



Successful Product Bundling Strategies for the Communications Sector

Why optimizing value creation is critical to success



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Executive Summary

Despite a dizzying rush of fresh technological innovation, old-fashioned customer development strategies remain key determinants of success in the newest round of competition between communication services providers.

The over-hyped “Age of Convergence” has already morphed into an “Age of Bundling.” Providers with newly enhanced networks and robust infrastructures vie for the loyalties of fickle customers by relying on retention marketing techniques developed by banks in the 1990s.

Bundling strategies were successfully deployed by banks and other retail financial services organizations to reduce churn, encourage loyalty and grow the overall value of the customer base. The results of these strategies were easy to measure and irrefutably effective.

Can communication services providers replicate those successes? Unlike banks, communication services providers invested billions of dollars into building new high-speed networks. They also spent billions on mergers, acquisitions and alliances formed to create synergies across multiple markets.

For example, SBC followed its US\$16 billion purchase of AT&T in 2005 with the \$67 billion purchase of BellSouth in 2006. Verizon, which purchased MCI for \$8.4 billion in 2006, is spending \$18 billion to vastly upgrade its fiber network. eBay purchased Skype. Google bought YouTube and also launched a WiFi network.

Apple plunged into the telecom competition by joining forces with Cingular (now part of the new AT&T) to market the iPhone. Cable stalwarts such as Cablevision, Cox, Comcast and Time Warner Cable all offer Internet-based telephony. As a headline writer at *The Economist* wryly put it, “Your television is ringing.”

Will Bundling Work in the Communications Sector?

Naturally, all of the companies mentioned above are now looking to recoup their investments. Bundling seems like a reasonable strategy for growing revenue and reducing marketing costs, but it's not clear that an approach that worked well in the retail financial services industry will work just as well in the communications sector.

Just consider the differences between a typical service bundle offered by a bank and a typical service bundle offered by a competitive communication services provider. The bank bundle might include a checking account, a savings account, a credit card, an ATM card, online banking, and a mortgage or some type of consumer loan. The communications bundle can include land-line telephony, high-speed Internet service, 500 channels of TV, and wireless telephony or wireless broadband.

The communications bundle requires significantly more infrastructure and raw processing power than the financial services bundle. Also, the communications bundle encompasses services that must be available 24/7/365. Downtime is considered unacceptable.

On the other hand, no one currently expects banking services (with the exception of ATMs and online banking) to be available around the clock. That represents an enormous difference in customer expectations.

In addition to accommodating far higher levels of expectations from their customers, communication services providers will be required to respond rapidly and effectively when demands for new services emerge.

Bundled services by themselves will not ensure loyalty or sustain competitive advantages in such a fluid marketplace. Consumers have already demonstrated both their willingness and ability to cherry-pick the best offers from a variety of providers. Price wars only ratchet up the pressure on margins as providers race to the bottom in an effort to steal customers from their rivals. Customer acquisition strategies based on steep discounting are unsustainable in the long run because they actually shrink the dollar value of the customer base instead of increasing it.

What Convergence Means to Consumers

From the perspective of a service provider, convergence means replacing a tangled knot of separate networks with a single infrastructure. Streams of encoded data packets then travel on that infrastructure. In theory, a single infrastructure should make it easy for providers to add or remove services based on demand.

However, from a consumer's perspective, convergence isn't about the infrastructure. It's about the customer experience. For the consumer, convergence means shopping, talking, listening to music, writing a report, watching movies, playing video games and checking stock portfolios – from anywhere and everywhere. It suggests a seamless flow of experiences from one device to the next, with minimal interruption.

That's the image in the mind of the consumer. Pitching bundled service packages to a generation of consumers looking for ubiquitous interactivity – and increasingly immersive forms of digital entertainment – is at best a tactic. This approach is not a strategy for long-term profitability.

Customer Focus Is Paramount

So, how should the communication services providers respond? Here's where the communication services providers can learn from the experiences of retail banks – to a degree.

Many of the early pioneers of bundled banking services were advocates of one-to-one marketing – a customer development strategy popularized by Don Peppers and Martha Rogers. In their books, Peppers and Rogers describe three basic types of customers:

- **Most Valuable Customers (MVCs)**
- **Most Growable Customers (MGCs)**
- **Below Zeros (BZs)**

One-to-one marketers strive to retain **MVCs**, grow the value of **MGCs**, and either convert **BZs** to **MGCs** or convince them to defect to a competitor.

