How Predictive Analytics Elevate Airlines' Customer Centricity and Competitive Advantage

Executive Summary

The unbundling of rate structures and ancillary services, combined with escalating demands of the "always connected" consumer, have made the similarities between airlines and retail more significant than ever. Retail and airline customers are influenced by many of the same factors. The two are increasingly comparing and contrasting products and researching their options before making purchases. Both are looking for inspiration to buy through many channels, such as online and physical world promotions and coupons, social media and input from friends. Additionally, retail and airline customers are both seeking the best value and have high expectations for the products and services they purchase.

Through advancements in technology and the proliferation of the Internet, more data is available to be harnessed by airlines, delivering a more tailored offering that spans the traveler's entire journey. This includes not only transportation from one destination to another, but also opportunities to sell more travel-related products, such as convenience- and entertainment-based offerings. It also democratizes information, making it easy for customers to make more informed, personalized purchase decisions.

This white paper lays out customer centricity lessons that airlines can apply to their business. It also explores the role that predictive analytics can play in enabling carriers to make timely, meaningful and relevant offers that drive deeper loyalty and engagement among existing customers, as well as ways airlines can apply the insights gleaned from predictive analytics to not only acquire new customers but also to outmaneuver the competition.

Customer Centricity Lessons from Retail

It is a fact of business that most companies bend over backwards trying to attract new customers, often expending a lion's share of their resources. What some don't realize is that while they are busy ushering new clientele through the front door, more valuable customers are walking unnoticed out the back door. This oversight leads to a significant impact to a company's bottom line. Consider that 81% of companies with strong capabilities and competencies for delivering customer experience excellence outperform the competition, according to a study by Peppers & Rogers.[1]

Loyal customers are truly the backbone of any successful business, given the high percentage of revenue derived from them. It costs significantly more to acquire a new customer than to retain an existing one. For this reason, many retailers have shifted to a customer-centric business model, focusing on individual customer needs and buying patterns. They have discovered that understand-

ing customer behavior is critical to building and maintaining true customer loyalty. That understanding begins with data analysis. Once data is captured and analyzed, the retailer develops a strategy to focus on its most profitable customers. Retailers build retention strategies to keep these "best" customers highly engaged and loyal. Additionally, these strategies are designed to drive more customers to behave like "best customers."

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One example from retail that illustrates the power of leveraging data to become more customer-centric is Best Buy. When Best Buy determined that 7% of its customers were responsible for 43% of its sales, the company segmented its customers into several archetypes and redesigned stores to cater to the buying habits of these particular customer groups, thereby enhancing the in-store experience and increasing same-store sales by 8.4%.[2]

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Most airlines have strong loyalty programs that bind their best customers and keep them returning to the same carrier. These loyalty programs are so powerful that they have become the sole retention strategy for many airlines. The "stickiness" of these programs has allowed airlines to focus largely on revenue optimization and airline operations, and less on customer satisfaction. However, with the changing dynamics of the airline industry, competing airline loyalty programs (such as credit card programs that offer travel benefits with any carrier) and the change in customer behavior (including the use of technology to research and engage their social networks), it is time for airlines to begin differentiating their customer acquisition and retention strategies by becoming more customer-centric. They need to learn from the retail handbook.

Predictive Analytics is the Key to Becoming Customer-Centric

How is it that so many retailers are able to turn data about the buying habits and patterns of their customers into actionable insights? For years, they have been using data analysis techniques like data mining, as well as applying predictive

analytics, to better understand the varying needs of their customers. Predictive analytics is a form of statistical analysis that is used in predicting behavioral patterns to shape business decisions, forecast trends and ultimately improve performance. Instead of looking backward to analyze "what happened," predictive analytics help answer the question, "what's next?" and "what should we do about it?"

Predictive analytics is applied in many ways to help businesses make well-informed decisions at a micro level. The core difference from one mode of application to another is what's being predicted. Whether predicting customer response, traffic patterns or defection, each require different models and deliver business value in different ways.

Predictive customer analytics is also quite different from forecasting. For instance, forecasting might estimate the total number of seats that will be sold on a given flight, while predictive analytics tells you which customer archetypes are likely to book those flights. The actuarial methods utilized by insurance companies perform the very same function as predictive models: rating customers by the chance of positive or negative outcome. However, predictive modeling improves on standard actuarial methods by incorporating additional analytical automation and by generalizing to a broader set of customer variables.

Using Predictive Analytics to Deepen Customer Engagement

Today, predictive analytics is primarily used by companies with a strong customer focus, such as retail, financial, communication and marketing organizations. It enables these companies to determine relationships among internal factors such as price, product positioning or staff skills, as well as the external factors of economic indicators, competition and customer demographics. It also allows them to determine the impact on sales, customer satisfaction and corporate profits. A company can use information from a variety of customer sources (e.g., spend history, comment cards or surveys, online browsing history, call center interactions, etc.) to create, among other things, targeted promotions and personalized interactions.

