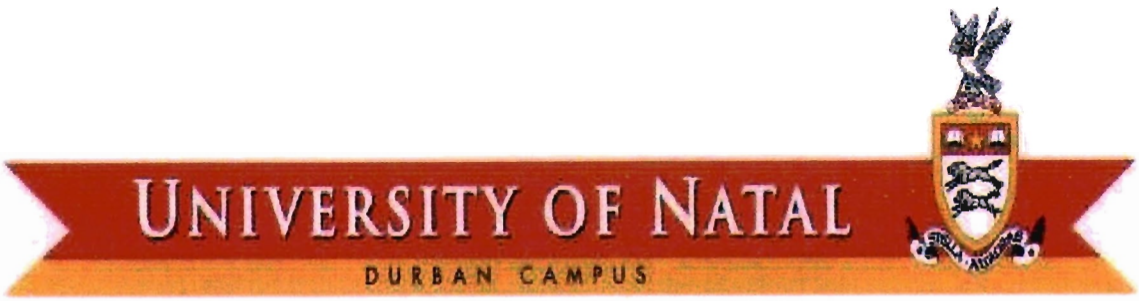

Implementing automated decision systems to optimise customer life cycle management in the retail furniture industry in South Africa.

by

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Submitted in partial fulfillment of the requirements for the degree of Masters In Business Administration

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Due to the strategic importance of this research it would be appreciated if the contents remain confidential and not be circulated for a period of five (5) years.

Yours sincerely

P.M.A Yon

DECLARATION

This research has not been previously accepted for any degree and is not being currently submitted in candidature for any degree.

Signed.....

Date.....8/8/2003..... 096275

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ABSTRACT

The origins of the retail furniture industry commenced with family run stores, traditionally known as "momma and poppa" stores as they were entrenched in certain families. A feature of these stores was that they traded with people that they knew and enjoyed a great deal of loyalty. As the businesses grew there was a need to supply furniture to their clientele with a facility to repay the full price over a number of months. Such arrangements were typically concluded on trust as the customers were well known by the owners.

The industry has evolved from this type of operation to a multi-billion rand industry. In terms of the size of business that is transacted and the size of the major furniture retailing organisations, it is simply not possible to continue doing business in accordance with the same ethos that prevailed during the early days. However, given the decentralised nature of the industry, the philosophy of knowing their customers has prevailed and this notion of wanting to conduct business on this basis has largely been responsible for a many critical functions remaining under the control of the individual stores within the broader network.

In terms of the high volume of transactions that are currently concluded, it is extremely difficult to ensure that the application of policy and risk-based decisions are made on a consistent basis. From a cost effectiveness and productivity point of view, it is not possible to realise efficiencies and economies of scale that could be enjoyed if certain business processes were centralised.

The intention of this research is to evaluate how the introduction of automated decision making business processes can contribute towards managing the organisation's exposure to risk with the view to achieving required levels of organizational performance and also sustainable value creation through a customer-centric philosophy.

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Chapter 1 Introduction and Objectives of the Study

1.1 Introduction

In the wake of recent problems experienced by ABSA and Saambou in the local banking sector, credit retailers have come under the spotlight. Over the last four years, furniture retailers in particular have not performed very well and their shares have not featured among the favourite choices of analysts. A large part of their problems has been on account of perceptions about the quality of their debtor's book. This has largely been on account of their strategy to grow revenue and earnings by granting weak credit.

Credit risk in emerging markets is also particularly high because of the "aspirational" mass market, which wants to buy more expensive products without the capacity to pay for them. Whilst a move by retailers towards generating cash sales may be an option, the inability of the mass market to buy goods with cash will ensure that credit sales will remain a strong part of our economy.

One of the biggest mistakes of the industry has been the strong focus on sales, without the necessary tools in place to assess whether credit applicants have the propensity to pay off their debt. Retailers fail to balance their strategy with the view that they are not purely retailers, but to some extent they are part bankers.

