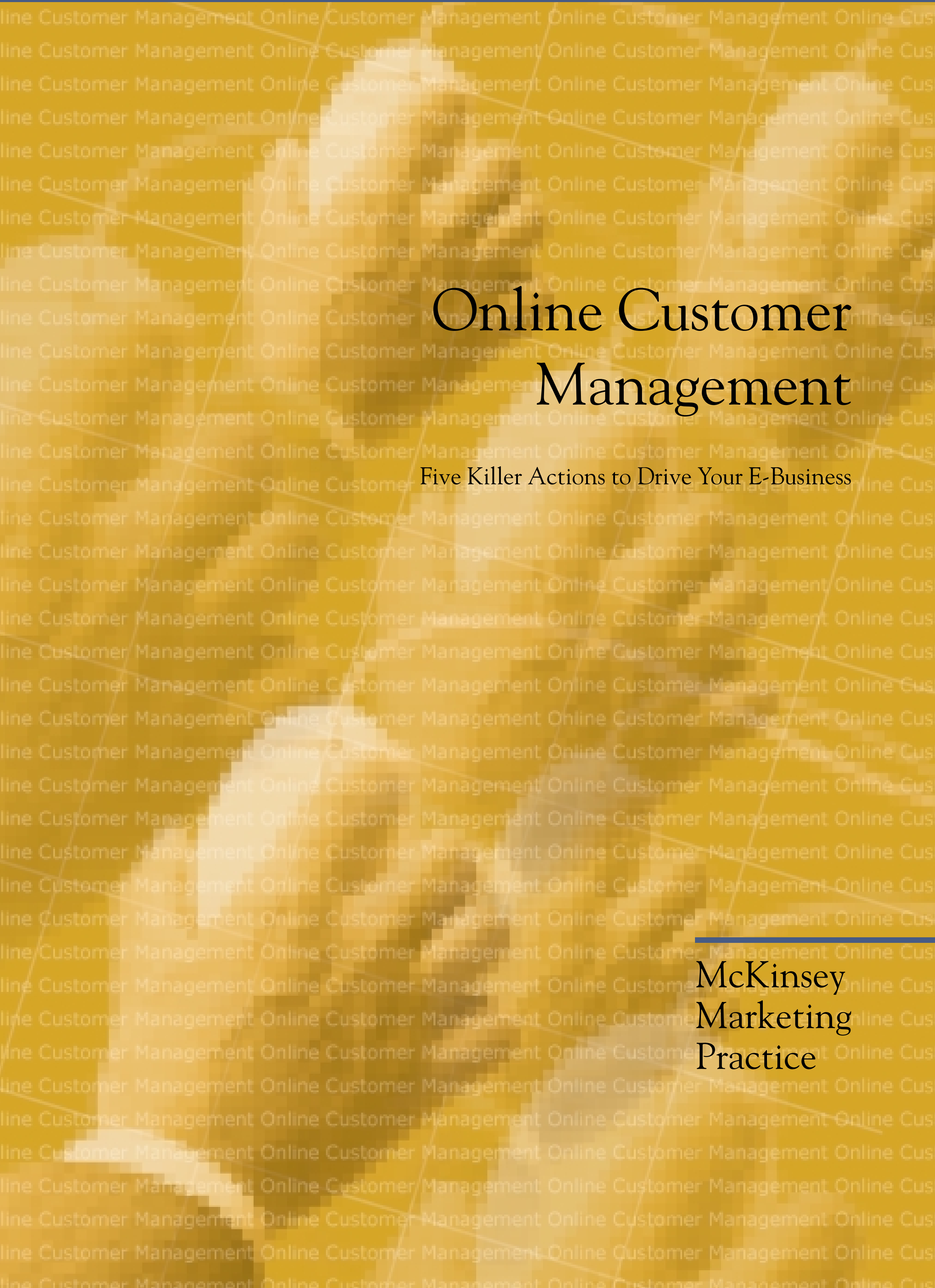


Online Customer Management

Five Killer Actions to Drive Your E-Business

McKinsey
Marketing
Practice

Overview

Online customer management can significantly affect the performance of most online companies. But you must first learn to unleash its power by identifying and reaching out to your most profitable and promising customers. Our research shows five key actions that you can use to help capture a leading e-business position.

