Customer Relationship Management
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Lecture – 18
Economics of CRM (Contd.)

Hello everybody. Welcome to this NPTEL Swayam course on Customer Relationship Management. This is Doctor Swagato Chatterjee from VGSOM IIT Kharagpur, who is teaching this course. In the last two-three videos we were discussing about branding, customer loyalty, customer lifetime value and I have given an idea about a case which is Rosewood; and in this particular class we will be doing a little bit of hands-on on Rosewood case to find out that whether they should go for individual branding or corporate branding.

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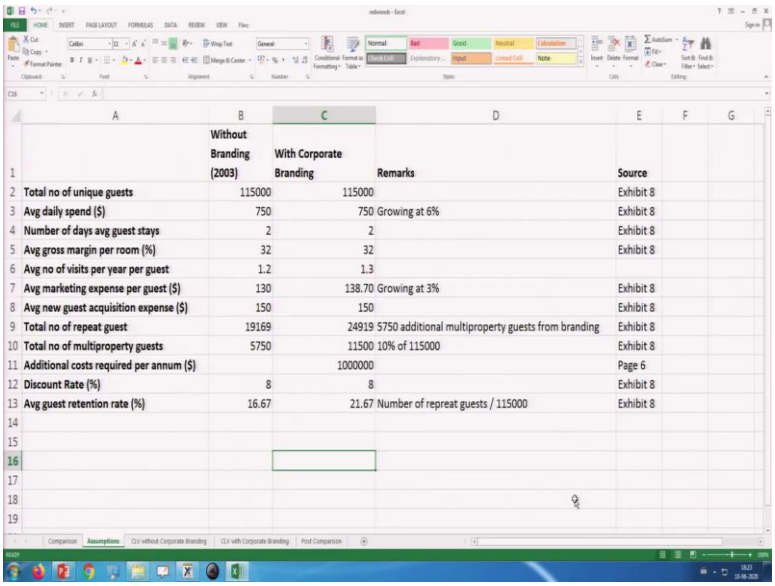

	A	B	C	D	E
1		Without Branding (2003)	With Corporate Branding	Remarks	Source
2	Total no of unique guests	115000	115000		Exhibit 8
3	Avg daily spend ($)	750	750	Growing at 6%	Exhibit 8
4	Number of days avg guest stays	2	2		Exhibit 8
5	Avg gross margin per room (%)	32	32		Exhibit 8
6	Avg no of visits per year per guest	1.2	1.3		
7	Avg marketing expense per guest ($)	130	138.70	Growing at 3%	Exhibit 8
8	Avg new guest acquisition expense ($)	150	150		Exhibit 8
9	Total no of repeat guest	19169	24919	5750 additional multiproperty guests from branding	Exhibit 8
10	Total no of multiproperty guests	5750	11500	10% of 115000	Exhibit 8
11	Additional costs required per annum ($)		1000000		Page 6
12	Discount Rate (%)	8	8		Exhibit 8
13	Avg guest retention rate (%)	16.67	21.67	Number of repreat guests / 115000	Exhibit 8

So, this particular thing has been taken from a case where different ─ the information's were collected from the different exhibits of the case. And the information were like that, if you have without branding, if you do not do branding this much was; this much was the number of unique guests and if you do branding by then this is the number of unique guest also.

But what happens is, the average daily spend is 750, it was there and it is growing at a pace of 6% ; the number of days average the stay is 2, average gross margin per room is 32, because that's what it has been told there.

But what happens is that average number of visits per year per guest goes up slowly when you do corporate branding. Because they come back, there is a repeat customer that comes up that is something, so which is not very high 1.2 to 1.3.

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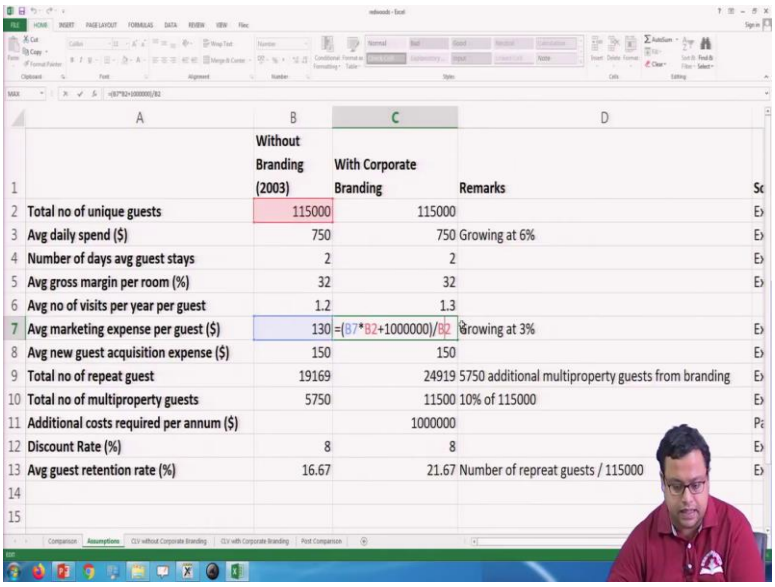

	A	B	C	D	
1		Without Branding (2003)	With Corporate Branding	Remarks	Sc
2	Total no of unique guests	115000	115000		Ex
3	Avg daily spend ($)	750	750	Growing at 6%	Ex
4	Number of days avg guest stays	2	2		Ex
5	Avg gross margin per room (%)	32	32		Ex
6	Avg no of visits per year per guest	1.2	1.3		
7	Avg marketing expense per guest ($)	130	=(B7*B2+1000000)/B2	Growing at 3%	Ex
8	Avg new guest acquisition expense ($)	150	150		Ex
9	Total no of repeat guest	19169	24919	5750 additional multiproperty guests from branding	Ex
10	Total no of multiproperty guests	5750	11500	10% of 115000	Ex
11	Additional costs required per annum ($)		1000000		Pa
12	Discount Rate (%)	8	8		Ex
13	Avg guest retention rate (%)	16.67	21.67	Number of repreat guests / 115000	Ex
14					
15					

And average marketing expense per guest here is 130 and here is you can see the calculation; it is basically, basically this extra 1000000 will be the cost of corporate branding.

So, 1000000, if it is the total cost of corporate branding and I have 115000 customers; so the extra cost on marketing is 8.7 rupees or dollars per customer. So, that gets added and that is growing at a 3% rate; because you have to keep on doing, as I told in a corporate branding strategy; if you have to keep on doing the branding, the marketing expenditure will go on and happening.

An average new visit is same, total number of repeat customer these goes up. So, the repeat customer ─ so not only the stay of the customer goes up, average number of visits of one customer goes up,but the number of repeat customers also goes up; how much? 5750 additional multi-property guests from corporate branding adds up to this.

So, that is how it changes. So, what is the total number of multi-property guests? In this case, it was 5750, these becomes 10% . So additional is how much, another 5750. And discounting rate we have assumed to be 8% and average retention rate also goes up by 5%.

So, in initially, it was 16.67, it was 21.267. So, this is a con that your marketing expenditure is going up. But the pros, is the average visit is going up, the multi-property guests are going up and your retention rate is going up. Let's see after doing this whether we will be in a positive position or in the negative position.