Retail banks that practiced one-to-one marketing became experts in differentiating customer groups by value. Then, they would tailor packages of products and services for specific groups of customers.

Retail banks precisely calculated the type and number of products required to ensure a customer's loyalty for a certain period of time. In addition, the bankers became adept at calculating which bundles were most profitable. As an added benefit, the banks were able to lower their overall marketing costs by targeting their promotions more selectively.

One of the key metrics considered by retail banks was customer lifetime value (CLV), which treats each customer or segment as an investment and considers present profitability in a long-term context.

CLV is a forward-looking view of wealth creation; it's the net present value of the likely future profit stream from an individual customer. This involves discounted cash flow (DCF) investment evaluation math for multiple periods, not just a single period. Using DCF calculations, you can equate the future stream of net cash flow (profits) into a single cash amount (i.e., the expected value) of profit stated in today's money.

Don't Lose Sight of CLV

As the retail banks discovered, a snapshot or static view of the customer does not accurately predict the long-term future value of a business relationship with that customer. The banks also learned that CLV is a moving target. People change as they move through various life stages, and their value as customers also changes. For example, a person who routinely overdrew his checking account when he was in college may become a very different customer once he lands a job at a prestigious law firm, gets married, buys a car and begins raising a family.

Many communication services providers have not yet learned these important lessons. Nor have they developed the capabilities required to reliably track CLV and other crucial measures of customer value. In a very real sense, they can't tell their good customers apart from their bad customers.

Customers with a history of paying their bills a couple of days late every month are often lumped into the same category as deadbeats – even when they subscribe to multiple service offerings and are highly profitable over time.

Most providers also lack the capability to discern critical trends in customer behavior that can radically alter purchasing habits and long-term profitability. Part of the problem stems from the failure of many providers to invest in robust customer intelligence solutions that would enable them to generate holistic views of customer activity across all product or service offerings.

In their haste to upgrade and expand their networks, the service providers simply forgot about their most important asset – their customer base.

The Importance of Customer Profitability

While the advantages and benefits of customer intelligence are generally well known, the ability to perceive and act upon shifts in customer profitability are less widely appreciated. Customer profitability intelligence generates detailed analysis across different product and service lines. Armed with this kind of intelligence, providers can accurately:

- **Understand the combinations of behavior, cost and revenue** that are actually driving profitability.
- **Assess the cost to acquire and retain subscribers** and deliver services to them.
- **Recognize profitability bands** that have the best cross-sell and up-sell propensity.
- **Develop demographic profiles** of profitable and unprofitable subscribers.
- **See the movement of subscribers** across profitability bands.

With the right technology, training and support, providers can distinguish between their most and least profitable customers in a multitude of complex, real-world scenarios. They can also determine which products and channels are driving financial performance – and which aren't.

SAS® Customer Profitability for Telecommunications, for example, uses activity-based management (ABM) methodologies to enable service providers to accurately allocate costs and understand profitability at a customer level.

Because ABM takes into account all of the cost factors involved, its benefits can be impressive. For example, some service providers who had been concentrating on reducing churn – an apparently obvious drain on profitability – discovered they had been attracting and keeping the most unprofitable customers. SAS Customer Profitability for Telecommunications generates insight required to avoid such costly errors.

This software solution integrates with the other components in the SAS Telecommunications Intelligence Solutions suite, which also includes:

- SAS® Strategic Performance Management for Telecommunications
- SAS® Customer Segmentation for Telecommunications
- SAS® Customer Retention for Telecommunications
- SAS® Cross-Sell and Up-Sell for Telecommunications
- SAS® Payment Risk for Telecommunications
- SAS® Campaign Management for Telecommunications

Customer Value Optimization Is an Ongoing Effort

Customer value development strategies are dynamic, not static. They can and should be continually improved, tuned and optimized for maximum benefit. For communication services providers, the customer value optimization (CVO) process offers numerous advantages. By spanning functional boundaries, operational processes and transactional systems, it provides both a local and holistic perspective on customers, offerings and touch points.

Because it coexists with a variety of information sources and analytical tools, CVO enables a fast, smooth transfer of understanding among departments, functions and roles. It also enables providers to simulate, test and assess new programs routinely. Best of all, CVO allows agile organizations to adjust even more rapidly and learn from unexpected or volatile conditions.