Not all credit retailers are affected in the same way, however. Clothing retailers have not been affected in the same way. Woolworths, for example, posted a 44% annual increase in headline earnings in August this year, whilst Truworths, on the other hand, posted an annual increase of 65% in earnings. One needs to analyse why the difference when in fact both industries target the mass market. Obviously, a factor is that clothing retailers offer revolving credit with shorter terms and furniture retailers offer

instalment credit with fixed terms, however, this should not have a material difference in the credit management process.

Clearly a strategy for furniture retailers is to review the level of sophistication with regard to credit management systems as well as their structure and business processes. Historically furniture retailers have operated within a decentralised environment resulting in inconsistent, judgmental decision making at their branches by employees with varying skills and intellectual capabilities. Surely there must be a move towards a strategy that involves automated decision systems, operating within a centralised environment. Immediate benefits will include consistent decision making, stricter controls, quicker response times, economies of scale and cost savings on account of critical mass.

1.2 Background

The furniture and appliance retail industry is currently experiencing a period of transition. One of the reasons is that the furniture credit retail industry in South Africa is overtraded, particularly the brands operating in the mass durable market. The overtraded nature of the industry has led to two non-sustainable practices by furniture retailers, who sell on credit: relatively low trading margins and advancing credit beyond the customers' ability to pay. Consolidation and rationalization within the industry is bound to take place in the short term.

In addition to the above industry environmental issues, there are other forces, both external and internal that are being exerted on the furniture credit retail industry. Externally there are factors such as inflation, rising interest rates, high levels of unemployment and retrenchments as a result of business failure, all of which has a direct impact on the performance of furniture companies. Other external factors such as the increase in the petrol price and the volatile nature of exchange rates ultimately filters into the economy, adversely affecting disposable income, which ultimately has an impact on retail sales and the ability of consumers to repay their debt. Internally, factors such as the increase in cell phone sales, the national

lottery and liberal gambling laws resulting in a boom in the casino and gaming industry, have also contributed to exerting pressure on furniture sales.

Recently there have been a number of examples of corporate failure of organizations operating within the consumer credit environment whose business has been predominantly aimed at the mass market. Companies such as Unifer, Saambou and Retail Apparel Group have all been casualties as a result of uncontrollable bad debt. A recent casualty has been one of the largest furniture companies Profurn, who experienced significant cash flow problems and had to be rescued by their bankers, First National Bank. In an effort to address their short-term borrowing problem, Profurn had to raise R600 million by way of a rights issue. A significant part of their cash flow problems also had to be on account of potential bad debts as they increased their provision for bad debt by R 477 million. The Competition Tribunal recently approved the acquisition of Profurn by the JD Group, one of the larger furniture companies in South Africa. Consolidation within the industry actually commenced a few years ago when a merger between two relatively large players in the industry took place. In 1998, the merger between Amalgamated Retail (Amrel) and The Beare Group (Beares) took place. Amrel was a division of South African Breweries who decided to dispose of non-core assets as a part of their unbundling strategy. The Beare Group was a division of McCarthy Retail Limited, who were forced to dispose of the Beare Group after the failed attempt of creating the first South African Furniture bank, in a deal with First National Bank. Shortly after the termination of the deal with First National Bank in 1997, Mc Carthy Retail had to disclose to the market that it needed to raise an additional provision for bad debt in the region of R 149 million. About two years ago, in 1999, there was an attempted merger between the JD Group and Ellerines, which was not approved by the Competitions Board.

Given the overtraded nature of the industry and the external and internal environmental conditions mentioned earlier, there is a tremendous amount

of strain being placed on furniture retailers to grow sales, let alone profitability as a means to grow earnings. This has resulted in a trend whereby furniture retailers focus on revenue streams generated by financial services as opposed to trading hence the low levels of earnings growth. A problem with this strategy is that if the quality of credit granted is not good, then profitability does not translate into cash and the only way to fund growth is through additional borrowing. This leads to a gearing problem, which has a detrimental effect on profitability. In April this year, Relyant Retail Ltd announced that it would undergo a R740 million rights offer. The major objective was also to address its high gearing levels. However, in this instance a major portion of the shares were taken up by a German investor with the view to repositioning the company for profitability.