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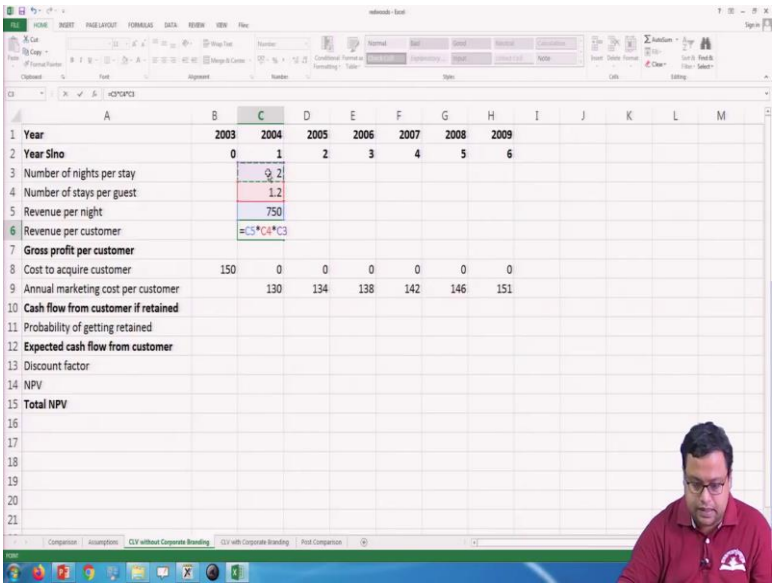

So, the first thing is we will calculate the customer lifetime value for when there is no corporate branding. So, when I take these things as my result. So, how many number of stays? So, in the first year you acquired the customer ─ in year 0 you acquire the customer and you don't do anything. So, what is the cost of acquisition? The cost of new guest acquisition is 150, so I will write 150.

Next year onwards you do not acquire the customer anymore, because it is already there with you and I assume that the customers lifetime is 6 years; this is an assumption that I am making based on my idea, you can reduce or increase as a the customer lifetime. Then what is the annual marketing cost? The annual marketing cost if you see here, it is written 130 and growing at a pace of 3%.

So, here the first year there is no marketing cost, in year 1 there is 130 is the marketing cost and that goes on increasing at a rate of 1.03, okay. So, this is the cost. Now, come let's come on the benefit part, how much? So, first year I am acquiring the customer, so it is 0, no nothing here.

The second year, the number of stays number of nights per stay is 1.2 and number of stays per guest ─ no actually 2. This is 2 and this is 1.2. And what is the revenue per night? It is 750. So, what is the revenue per customer? That is basically this into this into this that's the revenue.

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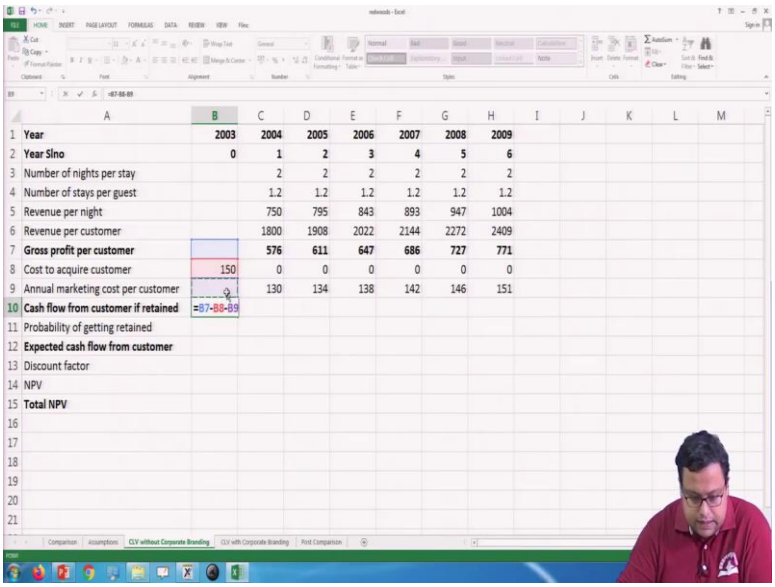

	A	B	C	D	E	F	G	H
1	**Year**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
2	**Year Slno**	**0**	**1**	**2**	**3**	**4**	**5**	**6**
3	Number of nights per stay		2	2	2	2	2	2
4	Number of stays per guest		1.2	1.2	1.2	1.2	1.2	1.2
5	Revenue per night		750	795	843	893	947	1004
6	Revenue per customer		1800	1908	2022	2144	2272	2409
7	**Gross profit per customer**		**576**	**611**	**647**	**686**	**727**	**771**
8	Cost to acquire customer	150	0	0	0	0	0	0
9	Annual marketing cost per customer	0	130	134	138	142	146	151
10	**Cash flow from customer if retained**	=B7-B8-B9						
11	Probability of getting retained							
12	**Expected cash flow from customer**							
13	Discount factor							
14	NPV							
15	**Total NPV**							

And what is the gross profit then? The gross profit is basically 32% margin is there; so, this comma 0.32 that is my gross profit. Now, the nights, number of nights per stay is it going up? No, it is not going up, nothing is written here; so I will keep it 2 for everybody.

Next question is, guests visit is also remaining same; this 750 is growing up at a rate of 6 % , so that becomes 1.06. And I get this revenue; so what? So, these things will be same, this is basically the multiplication of these three terms; this is basically the multiplication of these three terms and so on and each will have a 32% margin, I don't think the margin also changes, it is remain same, so 32% margin.

So, this is the, so this is the net money that I generate from his stay and this is the acquisition cost and I am at this moment I think that the referral and up sell and down sell will be same for both the third type of customers. So, what will be the cash flow if retained? So, first year you are making a loss, second year onward you are making some profit, right?

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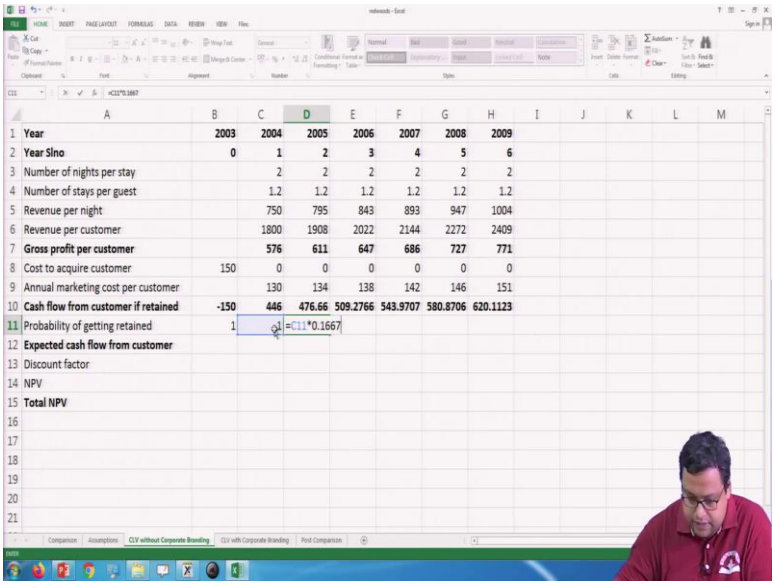

So, what is the probability of getting retained, retention rate? So, first year I in, I actually incurred these acquisition costs; so this is 1. And then I second year 1 actually, year 0 I incurred the acquisition cost, year 1 they all stay with me, because that is how I will calculate, the second year is also 1. But then third year onwards only 16.67 customers stays with me, yes.

