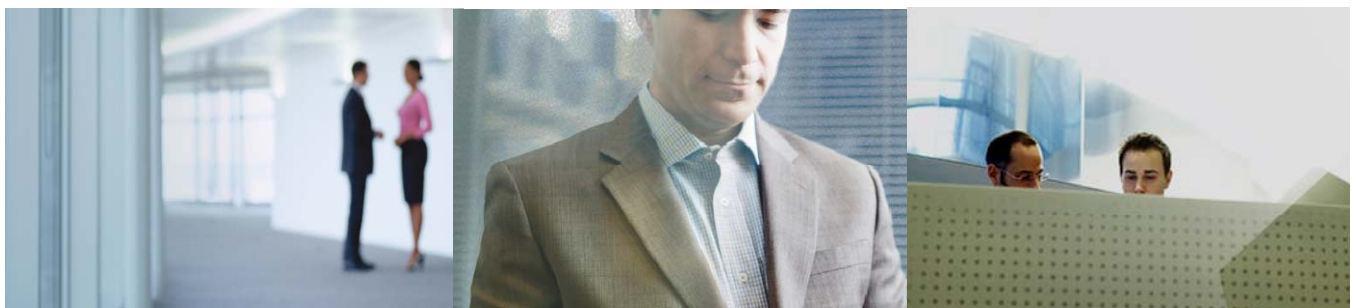


White Paper: **An Unfortunate Surprise**



Why Predictive Response Models Often Decrease Both Revenue and Marketing ROI

“What is surprising, is that while predictive response modeling usually does improve response rates, in many cases it actually increases customer acquisition cost per account - or worse.”

- Predictive response modeling as practiced by many companies can *decrease ROI*
- A singular focus on recent purchases is what often causes high value customers to be overlooked
- The Value-Adjusted Optimization Model considers the full value of responders, and can significantly improve ROI

Executive Summary

Predictive response modeling isn't new. By statistically analyzing the demographic and behavioral characteristics of responders to direct marketing campaigns, it is possible to predict the likelihood of response to a future effort at an individual prospect level. This allows the marketer to select prospects with the highest likelihood to respond and vastly increase campaign response rates, while cutting costs.

But what is surprising, is that while predictive response modeling usually does improve response rates, in many cases it actually increases customer acquisition cost per account - or worse, directs companies away from their most profitable customers and significantly reduces ROI.

To overcome these challenges, AccuData Integrated Marketing employs an alternative approach, called the *Value-Adjusted Optimization Model* that is changing how many in the industry manage their direct marketing campaigns. This approach - that is primarily used in only the most technically sophisticated organizations - was adapted to help all types of companies achieve measurably higher bottom-line results. It considers three factors when making prospect selection decisions: gross response, value creation per response and recurring value creation (or lifetime value) from that responder.

The Pressure to Perform

Marketing managers have always felt pressure to produce measurable results. But now that every area of an organization - large, mid-sized or small - is under increased scrutiny by the CEO and CFO, it is no longer enough to simply measure campaign response rates. Today, many marketing managers must deliver on specific value creation or cash flow targets.

The problem, however, is that response rates often do not translate into value or cash flow. In fact, response models frequently increase customer acquisition cost per account and steer companies away from their most profitable customers by focusing just on the initial value indicator - gross response.

Likely to Respond, but Not to Buy

Most response models predict which prospects will be the top responders or “hand-raisers.” However, prospects that have a higher likelihood to ultimately buy often do not fall in these top responder groups. Top responder groups are frequently composed of “promotion” or “offer” seekers. They may reply and therefore drive up the response rate, but they also tend to convert less, cancel orders more, and if they do purchase, buy less frequently.

As a result, marketers who focus their efforts solely on response rates may exclude potentially valuable prospects from their direct marketing efforts that are likely to convert into buyers. The following table illustrates this phenomenon.

Table: Customer Value Compared with Response Model Scores

Response Model Decile	Conversion	Margin	Returns	Repeat Purchases
1-2				
3-4				
5-6				
7-8				
9-10				

● - high ◐ - medium ○ - low

The data, compiled from actual AccuData modeling results and campaign histories across numerous campaigns and industry sectors, show that those prospects that scored in the top two deciles (deciles 1-2) by the response model also tended to convert less. They also purchased less, returned more and had fewer repeat purchases. In short, they were ultimately less valuable than prospects that scored in deciles three or four and possibly even five and six.

Solving the Revenue Riddle

This is precisely why AccuData developed the Value-Adjusted Optimization Model. As a holistic modeling technique, it helps marketers integrate value and response - the only way that campaigns can be truly optimized for both short- and long-term results.

The Value-Adjusted Optimization Model is effective because it simultaneously considers many factors, including:

- Demographics - Age, income, education and occupation
- Lifestyle - Magazines read, book interests, hobbies, arts, travel and sports interests
- Buyer Behavior - Goods and services purchased, types of credit cards used and Internet use
- Response Indicator - Has the person responded or not
- Revenue Indicator - Has the responder purchased something or not
- Value - Value of the purchase, recurring purchaser and tenure of customer

Using this data, separate predictive models are built and 'nested'. This creates an overlay of the best revenue-generating segments with the best responder segments, and allows managers to identify their most valuable prospects.

For example, the Value-Adjusted Optimization Model was used in the following manner to calculate one client's value-adjusted score.