The whole question of customer account management is very topical at the moment in that an article in the Business Day of 5 November 2002, commented on how "the retail industry counts the costs of wooing customers with credit" "The problems of furniture retailers Profurn, JD Group and Relyant reflect a general overextension of credit in SA, particularly to low-income earners who are unable to keep up payments" (Business Day, November 2002 :18) According to Abvest analyst Shawn Stockigt, "some retailers have been more eager to sell goods on credit in the latter part of the last decade, but forgot they were acting as a bank in providing financing for their customers.... while chasing sales, they neglected to collect the money that was owed to them" (Business Day, November 2002 :18)

The key issue facing such retailers is how do they differentiate from their competitors. Possible strategies that could be adopted to gain competitive advantage include:

- Low-Cost Provider
- Differentiation
- Focused or Niche Market Strategy

Given the competitive nature of the industry, an important technique that must be adopted, in the process of charting a strategy, is gap analysis. In reviewing their present position, companies would have to assess where they are in terms of the life cycle of the organization and the industry. They would also have to establish their positioning within the market and the industry so as to be able to evaluate the viability of adopting a particular strategy. Having done this, a strategy would have to be formulated and implemented that would lead to value creation and sustainable profit generation. This could entail one or more of the above-mentioned choices.

What appears to be very clear with regard to the furniture retail industry is that an integral part of whatever choice is made is that they are going to have to review very carefully their business model. In looking at all the major players, there appears to be very little evidence of an evolution of some kind in their model. There does not appear to be much room for differentiation and on account of this, the focus has to be on introducing innovative credit management technology and focusing on the quality of their people to drive competitive advantage.

1.3 Motivation

It would appear that the reason for furniture retailers being in their present position, is largely on account of the fact that they have not adapted their business model to meet the shift in conditions of the marketplace and the dynamics of the environment. The business structure has tended to remain the same in that, on account of the decentralised nature of the business, critical credit management decisions have been allowed to take place at branch level and certain business processes have not adapted to being more cost effective in terms of achieving economies of scale. For example, the credit granting process and collections process has remained predominantly under the control of the branches. This is not only inefficient due to inconsistent judgmental decisions being made, it is also not cost effective.

It is strongly believed that through the integration automated, business intelligence decision systems, within the realms of customer life cycle management, more accurate and more consistent decisions will be made. Through empirically derived scoring technology, better credit assessment decisions can be made and through the integration of adaptive control, customer account management technology, better results can be achieved with regard to the collection of outstanding debt as well as targeting the right customer from a marketing point of view.

In light of the above, the motivation for undertaking this research is to develop a model for the furniture retail industry that focuses on three fundamental aspects:

- Good account origination (credit assessment) decisions driven by automated credit scoring technology.
- Adaptive control account management technology designed to improve collections, retain good customers and prevent customer attrition.
- Account acquisition strategies to prospect new business and target existing customers through risk-based methodologies.

1.4 Value

"The debtors' book is one of the most important aspects of the business of furniture retailing." (Merrill Lynch, In-Depth Report, March 2002). Whilst differentiation may be a strategic option in so far as pursuing a strategy of targeting both cash and credit business, within a South African context, it is difficult to gain critical mass without having credit sales as a significant component of the business. By the same token, by having sound credit/risk management business processes in place, this will ensure that companies are well positioned to dominate the emerging market. The quality of the debtor's book of furniture retailers is currently under the spotlight of investors and is highly topical at the moment.

The benefits of this study will be that a strategy will be formulated, based on a model that will focus on customer valuation at the centre. This will be achieved through an inter-relationship between customer data management, customer risk management and customer marketing management, all driven by the integration of appropriate quality systems with the view to maximising the extent of good paying customers in the database. This should lead to positive perceptions by investors and analysts on account of a decrease in potential bad debt and an overall improvement in the quality of the debtor's book. This will lead to an ultimate improvement in the financial and operational performance of the company and a resulting increase in share price.