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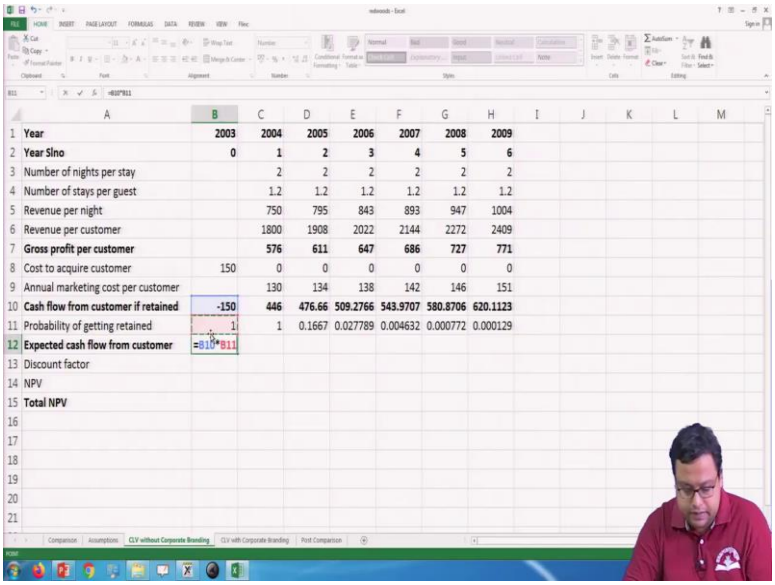

	A	B	C	D	E	F	G	H
1	**Year**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
2	**Year Slno**	**0**	**1**	**2**	**3**	**4**	**5**	**6**
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8	Cost to acquire customer	150	0	0	0	0	0	0
9	Annual marketing cost per customer		130	134	138	142	146	151
10	**Cash flow from customer if retained**	**-150**	**446**	**476.66**	**509.2766**	**543.9707**	**580.8706**	**620.1123**
11	Probability of getting retained	1	1	0.1667	0.027789	0.004632	0.000772	0.000129
12	**Expected cash flow from customer**	=B10*B11						
13	Discount factor							
14	NPV							
15	**Total NPV**							

So, this multiplied by 1667 and then I drag it. So, then what is the expected cash flow? Expectation is the number of cash flow into the probability.

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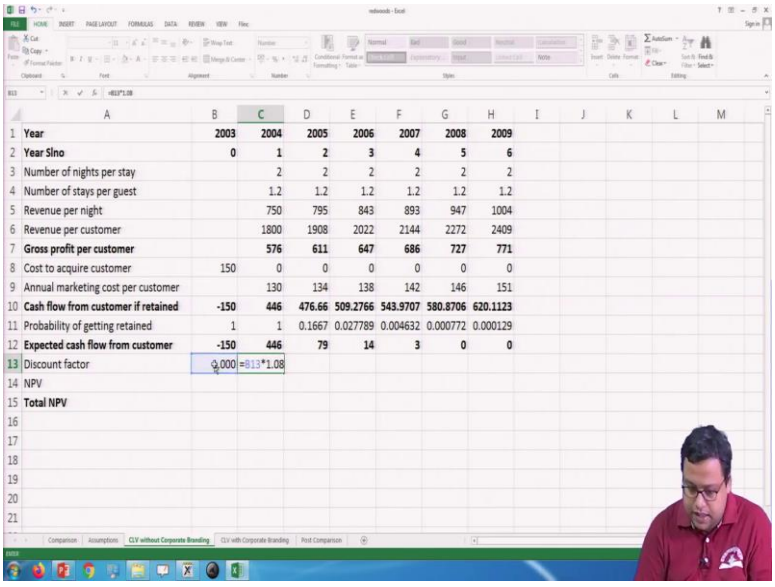

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11	Probability of getting retained	1	1	0.1667	0.027789	0.004632	0.000772	0.000129
12	**Expected cash flow from customer**	**-150**	**446**	**79**	**14**	**3**	**0**	**0**
13	Discount factor	1.000	=B13*1.08					
14	NPV							
15	**Total NPV**							

So, this is the expected cash flow; this becomes 0, because the probability that this guy will stay after 5th or 6th year is very low. So, practically, I can remove these two columns, anyways, I will keep it for now. So, what is the discount factor? The discounting factor means, what will its 8 % . So, what I will do is? I will do this is 1.08.

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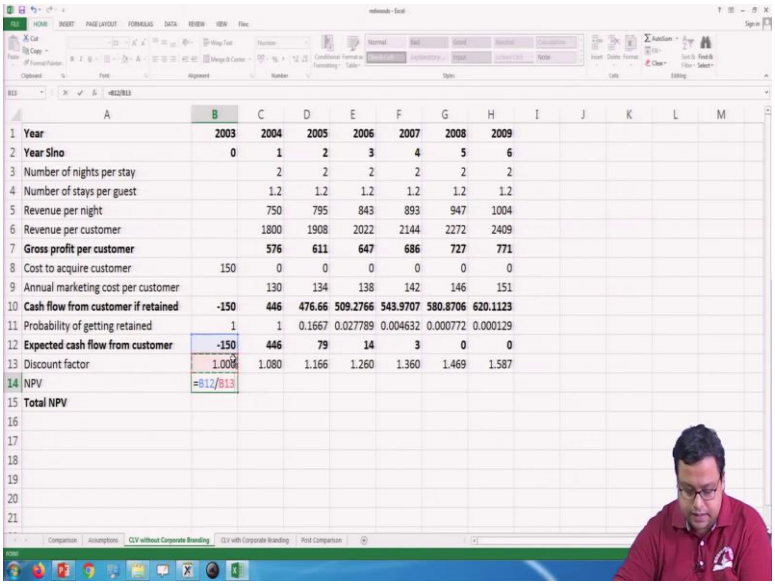

	A	B	C	D	E	F	G	H
1	**Year**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
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11	Probability of getting retained	1	1	0.1667	0.027789	0.004632	0.000772	0.000129
12	**Expected cash flow from customer**	**-150**	**446**	**79**	**14**	**3**	**0**	**0**
13	Discount factor	1.000	1.080	1.166	1.260	1.360	1.469	1.587
14	NPV	=B12/B13						
15	**Total NPV**							

No this year it is 1, second year it is this into 1.08 and so on; and this value 1.08, 1.08^2 , 1.08^3 and so on, this value will be divided.

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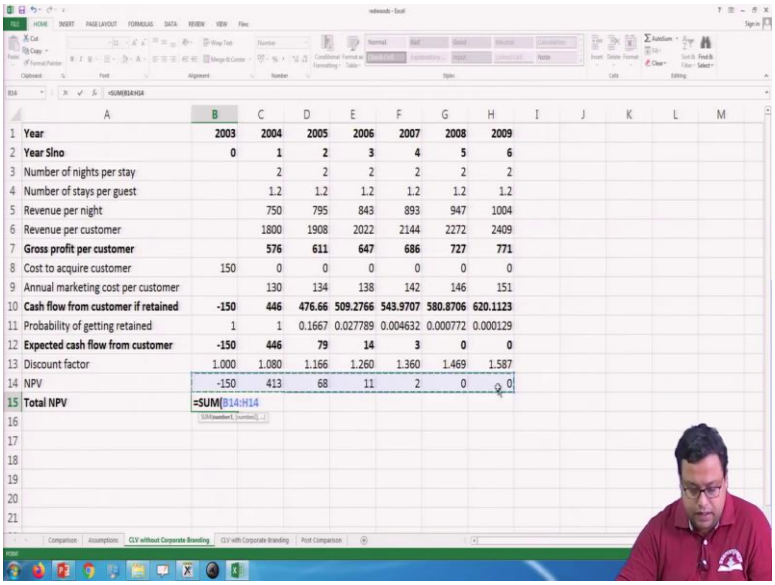

	A	B	C	D	E	F	G	H
1	**Year**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
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13	Discount factor	1.000	1.080	1.166	1.260	1.360	1.469	1.587
14	NPV	-150	413	68	11	2	0	0
15	**Total NPV**	=SUM(B14:H14						

So, this divided by this that is my net score.