- **Understand the "real value" of your most profitable customers to create a winning relationship model.** Model customer profitability using recency, purchase/transaction size and frequency, and margin of products purchased. Learn *who* the core customers really are and *what* makes them profitable, so you can cater to their needs and encourage these behaviors in existing and potential customers.
- **Maximize the economics of customer acquisition.** Determine which marketing vehicles deliver the best and most profitable customers. Deploy marketing and advertising dollars based not on click-through rates, but on a deep understanding of *customer acquisition costs of profitable customers*.
- **Prioritize marketing actions along the customer attraction/conversion/development cycle.** Map customers at each point of the cycle using the number of site visitors, how many register or become account applicants, and the number of new and repeat customers. Prioritize efforts according to the economic value of improving each stage of the customer attraction/conversion/development cycle.
- **Use session (single visit) analyses to optimize the site for key customers.** Watch customers navigate the Web site (through Web log analysis) so you can pinpoint needed improvements. Analyze session data to learn where visitors get hung up and which content areas lead to conversion.
- **Drive conversion, cross-sell, and loyalty through superior segmentation.** Use segmentation techniques to find groups of individuals, identify common characteristics, and develop targeted programs to improve conversion rates and set marketing and site-functionality priorities.

In today's unpredictable world of online business, there is no doubting the ability of online customer relationship management, or e-CRM, to provide powerful competitive and cost advantages. We have seen decreases in customer acquisition costs of 10 to 30 percent (and in some cases, 70 percent and higher), and a doubling of customer conversion rates through carefully executed customer relationship management initiatives. The winners include both pure play Internet and "bricks and clicks" companies.

The reality, however, is that today relatively few companies are effectively using e-CRM to drive the top and bottom lines of their business. The volume of data that can be analyzed and the variety of available software proves overwhelming for many e-marketers. But focusing on selected "killer" e-CRM analyses can have a significant impact. Through our work with many e-companies, we have found five key actions that we believe can unlock tremendous e-CRM value:

1. Understand the "real value" of your most profitable customers to create a winning relationship model. In any business, focusing on your best customers is a key to success, but the Internet provides companies with an unprecedented opportunity to understand who is really driving the business by providing a clear window on all purchases and transactions.

To understand the "real value," or economics, of customers, companies should model customer profitability using recency (time since the last purchase), purchase/transaction size, transaction frequency, and margin of products purchased. Many companies track a few high-level inputs (primarily sales) but fail to consider performance based on a full range of business drivers.

Knowing which customers are profitable and their real value has two critical implications. First, you will learn *who* the core customers really are and find ways to cater to their needs. For example, Wine.com, a leading online purveyor of wine and gourmet products, originally believed its core customers were wine connoisseurs. A careful assessment of data, however, showed that its best customers were wine novices. With this knowledge, Wine.com significantly modified its Web site to deliver the kinds of features these less experienced customers wanted, particularly recommendations and educational content.

