profit ethic must prevail and an organisation must deliver to its stakeholders. If a customer is not actively going to suffer from not using your service, then ethically it is acceptable to treat the customer in this kind of manner.

If the segment that you are looking to offload is defined by either postcode or telephone prefix, it becomes really easy to exclude these from mailings, from special offers, from various incentives that you would normally offer as a service to your clients etc. If the unprofitable segment is made up of more intricate components, it is more difficult to pinpoint them, and the methodology becomes more difficult. Because the nature of letting customers go often counters the aims of the mission statement of the organisation, the process may be executed in a somewhat 'clandestine' fashion. Meaning, less than transparent – not to mention a very difficult thing to achieve without causing internal disruption and external consternation. This is another key reason to evaluate whether it is worth undertaking such a process. Many organisations today are building into their business plans and their figures an element for unprofitable customers and the cost of maintaining them. The entire question of offloading unprofitable customers remains one that is up to each individual organisation to assess and to implement or account for.

Creating a Knowledge-Base about Serial Complainers

Serial complainers are a drain on resources. The effect that they have on call centre staff and service personnel, for example, can often outweigh the validity of their complaint. Always evaluate the financial cost of their ongoing complaining. Take into consideration the cost of the time the CSR spends with a serial complainer, the cost of any reparation (the outcome) and the effect that it has on morale. The serial complainer is a customer that nobody wants. Most organisations are capable of identifying serial complainers, yet data collection and dissemination is woefully weak.

Pub-watch is a scheme where landlords in a town share data with each other, as well as with police, about customers they find undesirable. Another scheme exists to capture shop-lifters and another to identify those who continually return clothing and other items to retailers. Serial complainers are a growing minority that need to be watched. Establishing whether a complainer is justified or not demands complete faith in the product and service you are offering. You must have absolute certainty that there is no possibility that the customer could be legitimately complaining because of your failings. Because a consumer has certain rights, there is very little action that can be taken unless outright fraud can be proven. And because most serial complainers are from the 'I-want-something-for nothing' brigade, the likelihood is that they are *not* serious fraudsters. So, the only way to deal with them is to collect data and disperse that data throughout the organisation, perhaps extending the knowledge to other interested parties, while at all times avoiding a witch-hunt approach. From a service perspective, the serial complainer is akin to the retail sector's shop-lifter – only you do not have the powers to deal with them as effectively.

How to Differentiate the Service Offering to Your Top Ten Per Cent

Your top 10 per cent of customers will become a segment in their own right. Within that segment, an organisation needs to identify the key drivers that make them its best customers. There will be common threads which must be pulled together, in order to offer the service and the differentiation to the particular client segment as appropriate. One of the simplest ways of differentiating

your service offering to this segment of clients is through the issuing of privilege cards. When a customer presents his/her privilege card, he/she can then receive a higher standard of service. You could also differentiate through a customer/membership number, which begins with a privileged prefix, so that in any communication that he/she has through any channel, the customer number will set him/her apart from the rest. The service offering can then be cohesive with the value you have attributed to that client's segment. If you happen to know many personal details of that customer (and you should), these can be passed to the call centre, or customer service department, who can then use caller displays on the telephones to indicate that the customer calling is a valued customer.

A couple of tried and tested strategies are exclusive open days or sales for these clients, invitations to events that are not extended to the entire customer base, corporate entertainment, hospitality and so on. Communication is always key and by ensuring that you communicate regularly with your best customers, you will be able to make an informed judgement on what is required to present them with the 'wow' factor. Engaging your top ten per cent of customers in interaction with the organisation will help you build valuable knowledge. This knowledge can then be analysed, in order to see if it is viable to offer incentives to some of the *other* sixty per cent, so as to encourage them to elevate themselves to the ranks of the prestigious 'ten per cent club'.

Further Reading:

- ✓ ***How to Deal with Difficult Customers: 10 Simple Strategies for Selling to, (2007), By Dave Anderson***
- ✓ ***Dealing with Difficult People, (Revised 1st Edition 2010), By Roy Lilley***
- ✓ ***Perfect Phrases for Dealing with Difficult People: Hundreds of Ready-to-Use, (2008) By Susan Benjamin***