Customer Relationship Management
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Lecture – 14
Economics of CRM

Hello everybody, welcome to Customer Relationship Management course in NPTEL Swayam platform. This is Dr. Swagato Chatterjee from VGSOM IIT Kharagpur, who is taking this course for you. In this week we will discuss about economics of CRM and what is the monitory part of CRM, how we can use CRM as a strategy or customer relationship management as a strategy to make money.

So, we have talked about quite a bit, quite a lot and we told that customer relationship management is like any relationship that you try to build. And, in earlier days of the relationship, when you try to build a relationship, you have to invest a lot on the relationship. And, we you generally do not get returns a lot. But, later part of time in a human to human relationship I will say you have to in so, some times in the earlier days of your relationship, you may not you may not feel good about certain factors.

For example, let me give an give an example, let’s say when me and my wife, who was at that point my girlfriend would have been, in the earlier days of our relationship what happened let’s say, she liked a certain kind of movies. And, now I am probably might have a different kind of preferences.

But, because I want to build this relationship for quite some time, I might probably go with her to watch that particular movie. And, even if I probably will not enjoy the movie as much as she does. And that same applies for some other kind of TV serials, some other kind of entertainments probably games, and some kind of sports, luckily we both used to like football and cricket matches and etcetera. But, this is very common that in many places you might want to hang out with your friends.

And, some of the friends in that group is somebody whom your spouse or your girlfriend or boyfriend might not like and for that you have to probably, not go to that particular friends meeting even if you might have enjoyed there.

So, that is because that we generally want to build a relationship and to make a relationship strong, and long lasting, and benefit generating, in the initial times you might not have certain good output from that. You have to make more input and get better not get better output in the earlier days.

But, what happens is once the relationship goes stronger and longer, the two or multiple agents in that relationship, in this context let us say me and my wife's context we are the two agents. So, we come to know better about each other. We come to under we have a better understanding our strengths and weaknesses our likes and dislikes; we have a better understanding about all those factors now.

And, now that we have a better understanding, probably we will choose such kind of products or even our weightages: the amount of weightage that we give to various aspects of our value systems or the amount of amusement entertainment that we get from various sources of entertainment. Even all these things go through a Bayesian process. Bayesian process means, it gets updated slowly. So, that they almost match or becomes very close.

So, when that happens, when that kind of a preference matching and understanding get generated, then you have to do very, you have to actually do incur very less cost to make the other agent in that particular relationship satisfied. For example, let us say now I know that what kind of movies she likes and I also have grown my preferences towards those kinds of movies. So, we both enjoy the movie.

So, while enjoying the movie I am giving her companionship, at the same time I am enjoying the movie. So, the cost of companionship, the cost that I have to incur to give her companionship is coming down because I am enjoying I am getting benefit, I am getting benefit from the companionship one and I am getting benefit from the movie also, earlier which used to not happen.

So, over the longer period of time, because the multiple agents in the relationship comes closer in terms of their behavior, their preferences and etcetera, the cost that they incur comes down. That is number one. The chances of getting a better output goes up, because for example, let's say, I want to give — I want to make her happy; I want to make her, make her satisfied. So, I am planning to get her some gift in our anniversary or in her birthday or something like that.

Now, earlier also I wanted to give that gift. So, the cost in terms of the physical, mental information search cost blah blah blah is more or less same let us say. In both the conditions, I want to make her happy.

So, I want to incur the cost, but will even if the wanting to in that the cost is same. Will the output be same in the earlier part of my relationship? I might not even know that what will make her happy, what will be the output of a gift called XYZ.

Now, I know what is the output of the gift called XYZ and ABC and DEF and GHI, and I find out that gift which optimizes maximizes the happiness. So, in other words I know that which I right now, I know that which gift will make him most happy as simple as that.

So, because that knowledge also get ─ got created over this long period of relationship, the chances of getting a better outcome in the context of marketing, the chances of getting a better revenue, or the chances of a successful closer of a purchase deal is higher.

And, that is an outcome of customer relationship management. So, it will show you, we will all show you that in the initial part there will be some losses, but that losses will be very well broke even and we will get much more profit. As the relationship stretch ─ relationship period goes longer.

So, one of the major goals that's why, is you have to optimally increase the customer relationship life, the customer life-cycle you have to improve that. So, these ideas came from 1960s.