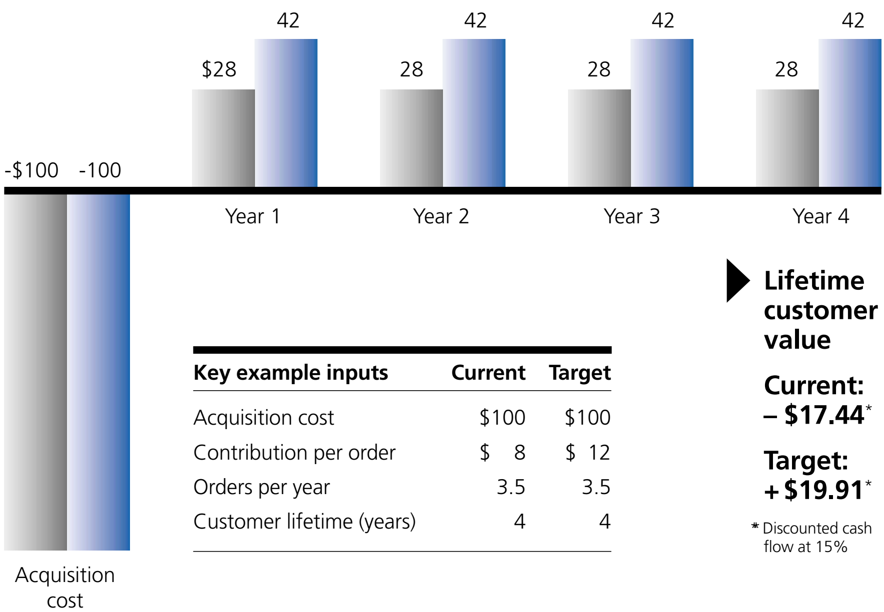
Second, it allows you to fully understand *what* makes customers profitable, then identify and encourage these behaviors in both existing and potential customers. Clearly, customer profitability will vary by type of product or purchase – from infrequently purchased large items to impulsively acquired small items. All companies need to understand customer behavior to make the economics work, but some may need a major rethinking of their business models. Extensions into complementary products might be required for a business that does not have sufficient basket size, or repurchase rate, to cover fixed costs. For infrequently purchased financial products such as loans, managing customer acquisition costs may hold the key to increased profitability.

Table 1 outlines the approach an online retailer took to improve profitability. Customer-profitability analysis showed that average lifetime value was negative over a 4-year period. While the company was unlikely to improve orders per year given the nature of its products, profit per order could be improved significantly which was enough to create positive lifetime value for new customers. With this information, it refocused its site and pricing to improve order profitability.

2. Maximize the economics of customer acquisition. The key to optimizing customer acquisition costs is determining which marketing vehicles deliver the best and most profitable customers. Winners decide where to deploy marketing and advertising dollars and resources based on a deep understanding of *customer acquisition costs of profitable customers*, not simply on click-through rates. To determine

Table 1 **Understand Customer-Level Economics**

In dollars — Current customer — Target customer



Key example inputs	Current	Target
Acquisition cost	$100	$100
Contribution per order	$ 8	$ 12
Orders per year	3.5	3.5
Customer lifetime (years)	4	4