Netflix, for example, has gained a leadership position in the video rental business by predicting the changing needs and desires of its customers and being first to market with a customer-centric

solution. In addition to introducing products that address customer desires, such as video rentals with no late fees and digital video streaming, Netflix mines its video streaming/rental history database to provide personalized recommendations to its customers.

Not only does being customer-centric enable companies to gain market share by being more relevant to their customers, but it can also help them to reduce promotional expense by delivering the right messages and offers to customers at the right time. For example, we helped a leading pharmaceutical company save 70% of promotional channel spend by leveraging an optimized multichannel approach.

Unfortunately, customer-centric business models have been slow to catch on in the airline industry. When looking for new streams of revenue, many airlines have resorted to increased fees vs. introducing new value-added products or services. And, with the exception of special treatment for some passengers with a high loyalty program status, airlines generally do not differentiate the way they treat individual customers. For instance, airlines do little to differentiate between the business and leisure traveler, a first-time or seasoned traveler, an individual or group of travelers. The needs of each of these types of travelers before, during and after their flight, are very different. Where a business traveler might need connectivity and speed of service, a leisure traveler's needs might be focused on in-flight entertainment, convenience and comfort.

To customers, airlines appear to be solely focused on getting the plane from point A to point B, and they feel like little more than a boarding pass with a seat assignment. If an airline were to leverage customer-centric predictive analytics, it would be able to identify opportunities to introduce products and services that customers desire and provide the right offers and messages – through the right channels – to their customers throughout every step of the journey.

Building Customer Loyalty by Being Customer Centric

Airlines can improve the loyalty of their customers by knowing who they are and what they want. Customers want loyalty to be their choice based on each and every interaction, and they want to be recognized and rewarded for their loyalty. This recognition can take the form of deals and pref-

erential treatment, but it is also about intimacy and respect.

While retaining customers is a top objective of many organizations, it can become costly to offer effective retention incentives, such as extremely rich blanket loyalty programs or discounted products. The advantage is really only attained when the incentives are optimized to drive the most profitable customer behaviors. For example, an airline should target the richest offers to customers who are most likely to defect. Many companies simply can't afford to deploy an aggressive retention strategy without knowing which customers are at highest risk of defecting vs. those likely to stay even without special treatment. This can be done with a high degree of accuracy by using predictive analytics. For example, we helped a major telecommunications company predict customer defection with 80% accuracy. Our client was then able to drive high customer retention through targeted retention strategies.

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Another example is a major airline that wants to increase the price for a product or introduce a fee. The airline realizes that some customers' loyalty won't be affected but that others will likely defect or publicly criticize the change. Predictive scoring can be used to target a campaign precisely and to identify which customers are most likely to defect. By following these predictions, an airline can provide exemptions or special treatment for their most loyal, profitable customers without leaving revenue on the table. The reverse logic applies when offering discounted fares or special offers. By applying predictive analytics, the campaign's return on investment is much greater, in terms of revenue growth and increased profits.

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Becoming customer centric starts with delivering relevant offers, messages, products and services to customers, based on their needs and desires, preferred channels (e.g., live agent, Web site,

mobile device, tablet, social network, etc.) and their current situation or point in the journey. Through the application of a supervised learning algorithm, we helped a travel operator identify 20% more unique and loyal customers. The travel operator leveraged this data to build a customer engagement strategy that improved its return on investment by 145%. In other words, customers will respond to these customer-centric offerings by becoming more loyal to a particular airline carrier. Loyal customers are known to deliver many advantages, including more frequent purchases and a lower sensitivity to pricing. They will also become ambassadors of their favorite airline by spreading positive reviews through their social networks about their travel experience.

> **Predictive analytics provides a unique competitive advantage and can actually reveal a competitor's weaknesses before it's even aware of them.**

With the proliferation of social media sites, such as Facebook and Twitter, the customer's voice has suddenly become louder, which only increases the importance of creating positive experiences that are buzz-worthy. In fact, it is estimated that 52% of leisure travelers actively use social media sites[3] and that two in five U.S. online leisure travelers have friended, followed or become a fan of a travel company or destination on a social networking site.[4] Furthermore, more than 50% of travelers say online ratings influence their travel choice[5] and that they are willing to pay more for products that have a four-star rating.[6] The customer voice is powerful, and customer centric-solutions will help to turn customers into advocates.

Acquiring New Customers by Learning from Existing Customers

By using data about existing customers, predictive analytics can help companies identify the ideal customer profiles to target for acquisition, as well as the channels through which they might find prospective customers. For example, online travel companies know when customers are on their Web site. Through ubiquitous tracking devices used across the Internet, they are able to capture customer information before they even arrive at the Web site, gaining insight into specific preferences of each one.