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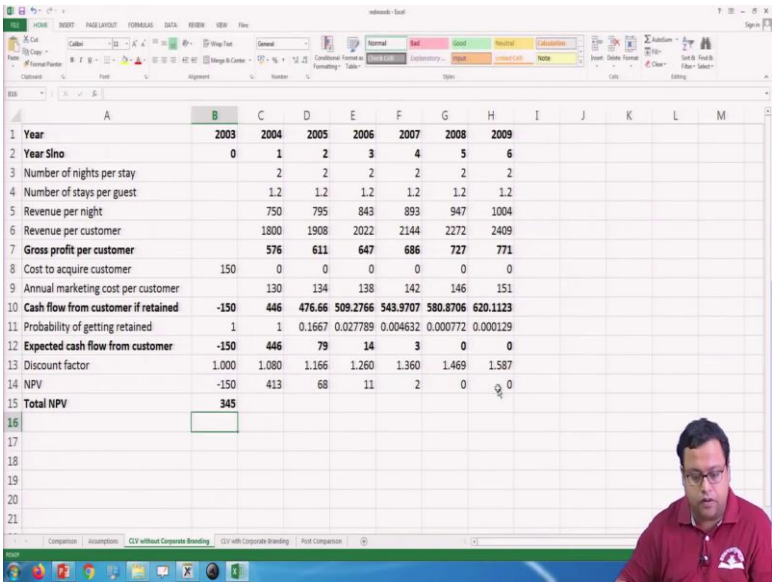

	A	B	C	D	E	F	G	H
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12	**Expected cash flow from customer**	**-150**	**446**	**79**	**14**	**3**	**0**	**0**
13	Discount factor	1.000	1.080	1.166	1.260	1.360	1.469	1.587
14	NPV	-150	413	68	11	2	0	0
15	**Total NPV**	**345**						

So, the net NPV is basically a sum of all these NPV. So, net present value for one customer, when we do not do this calculation is 345 dollars. So, that's how we get it in this condition.

Now, I have to do the same comparison. Now, if you remember, we are not talking about multi-property guests; this multi-property guest is going up because of this thing, this 1.3 is coming from there actually. Because, there this multi-property guest initially is how much? 5750 was the number of multi-property guests, these has gone up by 10 % .

So, total number of repeat customers is this, but these two values are not being taken into account currently in the calculation purpose. See there was never I took this 5750; but and 169 ─ 19169, these two is not taken into account. Even after that, even not taken into account whether that helps is something that I will be trying to check.

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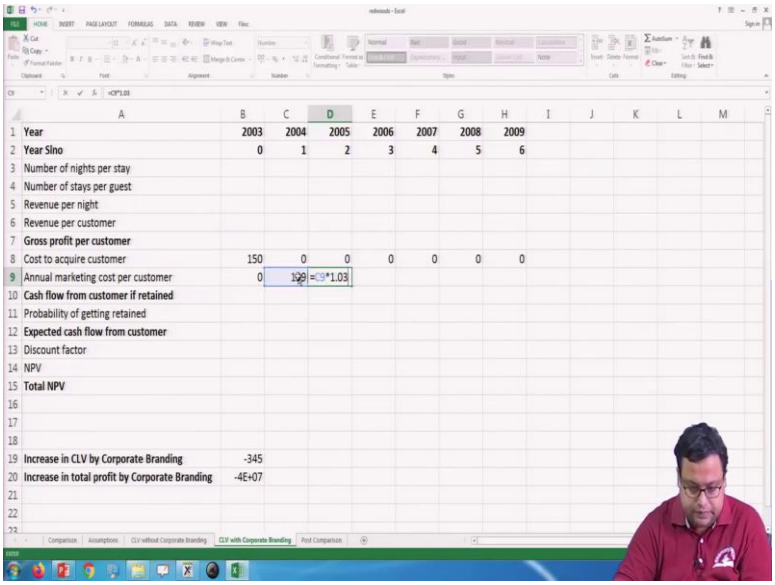

So, here how much is the acquisition cost? Same 150 and what will be the marketing cost? Okay. So, I will put it here, the marketing cost is, if I am not wrong it is 138.7 growing at 3% , so 138.7 and that grows at a 3% rate.

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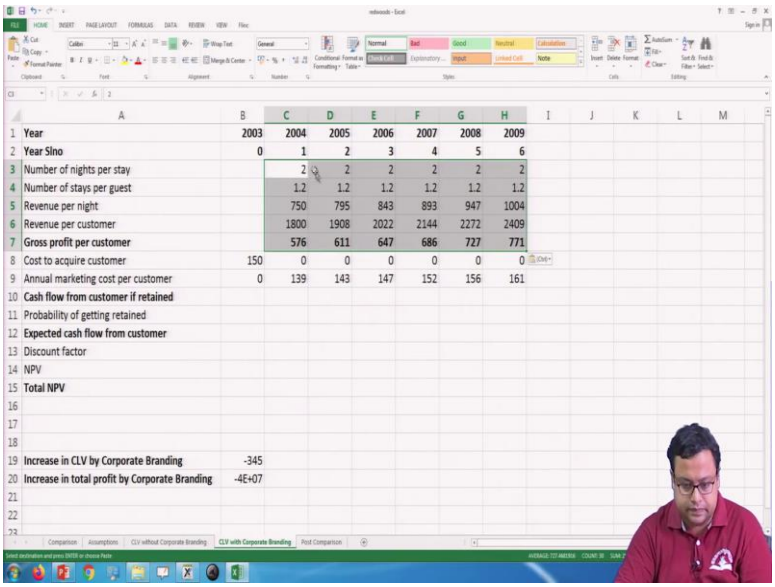

And what will be the cost here? First nine nothing, second nine onwards 2 comma 1.3 so, I will just copy this, let's. So, copy and paste.