Value-Adjusted Optimization Model Calculation

(Likelihood to respond) x (Likelihood to buy) x (Value of purchase - Returns)
x (Repeat purchase factor)

In this case, five predictive models were built and nested to produce the value-adjusted score:

- Likelihood to respond
- Likelihood to buy
- Likely value of first purchase
- Likelihood to return
- Likelihood to repeat

Producing Results

The results of AccuData’s modeling efforts confirm that buyers that appear to have a higher value did not necessarily fall into the top responding segments. It also underscored the importance of a holistic customer view - since even a singular focus on recent purchases caused marketers to overlook potentially high value customers.

The table below illustrates the gains produced by the Value-Adjusted Optimization Model at a large national retail organization.

Table: Response Model Gains and Value

Response Decile	Response Lift Rate by Response Decile	Conversion Lift Rate by Response Decile	Average Value per Customer	Average Total Value by Response Decile	% of Overall Total Value by Response Decile
1	198	76	1872	\$183,456	7.6%
2	187	290	2542	\$701,592	29.0%
3	137	233	2316	\$562,788	23.3%
4	97	201	2137	\$485,099	20.1%
5	91	104	2054	\$250,588	10.4%
6	84	51	1860	\$122,760	5.1%
7	82	27	1492	\$64,156	2.7%
8	53	11	1089	\$27,225	1.1%
9	43	6	967	\$15,472	0.6%
10	27	3	630	\$6,300	0.3%

* Source: AccuData Integrated Marketing

The table shows that most marketers are conditioned to select prospects only from segments with an above average lift rate - usually the top 3 deciles. Deciles 1 through 3 in this same table show a lift rate of at least 130% ('A' between 198% and 137%) that would typically be chosen for prospect lists.

However, when we look beyond response to value, it shows that the *greatest value* is produced from deciles 2 through 4 ('B' lift rates ranging from 290% to 201%). This means that if marketers were selecting prospects based on response propensity alone, they would have overlooked a solid value-generating group, decile 4, which *represents over 20% of the total value ('C')*. If the marketer desired to increase the size of the mailing to four deciles the table shows that decile 5 captures over 10% of the remaining value ('D') versus selecting from the top decile of the response model to receive only 7.6% of the total remaining value.

An Underused Approach

After seeing the significant benefits generated by the Value-Adjusted Optimization Model, one might find it odd that more marketers are not using it. The reality is that several sources of data must be obtained before a Value-Adjusted Optimization Model can be built. Many of those sources come from other functional areas of the organization, requiring coordination and cooperation to obtain the necessary data.

There are also specific challenges that need to be addressed before pursuing this approach:

- Multiple Purchases - How does one allocate purchases made over time to a single outbound solicitation effort?
- Time and ROI Considerations - To arrive at near-term value, a net present value calculation should be done. This requires a decision on which time period and discount rate will be used for the calculation
- Cost Accounting - Should value be based on gross sales, gross margin or net profit? If the latter, then a company's finance department needs to help assemble a cost accounting matrix by product, product costs, returns and overhead. All of these will factor in the near-term value calculation

“One or two simple cross tabs of list performance by decile can quickly uncover red flags.”

Additionally, this approach requires multiple statistical models that are embedded within each other or ‘nested’. This can add complexity when it comes time to score your data for future marketing efforts.

While these issues have historically created obstacles for many marketers, the benefits are simply too compelling to be overlooked in today’s market. With the help of a capable analytics team, marketing managers can quickly begin using these principals to see significant improvements in their revenue and marketing ROI.

How to Get Started

The first step to implementing a Value-Adjusted Optimization Model is to assemble response, conversion and value data for each individual that was targeted in recent campaigns, as well as their modeled response score decile membership. This normally will involve a file extract from a campaign management or CRM system.

One or two simple cross tabs of list performance by decile can quickly uncover red flags:

- Conversion or close rates that increase from deciles 1 to 2, or deciles 2 to 3
- A proxy for “value” increasing with each decile. For example a larger average purchase amount in decile 2 than in decile 1
- A higher return or cancellation rate in a top decile

If red flags are evident, then consider a deeper analysis to explore the possibility that the selection of the top response decile may be leaving value on the table.

Implications

All of this demonstrates that a focus on customer acquisition, retention and growth – not just on response rates – can make a significant impact on marketing selection decision making and ultimately on campaign value creation.

It is important to recognize that there are several implications of this fundamental shift in the direction of today's marketing analytics. First, it will result in a further measurable reduction in customer acquisition cost per account – welcome news for companies in every industry. And, by producing a more holistic approach to customer acquisition, it will encourage marketers to view customers as a long-term recurring revenue stream, rather than as one-time buyers.

This approach also gives managers the highest level of flexibility, placing a focus on areas that are most important – whether it is response or buyers, without regard to multiple purchases. In addition, it allows marketing managers to expand their targeted market universe and use the underlying profiles to test different creative messaging to improve performance.

But perhaps most importantly, this model finally gives you the insights you need to find your most profitable prospects and achieve the results that senior management now demands.

A Partner in Your Success

A leader in database marketing services, AccuData Integrated Marketing uses a full range of data resources, powerful marketing analytics and database technology to accurately target qualified buyers and increase ROI. For nearly 20-years, AccuData's industry experts have been dedicated to helping clients develop lead generation strategies and develop customized marketing solutions. AccuData has delivered results to more than 5,000 clients across the printing, agency, energy/utilities, travel/hospitality, financial services, healthcare, ecommerce, energy/utility, retail and telecom industries.

Call 800.732.3440 or visit www.AccuData.com for more information.

ACCUDATA INTEGRATED MARKETING
5220 SUMMERLIN COMMONS BLVD SUITE 200 FORT MYERS FL 33907
800.732.3440 INFO@ACCUDATA.COM WWW.ACCUDATA.COM