Lifetime customer value

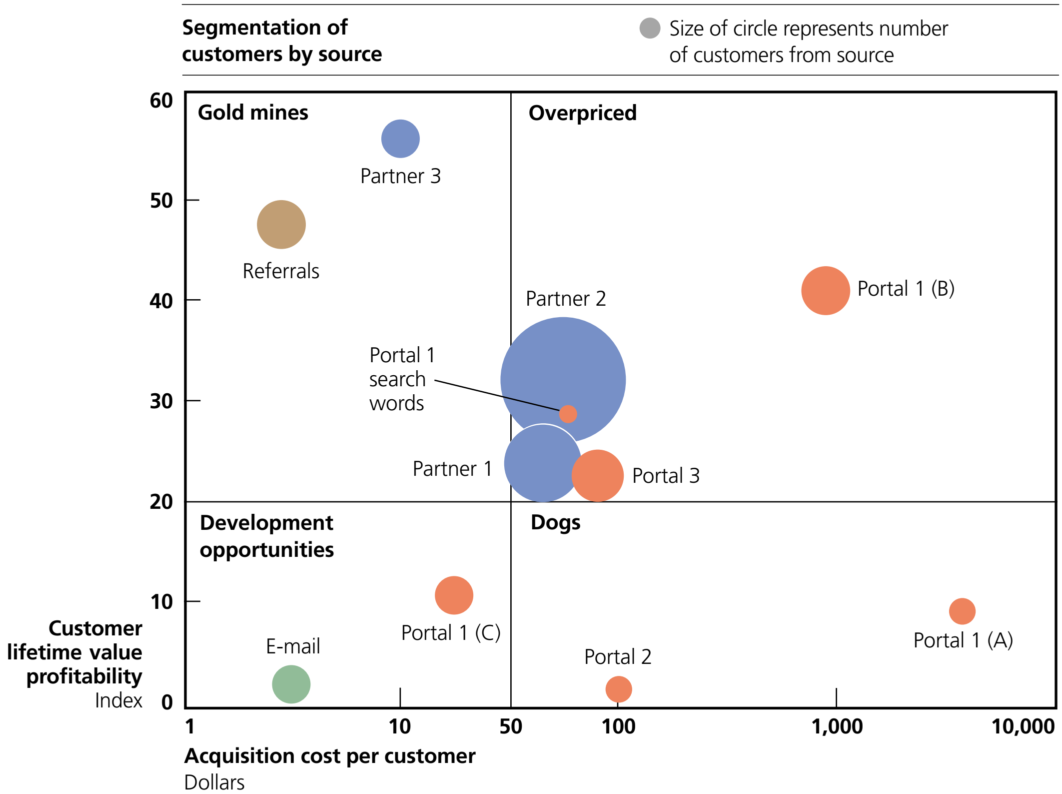
Current: – $17.44*

Target: + $19.91*

* Discounted cash flow at 15%

the true "productivity" of online customer advertising, it is necessary to link the ad source (e.g., sponsorship, banner ad, e-mail) to customer profitability in order to map the value that results from the ad. For each ad source, you'll have to understand the value and cost per customer. One online lender found a huge disparity in the productivity of its ads: it found a set of "gold mines" that attracted high profit customers for relatively low cost per customer, and a set of "dogs" where the cost to acquire customers was substantially higher than the customer value (see Table 2). It determined that it was spending nearly 70 percent of its advertising dollars to acquire roughly 10 percent of its customers. The company quickly redeployed its advertising spend to more productive partner and other sites and tested a variety of new promotions. As a result, it reduced customer acquisition costs by 50 percent while increasing total number of visitors by 100 percent (versus only a 5 percent increase in visitors for its competitors during the same time period).

Table 2 **Customer Acquisition Costs vs. Customer Profitability**



3. Prioritize marketing actions along the customer attraction/conversion/development cycle. Successful companies aggressively manage their customers from attraction to engagement to conversion to retention. This requires mapping customers at each point of the cycle by compiling such data as the number of site visitors, the number that become registered users or account applicants, and the number of new and repeat customers. However, companies will not get the most value by improving each part of the customer cycle simultaneously. Instead, it is critical that they determine the economic value of improving each stage of the customer attraction/conversion/development cycle and prioritize their efforts accordingly.

For example, for many Internet financial services companies, a 50 percent improvement in the number of visitors can result in a 10 percent improvement in site economics, but the same profit improvement can be achieved by just a 20 percent improvement in visitor conversion rate. One online lender believed it could improve either visitor-to-application rates by 100 to 200 percent or application-to-approval rates by 20 percent. The economic analysis described above showed that working on the former could reduce acquisition costs by 25 to 50 percent, and addressing the latter would reduce acquisition costs by just 5 to 10 percent. The lender focused its efforts on driving the 100 to 200 percent increase in visitor-to-application rates, driving down customer acquisition costs by nearly 50 percent in a 5-month period.

4. Use session analyses to optimize the site for key customers. The Internet provides a unique ability to observe customer dynamics: how frequently visitors and customers come to the site, how long they remain, how they interact with content and tools, and how they transact business. The ability to "watch" customers navigate the Web site (through Web log analysis) allows companies to pinpoint needed site improvements. Winners analyze session (i.e., any single visit) data to learn where visitors get hung up during site navigation and to better understand which content areas lead to customer conversion. For example, one company found that 40 percent of its visitors were not getting beyond the home page. It began to test a variety of techniques, including single-step registration, billboarding products on the home page, and using varied landing pages to improve visitor site penetration and, ultimately, purchasing behavior.