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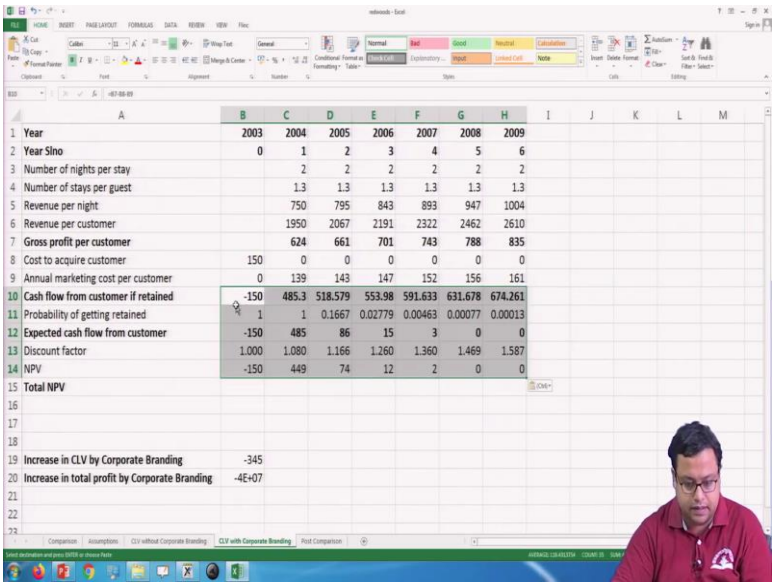

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5	Revenue per night		750	795	843	893	947	1004
6	Revenue per customer		1950	2067	2191	2322	2462	2610
7	Gross profit per customer		624	661	701	743	788	835
8	Cost to acquire customer	150	0	0	0	0	0	0
9	Annual marketing cost per customer	0	139	143	147	152	156	161
10	Cash flow from customer if retained	-150	485.3	518.579	553.98	591.633	631.678	674.261
11	Probability of getting retained	1	1	0.1667	0.02779	0.00463	0.00077	0.00013
12	Expected cash flow from customer	-150	485	86	15	3	0	0
13	Discount factor	1.000	1.080	1.166	1.260	1.360	1.469	1.587
14	NPV	-150	449	74	12	2	0	0
15	Total NPV							
16								
17								
18								
19	Increase in CLV by Corporate Branding	-345						
20	Increase in total profit by Corporate Branding	-4E+07						
21								
22								
23								

And this will be 1.3, instead of 1.2 and 750 is the expenditure; yes 750 is the expenditure.

So, the rest of the things will remain same; that is, from the things will remain same. So, this is my expenditure, this is my gross income and this is my marketing expenditure. So, what is the retention? So, if I just copy this values and paste it here; just to, so that this is – these are the values, basically, this is nothing but 6204 minus 0 minus 139, this is nothing but 661 minus 0 minus 143.

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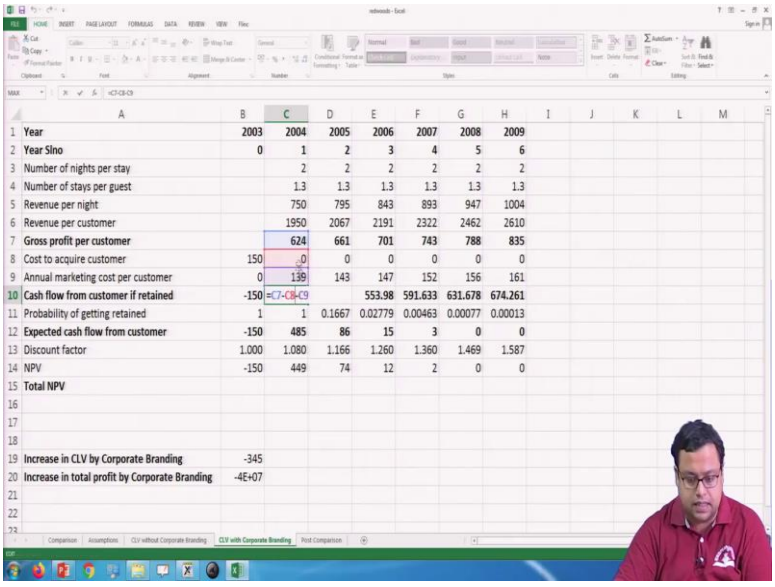

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15	Total NPV							
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19	Increase in CLV by Corporate Branding	-345						
20	Increase in total profit by Corporate Branding	-4E+07						
21								
22								
23								

These values are here rounded up and this is not rounded up; that is why it is coming like this, but actually the values are I got. And what is the probability of getting retained? Instead of 61.67, this should be 21.67 % . So, that improved.

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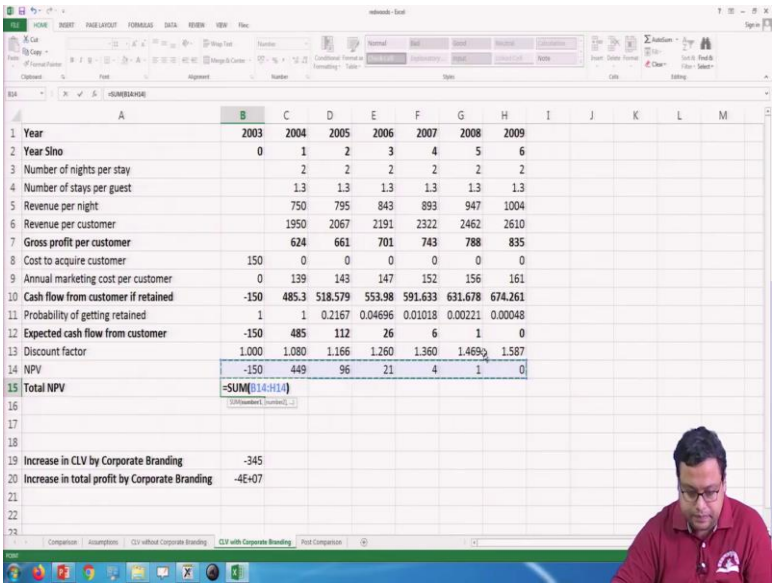

	A	B	C	D	E	F	G	H
1	**Year**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
2	**Year Slno**	**0**	**1**	**2**	**3**	**4**	**5**	**6**
3	Number of nights per stay		2	2	2	2	2	2
4	Number of stays per guest		1.3	1.3	1.3	1.3	1.3	1.3
5	Revenue per night		750	795	843	893	947	1004
6	Revenue per customer		1950	2067	2191	2322	2462	2610
7	**Gross profit per customer**		**624**	**661**	**701**	**743**	**788**	**835**
8	Cost to acquire customer	150	0	0	0	0	0	0
9	Annual marketing cost per customer	0	139	143	147	152	156	161
10	**Cash flow from customer if retained**	**-150**	**485.3**	**518.579**	**553.98**	**591.633**	**631.678**	**674.261**
11	Probability of getting retained	1	1	0.2167	0.04696	0.01018	0.00221	0.00048
12	**Expected cash flow from customer**	**-150**	**485**	**112**	**26**	**6**	**1**	**0**
13	Discount factor	1.000	1.080	1.166	1.260	1.360	1.469	1.587
14	NPV	-150	449	96	21	4	1	0
15	**Total NPV**	=SUM(B14:H14)						
16								
17								
18								
19	**Increase in CLV by Corporate Branding**	-345						
20	**Increase in total profit by Corporate Branding**	-4E+07						
21								
22								

So, this is 21.67^2, this is 21.67^3 and so on. So, that gave me these values. So, which is nothing, but cash flow into the probability, cash flow into the probability and so on and the discounting factor remains same. So, this is my total NPV and if I just calculate it; if I calculate the sum, yes sum comes up to be 422.