They may or may not know the customer's name, but they can cross-reference the data they collect with records of income, marital status, home ownership and family income, enabling them to make assumptions about the customer (e.g., marital status, favorite restaurants, etc.). Using statistical analysis, they can start to make assumptions about the preferences of individual Web surfers.

We helped a luxury retailer increase its recognition of online customers from 6% to 10%, which enabled the company to do more customer-centric marketing and preference segmentation. Similarly, data can be used to lead customers to buy based on their past travel behavior, specified preferences, social network, etc. Having insight into a broad range of data also provides the means to target specific audiences and to adjust marketing programs quickly and efficiently for optimal results.

Meet Today's Escalating Customer Expectations

As the choice of travel options grows, and customers are empowered with more knowledge, they have higher expectations. To keep up with these demands, airlines must find new ways to enhance their products, prices, promotions, operations and customer service. Predictive analytics can help determine how an airline should move forward by systematically learning from organizational experience. Improvements delivered through analytical quality control, reliability modeling, streamlined services and expedited application processing can all help to identify customer needs and wants, thereby enabling carriers to respond more quickly to meet escalating customer requirements.

In the airline industry, for example, predictive modeling can assist in moving from mass marketing to more personalized, targeted campaigns and offers. It can also provide insights into where airlines are or are not meeting traveler expectations. Rather than relying on intuition or limited data (such as revenue forecasts or focus groups) for pricing products, managing inventory or staffing, airlines can use predictive analytics against customer and operational data to improve efficiency, reduce risk and increase profits.

Beating the Competition Through Customer Predictions

Industry studies reveal why a "tougher competitive environment" is the strongest reason for companies to adopt predictive analytics. To stay competitive, airlines have to continuously change

and update their processes. Predictive analytics provides a unique competitive advantage and can actually reveal a competitor's weaknesses before it's even aware of them. How is this possible? A predictive model uncovers more refined buying patterns and trends. Since this data includes sales, or lack thereof, from customers who are exposed not only to an airlines' services and marketing but also to those of its competitors, the modeling process effectively distinguishes the micro-segments of customers who choose one airline from those who choose another. Airlines can use this method to identify where they – and, for that matter, their competitors – fall short.

Where To Go From Here

This white paper discusses the importance of predictive analytics and its role in the customer-centric business model. Most airlines already have access to a great deal of customer data and travel trends; however, they don't have the capabilities to take this information and analyze it in a way that provides actionable customer insights.

The world is changing, and the customer is in charge. Availability of choice, perceived benefits and personalized value are relevant factors, and if companies don't learn about, understand and invest in their customers, they will be left behind.

A customer-centric company can benefit from increased sales and market share, as well as an increase in customer retention. Additionally, investing in predictive analytics will contribute substantially to reducing the overall cost of serving the customer. When an organization understands its customers, it can interpret their needs and what drives them to buy a particular product or service. This enables the company to create offers that the customer needs or will be most likely to buy, thus reducing marketing and operational costs.

There is little doubt about the escalating significance of predictive analytics to the airline industry. Whether it is used to predict customer behavior, set promotion strategy, optimize ad spending or manage risk, predictive analytics is moving to the top of the management agenda.

Footnotes

[1] Martha Rogers and Jeff Gilleland, "Customer Experience Maturity Monitor," Peppers & Rogers Group, April 29, 2009, http://www.peppersandrogersgroup.com/view.aspx?docId=31376

[2] "Best Buy Plugs into the Power of Customer Centricity," FICO, 2009, http://www.fico.com/en/FIResourcesLibrary/Best_Buy_Success_2271CS_EN.pdf

[3] Sanskrity Sinha, "Social Media, Mobile Phones Make Global Travel Trendy," *International Business Times*, January 23, 2011, http://www.ibtimes.com/articles/103910/20110123/social-media-mobile-phones-make-global-travel-trendy.htm

[4] Henry H. Harteveldt, Elizabeth Stark, "How Travel eBusiness Can Win Friends And Influence Travelers," Forrester Research, Inc., September 2010.

[5] "2011 Canadian Travel Intentions Survey," Hotel Association of Canada, February 2011, http://www.hotelassociation.ca/reports/news%20releases/Travel%20Intentions%20Survey%20Release%202011.pdf

[6] "Online Consumer-Generated Reviews Have Significant Impact on Offline Purchase Behavior," comScore, Inc. and The Kelsey Group, November 2007, http://www.comscore.com/Press_Events/Press_Releases/2007/11/Online_Consumer_Reviews_Impact_Offline_Purchasing_Behavior

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