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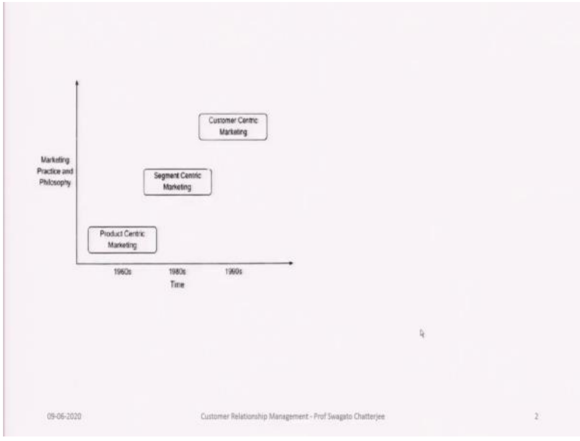

So, it is actually have dependent on the marketing concept or basic marketing concept, that in 1960s we had product-centric marketing concept. What is product-centric marketing concept? Product-centric marketing concept says that you create a very unique product, which will be required by these people. You create a very unique product and try to sell that particular product.

So, that is the product-centric marketing concept. The whole marketing with the first important step in that whole marketing procedure is to create a very unique high-quality product, but later came a segment-centric marketing concept.

So, now also we were creating products, but first, what we did is we created the customer. Sorry, we studied the customer and then we have broken the customer into multiple segments. And, for each of these segments we try to or depending on which segment we want, to target to ─ we try to create a product, which will be a useful in that particular market.

But, then in 1990s, ten years later came the customer centric marketing. Where it is the customers who will tell you what to produce, rather than you finding out what to produce, what to make, how to make them happy, it is the customers who will tell you what to produce?

So, all the customer-centric marketing is the whole customer company is looking towards the customer, everybody is there to help the customer, whether it is the HR of the company, whether it is the finance of the company, whether it is the IT IT team of the of the organization. All of this guys HR, Finance, IT, might not have a direct face to face contact with the customer.

For example, let’s say, it is a production company ─ it is a chemical organization. So, will the, will the IT team will deal with customers? No. Will the finance team will deal with the customers: no, HR team: no but still if you can create that philosophy in that particular organization, that, everybody is trying to help the customer, you are HR or you are finance your job is ultimately related to helping the customers.

So, you have to make sure that your employees are in a right stage, or your projects are rightly funded, or your economic condition, the cash flow and etcetera is in the right space so that your customer gets happy. So, that is something that we called is this customer-centric marketing from where this philosophy of CRM came in.

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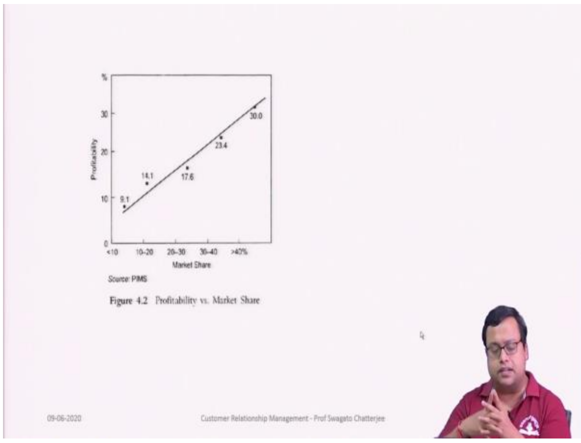

And, it had been seen that when you adopt that customer-centric marketing, the profitability and market share has a very strong relationship.

So, the higher is the market share, the higher is the profitability: why? Because, you generally go for economies of scale; if, you can produce a lot, you can probably create more; you can probably reduce your price a lot. And, because your cost is also low and you can probably make higher market share at the same time higher revenue.

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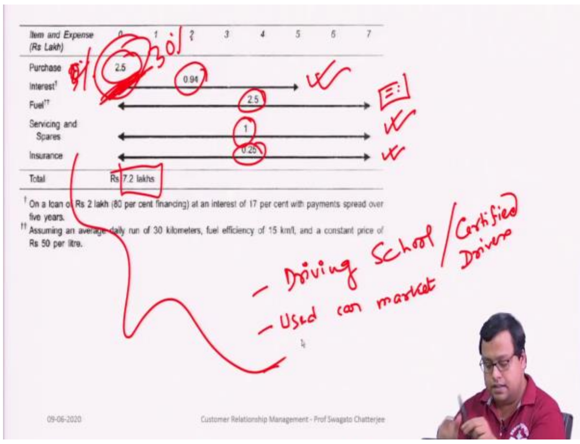

So, that kind of relationship we have got. Now, this is a classic example that I will talk about in this particular ─ so, just check about this particular thing.