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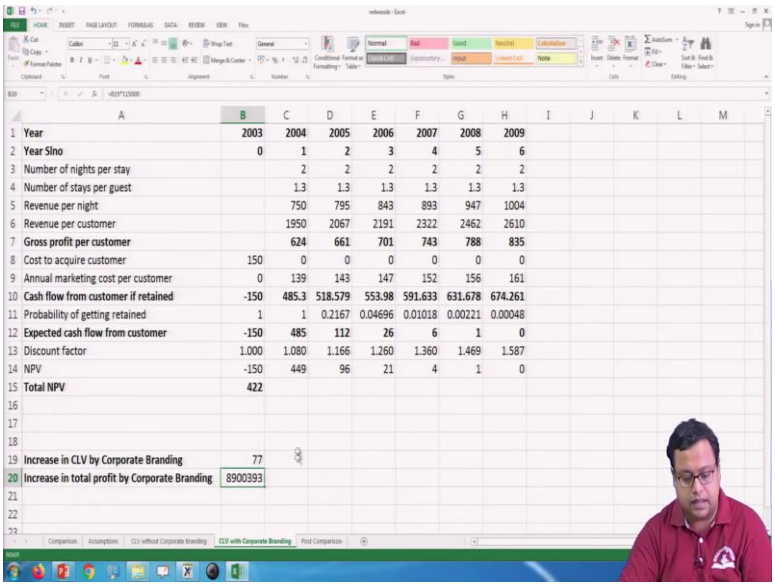

	A	B	C	D	E	F	G	H
1	**Year**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
2	**Year Slno**	**0**	**1**	**2**	**3**	**4**	**5**	**6**
3	Number of nights per stay		2	2	2	2	2	2
4	Number of stays per guest		1.3	1.3	1.3	1.3	1.3	1.3
5	Revenue per night		750	795	843	893	947	1004
6	Revenue per customer		1950	2067	2191	2322	2462	2610
7	**Gross profit per customer**		**624**	**661**	**701**	**743**	**788**	**835**
8	Cost to acquire customer	150	0	0	0	0	0	0
9	Annual marketing cost per customer	0	139	143	147	152	156	161
10	**Cash flow from customer if retained**	**-150**	**485.3**	**518.579**	**553.98**	**591.633**	**631.678**	**674.261**
11	Probability of getting retained	1	1	0.2167	0.04696	0.01018	0.00221	0.00048
12	**Expected cash flow from customer**	**-150**	**485**	**112**	**26**	**6**	**1**	**0**
13	Discount factor	1.000	1.080	1.166	1.260	1.360	1.469	1.587
14	NPV	-150	449	96	21	4	1	0
15	**Total NPV**	**422**						
16								
17								
18								
19	**Increase in CLV by Corporate Branding**	77						
20	**Increase in total profit by Corporate Branding**	8900393						
21								
22								

So, previously it was 345, now it is 422; the extra money that I generate is 77. So, in case in total profit is around how much? ─ 819 into these customers.

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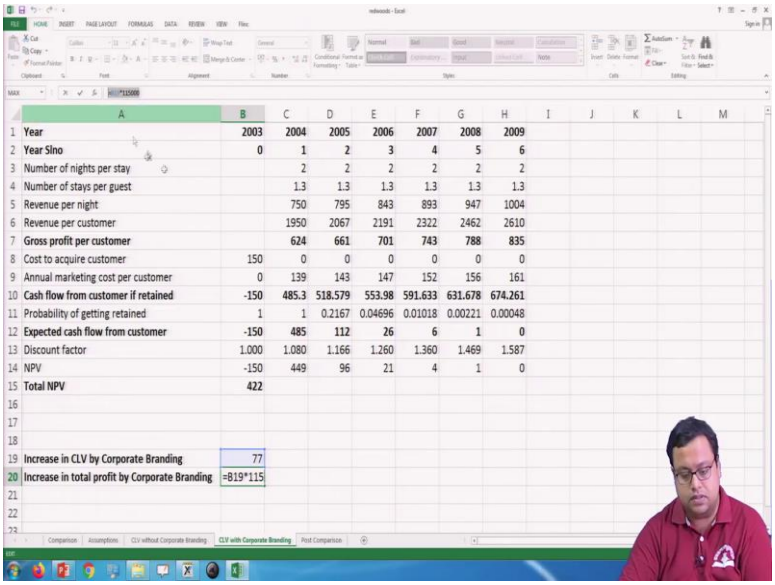

	A	B	C	D	E	F	G	H
1	Year	2003	2004	2005	2006	2007	2008	2009
2	Year Slno	0	1	2	3	4	5	6
3	Number of nights per stay		2	2	2	2	2	2
4	Number of stays per guest		1.3	1.3	1.3	1.3	1.3	1.3
5	Revenue per night		750	795	843	893	947	1004
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7	Gross profit per customer		624	661	701	743	788	835
8	Cost to acquire customer	150	0	0	0	0	0	0
9	Annual marketing cost per customer	0	139	143	147	152	156	161
10	Cash flow from customer if retained	-150	485.3	518.579	553.98	591.633	631.678	674.261
11	Probability of getting retained	1	1	0.2167	0.04696	0.01018	0.00221	0.00048
12	Expected cash flow from customer	-150	485	112	26	6	1	0
13	Discount factor	1.000	1.080	1.166	1.260	1.360	1.469	1.587
14	NPV	-150	449	96	21	4	1	0
15	Total NPV	422						
16								
17								
18								
19	Increase in CLV by Corporate Branding	77						
20	Increase in total profit by Corporate Branding	=819*115						
21								
22								

So, that is the increase and I have not taken into account ─ till now I have not taken into account the repeat customers. So, I have only taken into account the average customers so all of these, about the multi-property customers, probably that contributes towards that 1.3 calculation or this 21.67 calculation that multi-property customers. But we have not taken into account that thing.

So ideally, if you understand that, the corporate branding cost per year is 100000 and what I am getting in return is 900000 from one side of customers. So, even after 6 years onwards I can, I keep on doing this corporate branding; still I am in a good shape.

So, that is something that suggests that they should go for cooperate branding, not for individual branding; though that there will be lots of barriers from their company that I do not want to change, I will leave the job, if you go for major depending.

If my boss dictates from Delhi that great eastern has to be run like that and Leela Palace has to be run like that; a person who is centrally located and is giving suggestions that how I will run my show here, then that is not right, that kind of feeling might come. But still even after that kind of feeling comes, it is better for them monetarily to go for a global branding strategy.

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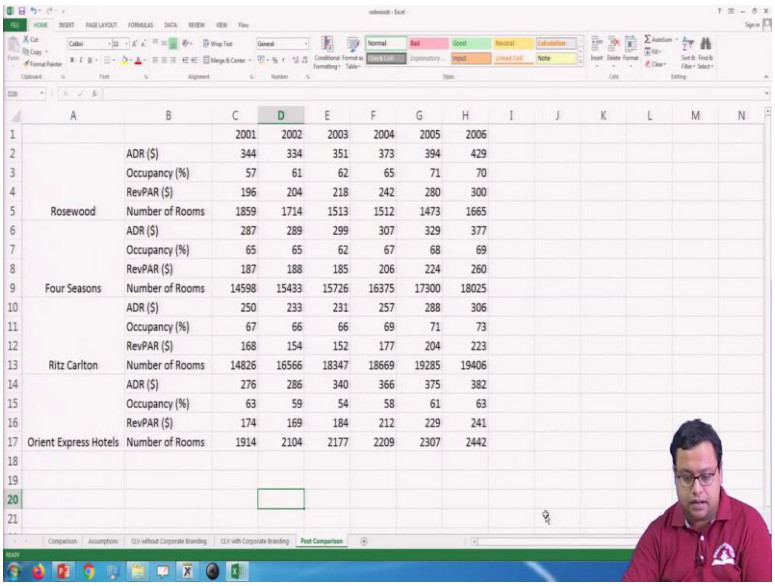