5. Drive conversion, cross-sell, and loyalty through superior customer segmentation. Beyond overall improvements, segmentation enables companies to find groups of individuals, identify common characteristics among them, and develop targeted marketing programs to improve conversion rates. We have found two applications of good segmentation that can help produce impressive results:

- **Use customer needs and behavior segmentation to set marketing and site-functionality priorities.** By understanding customer behavior on the Web, companies can often improve cross-selling and retention. Analyzing this behavior based on the wealth of data available through the Internet is usually sufficient to develop a broad set of marketing actions, though traditional customer research (e.g., focus groups for identified priority segments) can be useful in designing relevant offers and messages.

- **Use visitor behavior segmentation to develop targeted messages.** The ability to monitor visitors' browsing behavior provides a unique opportunity to use targeted messages and content to help clinch a sale. Winning companies track and capture the behavior of visitors across multiple dimensions to determine which customers have the most potential to be profitable. Travelocity.com identifies visitors who do heavy research at its site but have yet to make a purchase, and tailors marketing messages, pricing, and other promotions to induce this high-potential group to try its travel services. Other companies track visit frequency, duration, and recency to establish overall behavior patterns. Garden.com uses knowledge of customer geography and buying behavior to provide content specifically suited to specific climates and individual gardening

Table 3 **Significant Impact Possible From Testing and Tailoring Content to Segments**

Best and worst performing home page content*

	Items shown on home page		Net additional conversion for best content (percentage points)
	Best conversion rate	Worst conversion rate	
Segment A	**Sportswear**	**Casual Wear**	**1.3%**
Segment B	**Kitchen**	**Sportswear**	**0.9%**
Segment C	**Fitness Wear**	**Jewelry**	**0.8%**
Segment D	**Sportswear**	**Casual Wear**	**0.7%**

*Based on 4-week test
Source: Angara; McKinsey & Company analysis

Table 4 **Understand Key Customer Segments to Determine Potential Actions**

☐ Above average ◯ Below average

Customer segments based on purchase and site patterns	Sales/purchase data: Average dollar sales per item	Sales/purchase data: Average items per order	Sales/purchase data: Percentage buying multiple categories within site	Site behavior for purchasers using Web site: Number of visits/year	Site behavior for purchasers using Web site: Average visit duration	Site behavior for purchasers using Web site: Percent visits including content
Loyalists	$60	1.7	60%	12	15	8%
Big ticket repeaters	110	1.3	19	8	13	6
Explorers	19	2.0	51	5	21	30
Targeted item seekers	110	1.0	0	3	18	9

Use promotions or product bundling to encourage cross-sell

Send follow-up e-mail to encourage revisit

behaviors. On many sites, visitors' use of online tools, calculators, and games, as well as their viewing of specific content also provides fodder for segmentation and targeting. One online retailer, for instance, dramatically improved its visitor conversion rates by tailoring home page content based on "instantaneous" visitor segmentation (see Table 3).

What e-marketers need to develop is a description of the different types of customers (both *how* they shop and *why* they shop) and the current and potential profitability of the segments, which can then be used to develop segment-specific marketing actions. For example, Table 4 shows a customer segmentation model developed by an online retailer. The segments have radically different behaviors and values which the retailer used to develop meaningful marketing action plans to improve profitability, ranging from product bundling promotions to targeted e-mails that encouraged site revisits.

For many online companies, understanding customer segments is the first vital step to prioritizing and targeting their marketing efforts, which will in turn help them make informed decisions about technology, people skills, metrics, and processes. Combined correctly, these elements pave the way to cross-selling, customer retention, and e-business success.

E-CRM can make a significant difference in the performance of most online companies. But they must first learn how to unleash its real power by identifying and reaching out to their most profitable and promising customers in a host of highly targeted ways. This often means segmenting customers and visitors to their Web site, and then tailoring messages and promotions aimed at their specific needs and behaviors. The rewards of a superior e-CRM strategy include greatly reduced customer acquisition costs, increased loyalty, and more frequent conversion of customers at each critical stage of the development cycle.

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11/2000

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