So, let’s say, if we are, I am giving an example of a car purchase. Let’s say, you have purchased a car. So, it is a Maruti Alto. If, it is a Maruti Alto, then you will purchase the car at probably the cost of the car is around 2.5 lakhs.

The question is, here that whether this 2.5 lakhs is the only money that you generate for the car company. You have to understand that here, what is the purpose of car? A service dominant logic says that, there is nothing called a product.

Every product is trying to create a solution for the customer; it is there is the problem that the customer faces. And, the product or service or whatever is trying to create a solution for the problem. So, the question is, why do a customer want to buy a car? So, why will they want to buy a car? What is the problem that they face?

They might want to buy a car, because of problems that they face is that they want a private transport. They ─ why they want a private transport, what is the problem with the other one that is public transport? Public transport can be crowded, public transport might not give you convenience, because you might want this particular, you might have a particular time, when you want to reach.

And, you might want to have a, you might have a particular time, when you want to start. And, you want, you might want this particular transport absolutely available whenever you want.

So, all these things create a problem, which public transport cannot solve and that is why you might need a private transport. You might also want something which will give you some amount status in the society. Whatever society you live in, it will give you some amount of status in the society, which is also a problem, which you try to solve using your car. So, all of these things ─ these kind of problems you try to solve by buying a car.

Now, the question is that whether buying a car only, you have bought a car that is in your garage solves the purpose: no, because the car cannot drive on it is own. So, the first thing that the car needs is fuel.

Now generally, when we buy a car what is the life cycle of the car, product life cycle of the car, how much time period you have in your mind? You keep in your mind when you purchase the car let us say 5 years, 10 years. So, here we take an average 7 years.

So, what these 7 years you will be paying ─ 7 years means around 84 months. And, if I say that in 84 months you will be paying 3000 rupees on fuel per month. So, that comes up to be around 2.5 lakhs. So, another 2.5 lakhs rupees that you will spend on fuel was 7 years. When you buy a car in loan, probably the interest rate here it is written as 17 percent interest rate.

So, then you will pay around 1 lakh, close to 1 lakh over 5 years in interest. So, that is also something that you pay. Now, over the 7 years that you are keeping this car, the car will need maintenance and the maintenance you have to go to the so, sometimes there is extended warranty, sometimes 1 year warranty or whatever will be the case you want to spend some money on the maintenance also.

So, if we assume that every month it is, every year it is 15,000 rupees then total maintenance is around 1 lakh. And, then you have to also pay for insurance so, was 17 for 7 year 3000 rupees or 4000 rupees every year. So, it is around 0.25.

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So, if we just add these things up properly, you will see that around 7.2 lakhs is the total expenditure that you are doing on the car. And, out of which only 30 percent at max, 30% is basically the 30% is basically your cost, the initial price of that thing.

The rest is basically coming from some external sources. Now, how I can tap these external sources? Let's say insurance company, I can have a tie up with the insurance company. That whenever a purchase happens in my store or for my car, XYZ insurance company is the only insurance company will come.

So, that is one way; so, that is one way. Next is, I can also have my own service centers, if I have to tap this 1 lakh. What will I will do, I will create my own service centers, like Maruti Suzuki has it is own service centers.

What else if there is a fuel cost, then, I will actually have a tie-up I can have a card, that whenever you buy fuel from this particular service provider, then you will get some points or I can say that only these xyz lubricants can be used in my car.

So, the lubricants: if you have a tie up with the particular brand of lubricant, then you are actually pushing the customers to buy that particular brand's lubricant and you are making a cut out of that because you are creating leads ─ creating customers for the fuel company.

So, you can make a profit out of that and also probably the interest again the banks you consider that you can only bank loans has to be taken from this particular place. You can arrange for the bank loans and you can create leads and you can make money out of that.