	A	B	C	D	E	F	G	H
1			2001	2002	2003	2004	2005	2006
2		ADR ($)	344	334	351	373	394	429
3		Occupancy (%)	57	61	62	65	71	70
4		RevPAR ($)	196	204	218	242	280	300
5	Rosewood	Number of Rooms	1859	1714	1513	1512	1473	1665
6		ADR ($)	287	289	299	307	329	377
7		Occupancy (%)	65	65	62	67	68	69
8		RevPAR ($)	187	188	185	206	224	260
9	Four Seasons	Number of Rooms	14598	15433	15726	16375	17300	18025
10		ADR ($)	250	233	231	257	288	306
11		Occupancy (%)	67	66	66	69	71	73
12		RevPAR ($)	168	154	152	177	204	223
13	Ritz Carlton	Number of Rooms	14826	16566	18347	18669	19285	19406
14		ADR ($)	276	286	340	366	375	382
15		Occupancy (%)	63	59	54	58	61	63
16		RevPAR ($)	174	169	184	212	229	241
17	Orient Express Hotels	Number of Rooms	1914	2104	2177	2209	2307	2442

Now, they did that actually and these were their situation. If I just plot the occupancy rate and the ADR.

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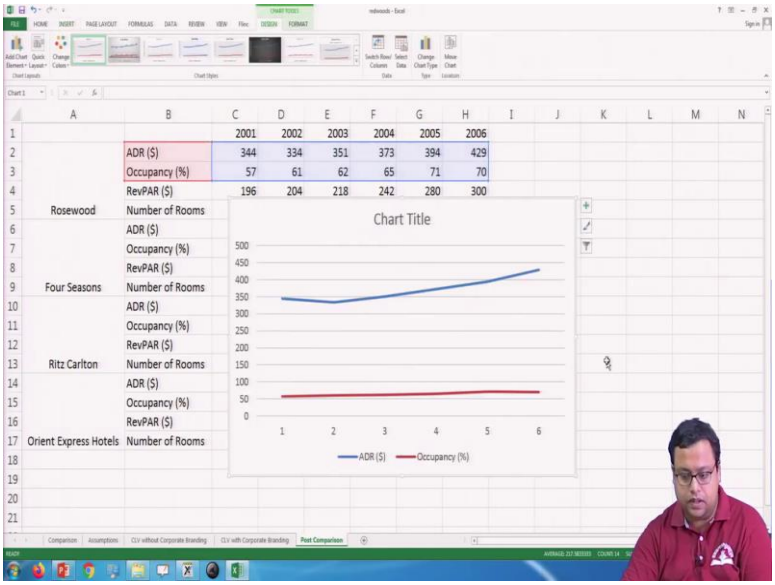

Just two things I will plot: the occupancy rate and ADR, just one minute.

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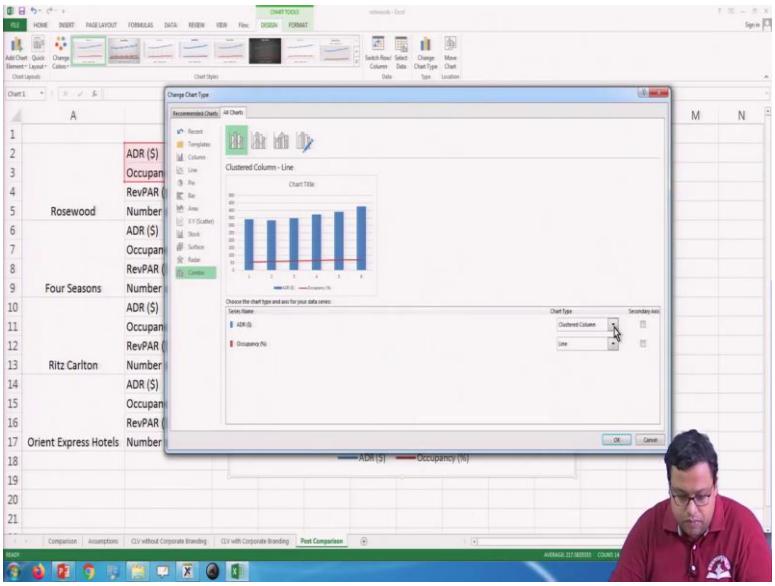

So, okay─ so, occupancy ADR we had in a ─ ADR I will put a line chart and occupancy rate I will put a bar chart, and ADR is a secondary axis, okay.

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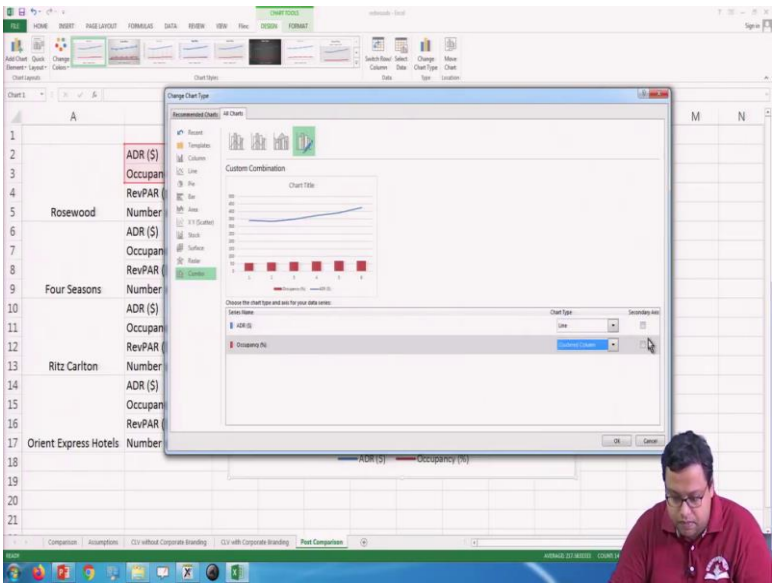

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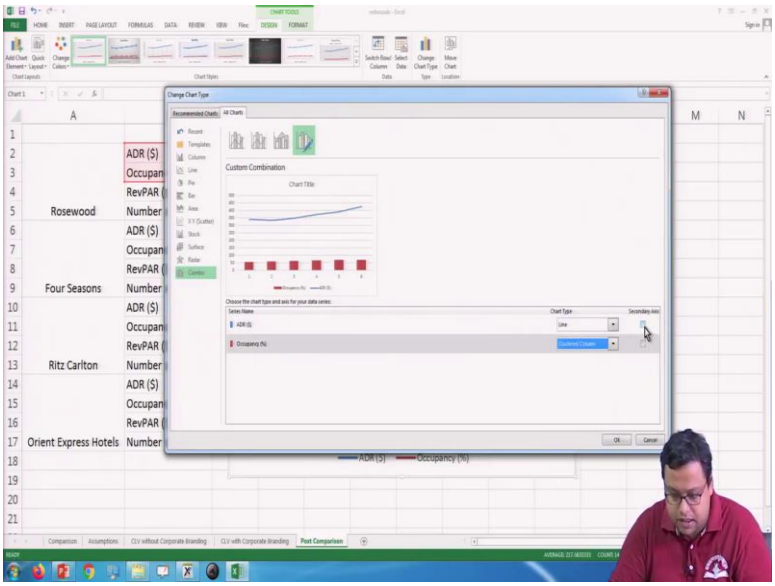

