All You Can vs All You Should Eat: A Case Study For Database Marketing

by Gary Angel and by Joel Hadary

Summary: *Establishing disciplined market-testing procedures today will more than pay for itself in the short term and will be a critical success factor in the long term.*

Just as it is difficult for many people not to overload their plates at an "all you can eat" buffet, it is difficult for many companies not to overload on data. Based on a few, well-publicized (and sometimes exaggerated) case studies of enormous, multi-terabyte databases successfully used for marketing, there is a common misconception that bigger is better, that database marketing is "all or nothing." However, in database marketing, the 80/20 rule often applies. Eighty percent of the benefits are obtained from 20 percent of the data. In many cases, it is not "all or nothing," but "all is nothing," since attempting to use every scrap of available data is too much and results in failure.

A successful approach to database marketing almost always starts with and consists of a series of small manageable efforts that can be combined to establish a comprehensive process. These small efforts can ensure profitability by going after "low-hanging fruit." They are small enough that a portion of their business justification can reasonably be for their learning potential. They can pay for themselves and provide valuable lessons about what works and what does not. They can provide a springboard for the next effort – modifying and improving overall database marketing plans. As experience is gained and revenue generated, efforts can be expanded and data added.

An excellent example of the benefits of this approach and the constraints that the real world often places on "eating too much data" can be found in the electric utility industry. In the process of being deregulated, utilities are just beginning to market and are blessed and cursed with the possession of far more data than is common in emerging markets.

Why is too much data harmful? To be sure, more data requires more computer hardware. However, that is only a small part of the problem. As the number of data elements increases, the complexity of design and implementation increases exponentially. More tradeoffs and decisions are required. There is much more uncertainty and significantly more risk. The seemingly innocent decision to add more data can easily add years to a database marketing effort.

The market potential for electric power is tremendous. It is approximately three times the size of the long-distance telecommunications market. Furthermore, new technology is fueling the demand for electricity in industries such as restaurants and metal fabrication that until recently were almost entirely gas. While the market is enormous, it has unique difficulties. The deregulation process has only just begun with regulatory agencies frequently changing regulations as well as direction. Marketing practices that are commonly accepted in other industries are proscribed for utilities. Consequently, marketing expertise from other industries often does not apply.

Except for the largest commercial customers, there is little sophistication about the use or purchase of electricity or electricity-related products and services. Few consumers have any reference point to judge if a rate is a bargain, let alone make more sophisticated judgements such as whether gas or electricity is a more efficient source of energy. It will take many years for customers to become sophisticated electricity consumers. However, in the meantime, like long distance service it will be sold on the basis of savings – not real savings but claimed savings or the appearance of savings (for example, "40 percent less than competitors' standard prices" even though no one pays the competitors' standard prices or knows what they are). This will result in creative, exaggerated and sometimes abusive marketing.

Further complicating utilities' marketing decisions is the uncertainty of their future product mix. Will power companies provide electricity and electricity-based services or will they provide connectivity delivering electricity, phone, Internet and TV services produced by others or something totally different? Nobody knows. Similarly, no one knows who the competition will be.

The proper response to these uncertainties is a combination of a realistic evaluation of what is possible today and a cost-effective preparation for the unknowns of tomorrow. With deregulation only partially complete, low customer sophistication and technology changing what is possible, it is very easy to either over- or under-invest in marketing electricity. Realistic evaluation of return on information/investment is required. The first step is to analyze existing data to understand what is possible right now. Most utilities have prodigious amounts of data about their customers collected in a wide range of disparate systems. To integrate every system and every piece of information will take years and may not be useful. However, there is a subset that can be quickly integrated and analyzed with enormous benefit. Start with the obvious: core customer information (such as name and address), core demographics (such as SIC and number of employees for commercial and household type and income for residential), core geographics (location and neighborhood characteristics), and key cost and profitability drivers (load, load pattern, service cost, billing method) and work from there. Judgement must be used, decisions made and priorities set. The 80/20 rule applies to data: 80 percent of the benefits can be obtained from integrating 20 percent of the data.

Because utilities have for years focused on keeping the power on at all costs, there is an abundance of operational, accounting and regulatory data that is of marginal marketing use and difficult to integrate with customer data. Most of this data is not important enough to justify delaying the realization of a return on an information/investment for a year or more. Information that *can* be integrated *should not* be integrated until there is a demonstrable benefit for it. Similarly, neglecting small quantities of important customer information such as SIC and number of employees for commercial and household type and income for residential customers is just as detrimental as including large quantities of irrelevant data.

Once core data is integrated and made analyzable, the "low-hanging fruit" can be picked. For example, even though the restaurant and metal fabrication markets are not the largest mass market segments for electricity (retail stores are), their potential for growth, due to recent advances in technology, is one of the highest. By combining existing data on load factor, usage, geography, size and industry across time, a very useful profile of what companies are most likely to convert from gas to

electricity can be developed. Using that profile, a targeted campaign can be profitably implemented to convert customers from gas to electricity.

Another example of "low-hanging fruit" is cost reduction. With revenue growth limited by regulation and customer sophistication, cost reduction is an important source of profitability. Targeted cost reduction is much more effective than across-the-board cost reduction that can, in some cases, actually reduce profitability. Cost reduction must be considered in relationship to profitability. Utilities that cannot identify their most profitable customers cannot effectively reduce costs. For example, which of the following customers are more profitable? One hundred customers in a single apartment building with all meters in one place or one hundred expensive homes with large yards filled with large old trees that bring down the power lines with every storm. Most utilities could not identify these two groups, let alone gauge their profitability. To do so they must integrate usage, call center, billing, meter reading and payment data.

Fifty states have fifty different sets of regulations. The "low-hanging fruit" that is permissible to pick in one state maybe forbidden in another. Utilities that use their understanding of their environment (including regulations) in implementing their marketing database will be successful. Those that do not, waste money and end up abandoning what could have been a profitable effort. Database marketing is only successful when implemented with a thorough understanding of what *should* be done to ensure profitability, not what *can* be done.

Since the mass marketing of electricity is so new and there is very little experience, testing and tracking are vital. What prospect lists will be effective and how a new market will respond to different offers is impossible to predict and often appears irrational. In a market with no experience, the only way to determine useful lists and effective offers is through testing. Establishing disciplined market-testing procedures today will more than pay for itself in the short term and will be a critical success factor in the long term.

The big battles to be fought for electricity customers will not be for several years. However, when they come, they will come quickly and with little warning. While it is difficult to cost justify spending for battles at an unknown date with unknown competitors, properly designed short-term database marketing efforts can provide the information and build the expertise necessary to win. The experience gained now in implementing small marketing campaigns will be worth more than all the data in the world when the big battles are finally fought. As savvy restaurant-goers know, experienced chefs, well-chosen ingredients and reasonable portions make for memorable meals while massive portions and poor cooking results, at best, in overweight. The same is true for data.

In 1997 Gary Angel and Joel Hadary founded Data Insight, a data mining company specializing in the analysis of large volumes of transaction data and the development of applications necessary for that analysis. Data Insight's customers are in the financial, insurance and public utilities industries.

Joel Hadary is co-founder and chief operating officer of SEMphonic. He has over twenty-five years of experience in information technology including operations,

finance, data mining, and application development in industries ranging from finance, aerospace, to telecommunications. At Hughes Aircraft he developed systems that saved Hughes over $300 million in taxes. His primary expertise focuses on using large volumes of information for actionable results. He may be reached at jhadary@semphonic.com.