There are many other things from which you can make money. You have to understand we missed some of the things. For example, even if your car is there you have managed all the finances, insurances, fuels, repairs, somebody is there to drive the car. Now you have to at least, either you need a driver or you have to learn the driving. So, for that the car companies like Maruti Suzuki comes up with driving school, or certified drivers.

So, you can money out of that, make money out of this. So, whenever we buy car, either we need a driver, or we learn to drive. So, that is something which is also one avenue from where, I can make money right? Where else I can make money? Now, let us say I have used it for 7 years, now I want to sell the car and I want to buy a new one.

So, there is a huge used car market. And, you can create that used car market for your customers. You can say, that you don't have to go somewhere else, you can come here we will arrange for your sale, and I will give you ─ I will take small commission, Again you are making money out of it.

So, there are many ways in which you are making money from a car and only very less percentage of that making money is basically the purchase. The rest, so you do lots of branding and marketing blah to make sure that the purchase happens, but it is actually the money making happens after you made the purchase. For the customer the Maruti Suzuki they start making money, through the services and solutions that they provide rather than the car.

So, then I actually sometimes wonder that, what is the business of Maruti? Is Maruti's business is to make cars, sell cars or to sell something else? Sell car accessory service is something that is an important factor to understand. So, that is what customer lifetime value is or economics of CRM is that you do not make money from these, you make money from all of these.

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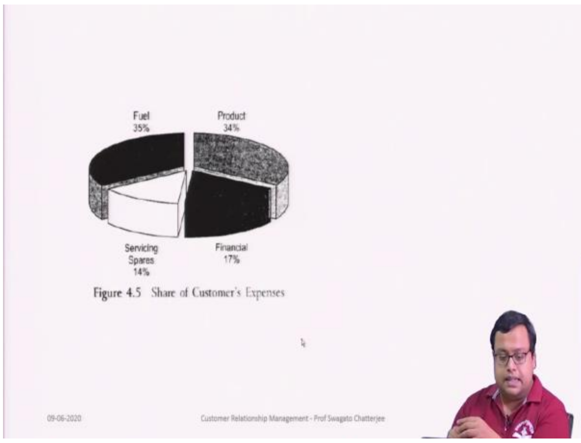

So, you can see that, it has been told that based on the calculations on before, the product cost is 34% and actually low because if you consider driver and the other things. The fuel cost is 35%, and the financial costs are 17%, and a spares and services is 14%. You have to focus on all these other things also along with the product.

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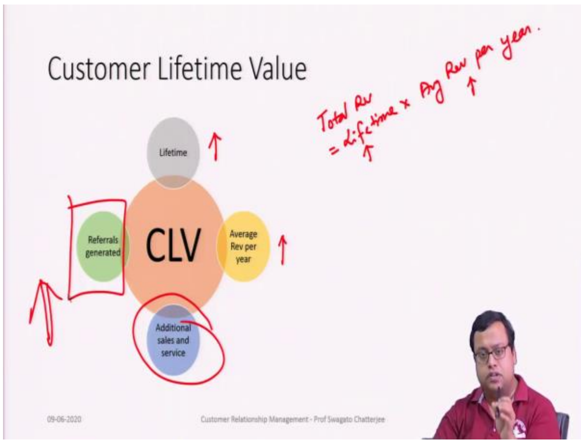

And, we have also seen, that customer lifetime value: then it depends on what if you, if I just talk about this customer lifetime value. One of the major drivers of customer lifetime value is the life time. So, let us talk about what is customer life time value first.

Customer lifetime value is the total amount of money that you can generate from one customer, over his life time. The total amount of not revenue: the total amount of profit ─ the total amount of net income that you can generate from the customer over his life time. What is the current day value of that? That is the customer lifetime value.

In the today's price what will be the today's money's worth, what be the total income that you can generate from a customer. Now, if the customer life time is long, lifetime means not 70 years 80 years life of that person it might be, but not. Here, we are talking about a significant amount of time till which you expect that customer to be in your customer base that is customer life time.

So, it varies depending on ─ for example, for IIT Kharagpur, if it is a B. Tech student the customer lifetime is four years. If, it is engineering students, the sorry, MBA student's life time is two years, but the alumni lifetime can be very long, but the customer ─ the student lifetime probably is 4 years, 2 years. In other context probably lifetime is of 5 years.

So, that is customer lifetime, within that lifetime how much money you can make basically…So, life: the first important factor that contributes to CLV is the lifetime, as this increases the customer lifetime value increases.