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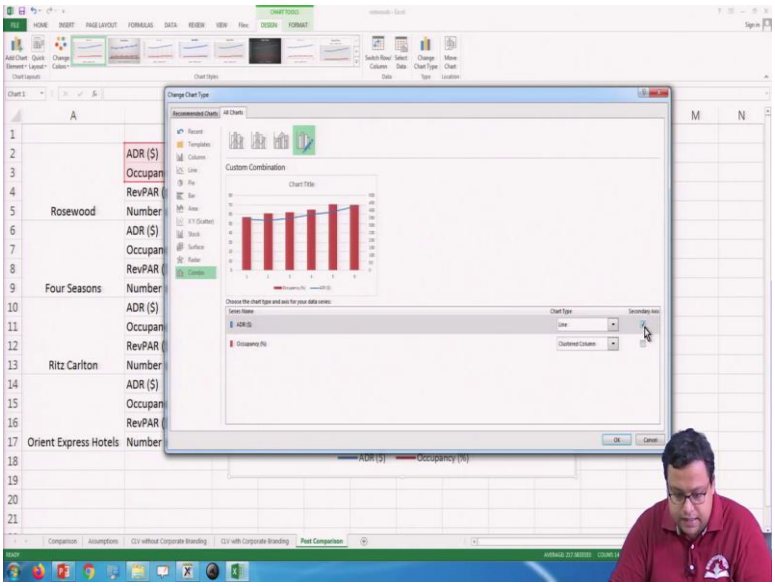

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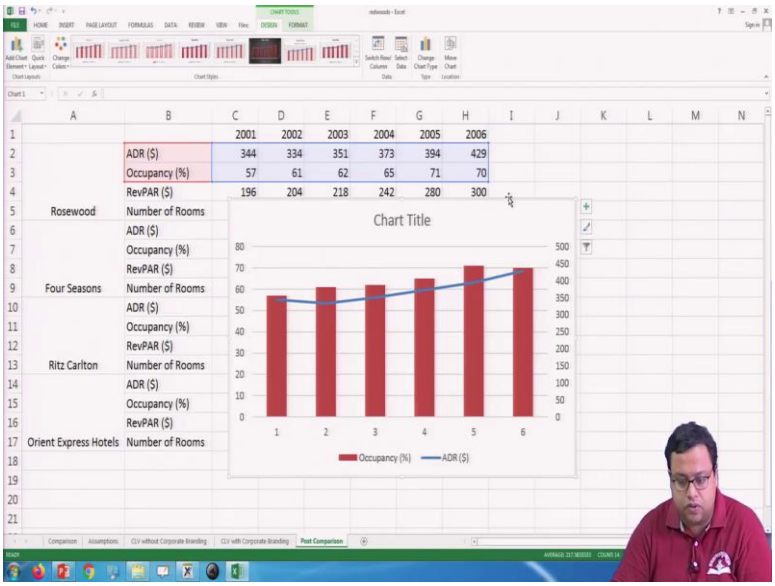

So, you see that this is I am doing only for Rosewood; you see that even after doing that. So, this is these are what ─ these are basically and if I just one minute.

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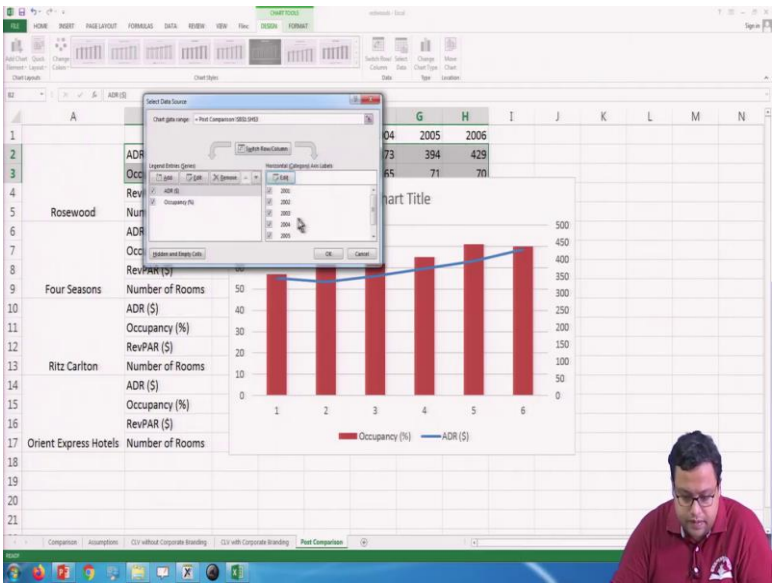

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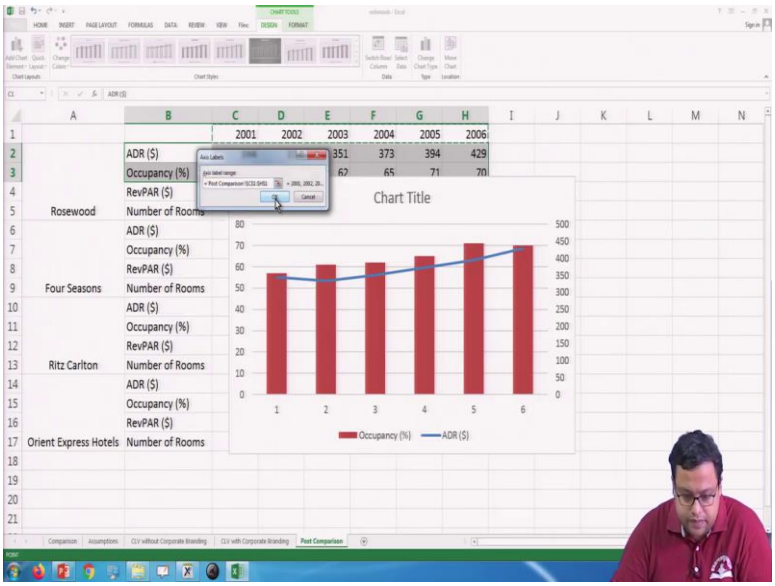

So, what I will do is: I will edit the axis ranges like this. Oaky, it did not come properly probably some reason. But this is 2001, this is 2002, 2003, 4, 5, 6. If you see that 2001, 2, 3 we have plotted till this point, after that their ADR also went up. But still the occupancy rate went up, occupancy rate went up to 70 % , probably sometime higher the 70% , 72%.

So, though they after adopting corporate branding, still they could increase the price and still their occupancy rate went up; because now the Rosewood brand become well known for the heritage sites and etcetera rather than individual brand.

So, they could keep their high rate, high rate of the rooms, because people were willing to pay. But at the same time their occupancy rate went up and their probably the ─ what happened on the other hand that, their number of rooms slowly came down. So, 1859 to 1704 to 1512; so it is slowly came down and at the late of the time it is stay again went on increasing the little bit, but this was the good scenario.

So, in and ultimately what I wanted to show you is that, corporate branding they did and corporate branding what; even with higher ADR rate, they could have higher occupancy rate in this Rosewood and cross multi-company multi-property visits went up, cross-property sales went up, the overall Rosewood branding went up.

So, that is how you can use CLV calculation in your strategic decision making also. It's a very long term decision; it's not a short term decision. So, though you may make some losses in the short term, you should look for long term advantages, long term benefits and you should focus on that.

So, keeping that as the background, I will stop this video today here. And I will come back with another case and social CRM in this particular week before we go ahead for B2B and B2C customer relationship management in the next weeks.

Thank you very much for being with me. I will see you in the next video.