At the architectural level, a CVO process can be achieved with the following technology components:

- **A centralized data repository** that synthesizes data from incompatible data silos on any platform and in any format.
- **Sophisticated ETL (extract, transform, and load) processes** that maintain data quality, so you can have faith in the accuracy of intelligence based on that data.
- **Industry-specific analytics** that enable non-statisticians to surface meaningful intelligence from vast amounts of information about customers, services and the market.
- **Predictive analytics** to deliver more accurate churn forecasts, proactive actions, targeted marketing campaigns and improved retention rates.
- **Query, reporting and visualization tools** that give various types of users the highest quality of information – where and when needed – via multiple platforms and channels.

Incremental technology investments can unite existing capabilities into a cohesive CVO technology platform that encompasses:

- **Strategic analysis and optimization** – Forecasting, lifecycle analysis, program development and reporting.
- **Program optimization** – Developing, executing and managing customer management initiatives designed to minimize churn and increase revenue and profitability.
- **Optimization sciences** – The ability to design, build and employ advanced analytical systems that provide predictive models, segmentation analysis, mathematical optimization, experimental design and inference testing required to evaluate specific customer management actions.
- **Touch point optimization** – Synchronization and optimization of intentional customer interactions across direct marketing, contact centers, online and other touch points.

CVO Is an Iterative Process

CVO offers service providers the ability to identify opportunities, optimize practical customer management actions and feed results back into continuous improvements – swiftly and cost-effectively.

With CVO technology and competencies in place, the organization can systematically and continually:

- **Align customer management actions** with business strategy, objectives and forecasts.
- **Identify the needs of specific customer segments**, based on a unified view of the customer across the organization.
- **Design the most profitable opportunities to address pains or needs**, with full consideration of programs in other areas of the organization.
- **Implement effective campaigns or programs**, leveraging resources from multiple departments for a cohesive approach.

In addition to continuously refining processes to increase customer value and boost profitability, CVO generates answers to complex, critical questions such as:

- Which of our new products are fully aligned with our current business growth strategies, and which aren't?
- Do our loyalty incentives create customer value or destroy it?
- Which new programs will create short-term spikes in sales but degrade long-term sales performance?
- Are we wasting precious resources to win back unprofitable customers?

The Big Picture of Successful Retention and Profitability Strategies

All around the world, communication services providers are responding to technology and regulatory changes by investing billions to enable their networks to deliver converged broadband services.

The challenge for managers at communication services providers is to generate profits from these large investments over an extended period of time. In the past, service providers counted on high penetration rates to ensure steady, predictable revenue streams. Today's new services are more likely to appeal to segments or niches within broader markets. That severely limits the usefulness of traditional mass-marketing techniques.

Sustainable competitive advantage can be achieved only through the ability to consistently attract and retain profitable customers. Building customer profiles and then using this information to make smarter decisions at every customer touch point is the only way to minimize churn while maximizing profits. It is also the only way to make the right offers, at the right time, through the right channel.

Addressing customer satisfaction, retention and profitability is not a one-time activity. Nor can it be the responsibility of a single department. It is a cross-functional discipline that must become a way of doing business. What worked yesterday may not work tomorrow, so the organization must continually strive to learn all there is to know about its customers and then adapt to meet their needs.

Communication services providers need to build this discipline and leverage organizational talent across functional boundaries, with the flexibility to adapt quickly and respond meaningfully to customer lifecycle changes.

Service providers must look beyond convergence, which is largely invisible to the consumer, and should avoid relying on discounted service bundles to attract customers. Other industries have proven that carefully developed customer-centric strategies can be highly effective drivers of both revenue and profit, even in the most highly competitive environments.

About SAS, the Leader in Business Intelligence

SAS is the market leader in providing a new generation of business intelligence software and services. SAS solutions are used at more than 43,000 sites – including 96 of the top 100 companies on the 2006 FORTUNE Global 500® – to develop more profitable relationships with customers and suppliers; to enable better, more accurate and informed decisions; and to drive organizations forward.

SAS Customer Profitability for Telecommunications leverages the investments you've already made in existing systems and applications, adding a layer of intelligence you can't get anywhere else. For three decades, SAS has been giving customers around the world THE POWER TO KNOW®. Visit us on the Web at www.sas.com.



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