Now, average revenue per year; so, basically, if the total revenue that you make from me is lifetime multiplied by average revenue per year. So, both increases I am good, if this increases also I am good, if this increases also I am good. So, I have to make sure I can give certain kind of services and etcetera to a solution to the customer, such that his average revenue per year goes on increasing.

So, he starts purchasing more, he starts adopting more and more services. How by making sure that he tries additional services? If, he tries additional sales and services then he will actually ─ the average revenue per year will slowly keep on going up.

So, it will not be a constant it will be an increasing curve. So, by making sure that you can do lots of cross sell and upsell to this customer, but what we left aside is the referrals, he will not only make, he will not only make money from the customer, which we have discussed in the previous one. If, the guy is happy with the car, he will talk about the car to many other people. And, those many other people some percentage of that will come and buy your car.

So, your existing market share contributes towards your upcoming market share through referrals. So that referrals become important and you have to make you have to encourage customers to increase the referrals. There are multiple strategies that people adopt to induce the referral creating strategies in the in the customer relationship management, but referrals is a important factor.

So, all of these things together create the customer lifetime value and you have to monitoringly calculate this customer lifetime value. Why you have to monitoringly calculate? Because you have to know that who are your profitable customers, who are your non profitable customers, we have discussed about based (Refer Time: 22:44) case.

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So, it is important to identify your profitable and not so, profitable customers one. Second is you have to understand that, whether there is a way to make your not so, profitable customer to more profitable customer, or is there a way to make your profitable customer to further profitable customer. What is the back log; what is the blockage, what is the, what is the thing that you can do so, that that blockage goes away?

So, is it that the referrals are not happening or upsell or cross sell is not happening or the lifetime is small, and within that small life time lots of purchase happening. So, which one is the major reason for your customer lifetime value to be small is something that as a company that you have to find out.

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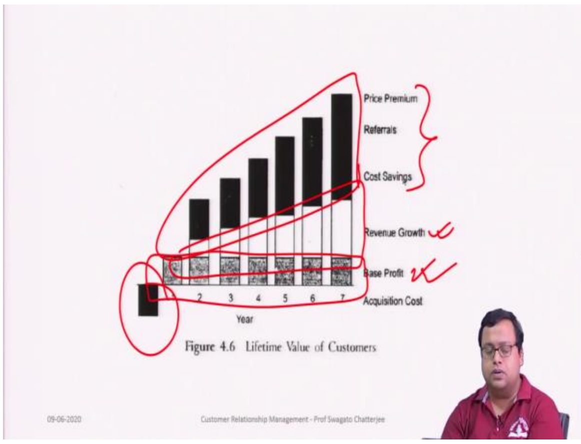

So, all of these thing details when you do it properly then you can see something like this curve. That initial in year 0 there will be a loss. In the year 0 the acquisition cost is there and that is why the base profit is negative. But, next there is a base profit and then there is a revenue growth, which is additional sales and services and then there is referrals.

So, slowly from 2nd year, 3rd year, 4th year onwards, your total profit keeps on increasing slowly. So, the base profit remains same, but if you start selling lots of other stuff and then you starts charging for some additional upskill product or upsell product or you can make money from the referrals also. So, this is something that we try to see.

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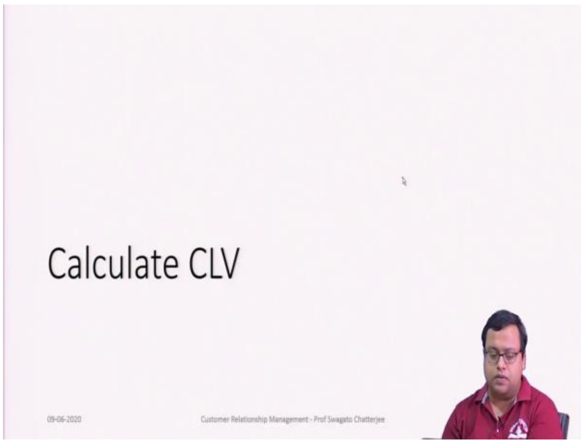

So, in the next video what I will do is: I will show you certain examples of how to calculate customer lifetime value with some data. So, thank you very much for being with me in this particular video. In the next video I will back with some excel hands on.

Thank you.