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The Importance of Customer Segmentation

By Ric Kosiba, Ph.D., Bay Bridge Decision Technologies

Many years ago, I was placed in charge of a team of analysts whose task was to provide decision support to an entire credit card enterprise. For me, it was a dream job. My team and I got to tackle difficult but fascinating projects in all areas of the company, from who to offer credit cards, how much of a credit line to give them, who to offer marketing promotions, who to watch as a credit risk, how to staff customer service and collections, which customers who were late in paying should we call, what payment programs to offer them, how to prioritize collections calling resources, and more.

Of the many things that I took away from these jobs, two come to mind. The first is that you can apply some fairly theoretical math techniques to real-world problems and come away with very impressive improvements in operational and marketing performance. In the credit card world, you do a lot of test and control to determine the best approach to shape customer programs and offers and, invariably, the use of math modeling always trumped "expert's best judgment" methods.

The second item I took away from this job was the power of customer segmentation — for both good and bad.

What is Customer Segmentation?

Customer segmentation is simply treating your customers differently. We see this every day. When a customer boards an airplane first because of her frequent flyer perks, she's been segmented by the airline for preferential treatment. When you get a different set of coupons on the back of your grocery receipt than the next customer, it is because the grocery company has put you in a different customer segment. It happens all the time. Segmentation can be very powerful. It can also complicate how we manage our contact centers. Here, we'll discuss both the power of segmentation and the some of the complications associated with managing a segmented world.

The Power of Segmentation and Being Average

We have been working with a large and well-known credit card issuer. This company has its act together. They spend a fair amount of resources analyzing and segmenting their customer base to determine which customers are receptive to which product offerings, and when, how, and how often they should be marketed. Through training, technology, and careful hiring, they seamlessly work these marketing messages and approaches into their operation. Their operation always delivers.

In informal conversations I've had with their workforce director, I've been told that this approach is a tad expensive, but that the results are fantastic. They have been able to tie financial return with better customer retention and significant customer sales. Their customer service function delivers significant and known sales returns. This company made a decision to have a great operation. Not average. Not above average. Great.

When the decision was made to turn this company's contact center from a simple customer service function to a real channel for marketing growth, I imagine the process was considered very risky. Running a great, leading edge center rather than an average, technologically third-generation center involved executive risk. There were probably significant hurdles to overcome and there were likely periodic setbacks. But it was the right thing to do.

There are significant risks to remaining average. Often these risks are hidden and external — they are simply that your competition will eat you for dinner.

When pulling out a credit card for making a purchase, the customer pulls out the competition's card product. In collections, when deciding to pay one loan over another, your delinquent customer will pay the competition. Or given a choice, the customer chooses to buy your competition's product. And you'll never really know why.

Often, being average will mean that your staffing costs are a tad higher than your competition; that your contact center is run more inefficiently than your competition, maybe because you use different staffing and forecasting models. Maybe your competition can run important what-if analysis that you don't have time for.

I would argue that the risks involved, while often hidden, are much higher with the conscious or unconscious decision to run an average center than to run a great one.

In a nutshell, what this company has done is to segment their customers, and organize their contact center and its strategy around delivering sales via their customer service function. Their segmentation drives their call centers.

Rule of Thumb #1: Tie Segmentation to Your Goals

Segmentation always involves an exercise in determining to whom, out of your base of potential customers, you will offer products or services. The methods that you (or your marketing folks) use to determine who to make an offer to are very important. In many organizations, the segmentation task is left to marketing, but in some organizations, this task is left to call center management and is handled through call routing.

There are many companies and consultants whose business is providing data and services geared to helping you segment your customer base. And while segmentation is a complex subject, I'd like to quickly discuss a few simple rules that often get overlooked. Later we'll discuss what this means to managing our workforce. The first rule is to tie the segmentation of your customer file to your company goals. While it sounds straightforward, you'd be surprised by how often sophisticated and analytically driven firms miss the mark. Here is a simple collections example which I had firsthand experience.

A large credit card collections shop utilized segmentation to prioritize who to contact and when to try and call their delinquent customers. They used "how late" as their primary segmentation and used a commercially available risk score as a secondary segmentation. All that was fine and normal.

However, they overlaid on top of this segmentation a sophisticated and commercially available contact optimization system that reordered the daily calling list each morning. Again, all of this seemed logical. In my experience, most collections shops are a tad overstaffed, and this shop was no different, until one week when part of their contact center network went down. This was when the segmentation scheme's faults became obvious. I received a phone call from the remaining on-line contact center manager: "Something is wrong with our system! We're only calling people who are barely delinquent! How do I get it to stop?" What did we do wrong?

The mistake we made is that we let our contact optimization software, in the guise of maximizing contacts, determine who we called and how often we tried to contact them. In simplest terms, once we became resource constrained (when the network went down) our system began calling the delinquent cardmembers who were easiest to get on the phone. In our portfolio (and most portfolios) those folks who will answer the phone the most readily are those customers who are only barely delinquent (and will pay anyway).

The hard lesson we learned was that we were using risk score thresholds and lateness to determine who was most important to call, and then, overriding them all, contact probabilities as a proxy for our real goal, which was to reduce dollars lost through bad debt.

Even on normal days, the contact optimization tool threw everything out the window and focused our entire collections effort, not on our true company goal, but instead, on filling our agent's time with chatting to our easy to contact customers. Does this make sense?

In collections, it is critically important that you focus your organization toward your supreme goal of minimizing charge-off dollars. Your segmentation should be focused directly on this goal as well.

Rule of Thumb #2: Consider The Program

The next rule of thumb also sounds simple, but is almost universally ignored, and that is to make sure to target your segmentation to the program you are considering. In other words, one of your first cuts in your overall segmentation should be to throw out all of those customers that are simply not eligible for the treatment you are considering.

A huge part of segmentation is to determine who will get what sales offer (in marketing), or payment program (for collections) or preferential treatment (e.g., frequent flier perks). When analyzing who should get what offer, it's important to build your models only on the customers who could potentially get the offer.

Again, let me use a credit card example. The company was going to try and determine who to market a "Low-interest through Christmas" program. It was important to determine who would most likely use this feature, as the cost of the communication was high.

We used a computer model to determine who was most likely to use this program. So we sent out many offers to the folks we thought most likely to respond, but after implementation we did not see an increase in the amount of credit line that our customers used. In other words, not many folks took us up on the offer. This costly program saw no benefit to the company.

Why was this program a flop?

The reason turned out to be simple. When we built the “most likely to respond to our offer” model, the segment most likely to respond had already maxed out their credit line. While they might have used the low interest rate program, they simply couldn’t because they were at their credit limit. Later when we did a better job on a similar subsequent program, and modeled only those eligible for the program, it was a huge success. We had learned this lesson.

Rule of Thumb #3: Response is King

One last point about segmentation, and that is: response is king. All segmentation exists to elicit response from your customers. If you are a credit card collections shop, you are trying to influence delinquent cardmembers to make a payment. If you are a marketing department marketing a product, you are concerned with response rates. If you are an inbound customer service function, you are concerned with customer retention, satisfaction, and cross-sales. If you are a sales center you are concerned with closing those sales.

Segmentation for the sake of segmentation is always confusing and costly. Your segmentation should be designed to elicit a specific response — and if that response does not occur, the segmentation scheme should be dropped.

Your segmentation and your contact center organization should support these efforts in a very direct way. Each customer segment should reflect in some way the expected response of your customer to your main offering and your center organization should reflect the customer segmentation.

The simple example is to make sure that you staff each specialized function appropriately so that the goal of the segmentation is met. In other words, you should staff enough sales folks available to handle your sales calls and meet your sales goals.

An Important Multi-Skill Call Center Metric: Capture Rate

For some of us, segmentation is a significant part of our job, our contact center manages an outbound calling list, or our inbound customer list is periodically passed by us to differentiate cross-sell opportunities. Others manage a contact center through skills based routing, and maybe our call routing is rudimentary or obvious or just un-analyzed.

Part of the reason, I believe, that for many of us the connection between staff planning and segmentation is only a distraction is that we do not have the tools and the metrics to measure whether we are doing a good job. Multi-skilling your workforce always adds complexity. Supporting a segmented customer base always adds complexity. But customer segmentation is here to stay. Determining whether you are doing a good job or not with your segmented customer base and segmented workforce is, however, difficult.

I’d like to discuss the concept of Capture Rate. A very smart customer (and friend) of ours introduced this concept to me, and it makes perfect sense as a metric for centers with multi-skilled agents and particularly for segmented customers.

When planning for a multi-skilled workforce there is more than your service level goal at work. If I have two or more groups that can handle the same call queues — albeit with different priorities — I can achieve the same service level (or ASA or abandon rate or occupancy) with very different staffing ratios. What becomes important and what is the differentiator between a plan that hits my service goal and one that hits my service goal optimally is whether the calls end up with the right agent group.

Staffing Versus Capture Rate

Capture Rate is the percentage of calls that go where you want them to go. Every plan you produce has an implied Capture Rate in a multi-skilled environment. The trick is to add this metric to your planning system, to your daily activity reports, and to your workforce management schedules.

In much the same way that you staff to a service goal, you should also staff to a Capture Rate goal. As you specialize your workforce, you necessarily begin to add inefficiencies, and the trade-off between higher staffing costs and more sales needs to be explicitly considered when putting together your plans. Certainly, ignoring your Capture Rate means you are ignoring a true measure of success in a multi-skilled world.

Segmentation is important and profitable, and we need to provide metrics and analysis that supports this concept. A good place to start is with Capture Rate.

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