1.5 Problem Statement

"Most South African furniture retailers rely on providing their customers with credit facilities in order to facilitate sales. Therefore sales become a function of the credit granting process. Easy credit can boost sales in the short term, but may return to hurt the retailer as customer debt turns bad and needs to be written off. In times when trading conditions are difficult, the temptation is to ease credit-granting criteria or alternatively not to provide adequately for potential bad debt is great." (Merrill Lynch, In-Depth Report, March 2002).

In determining the performance of furniture retailers from an investor point of view, the extent of Arrears and Bad Debts have become key measures. In light of this, in managing a debtor's book, a key focus must be maintaining a balance between sales growth and bad debts.

It is from this point of view that the following problem statement has been articulated.

Will the integration of credit/risk management decision systems into customer life cycle management processes, lead to the improvement in the quality of the debtors' book in the Furniture Retail Credit industry in South Africa?

1.6 Objectives

The objectives of the study can be defined as follows:

- To investigate whether credit application scoring technology applied to the credit granting process and adaptive control decision systems incorporating behavioural scoring applied to the collections process, will lead to a higher volume of good paying customers within the customer database.
- To investigate whether risk-based predictive systems, as a tool in customer relationship life cycle management, will lead to increased sales due to customer retention, cross selling and a lower incidence of customer attrition.

1.7 Research Design and Methodology

The approach to this research is in the form of a case study. The theory of customer relationship life cycle management will be covered within the context of the component parts of the life cycle. A case study of Relyant Retail will be completed and the approach to customer management as a specific strategy will be evaluated against the theory. Following this process will be recommendations to achieve competitive advantage within the retail furniture industry by pursuing a strategy of differentiation through a customer centric approach to retailing.

1.7.1 Presentation of a Case Study

The research approach will be largely qualitative in nature. After the introduction, will follow detailed research on the theory of customer account management systems and processes. From this, a model will be developed that is relevant to furniture retail and can be integrated into the overall strategy of an organisation to achieve operational excellence. This will address how improvements can be made to the business structure as well as to business processes in a way that credit management can fulfill an important support role in leveraging maximum benefit from the overall value chain of the business. The strategy of the company that I work for will be evaluated in terms of the theory and statistics and trends of the

organisation, that have emerged over the last few years, will be used in the study.

Given the details contained in the background and literature review, the company that will dominate the industry will be the one that is best able to differentiate itself from the rest and in this way ensure competitive advantage. The nature of the industry is such that there is not much room for differentiation. The merchandise is generally very similar, stores are located and trade within more or less the same geographic areas, the method of advertising is very similar and financial product offerings are almost identical. In light of this the obvious areas for differentiation must rest with being customer centric and ensuring that your people give you a competitive advantage.

1.8 Limitations

The study will be restricted to the furniture retail industry in South Africa. Statistics and trends will be reflected wherever they are available. Comparisons will be made, where relevant, to aspects of credit management and the utilisation of quality systems within the retail clothing industry.

The research will be confined to customer relationship life cycle management within the context of credit/risk management in the furniture retail industry. It seeks to demonstrate that by introducing automated decision systems in a centralised environment that is separated from retail operations, will contribute to improving the quality of the debtors' book of furniture companies.

The extent to which it can lead to improved profitability will not be covered and further research will have to be conducted in this regard.

1.9 Conclusion

It is evident that a critical area of focus with regard to furniture retailing is the strategy adopted with regard to management of the debtors' book.

Given that, in most instances, credit sales forms the major part of total sales, the customer base is a cornerstone of the business and is very often the basis upon which such retailers are perceived in the marketplace.

In light of the above, it is not only good business sense to effectively manage this important asset, but to also leverage maximum benefit from this asset with the view to value creation and sustainable profit generation. This chapter raises the issues that are crucial as a means of justifying the need for a specific strategy to be adopted with the regard to customer management. It also outlines the critical components requiring a fully integrated approach to customer management, which are encapsulated within the objectives for completing this research.

Chapter 2 Integrating the Customer Life Cycle Processes

2.1 Introduction

"The theory of customer relationship management (CRM) is based on a single premise: maximise the value of the business to each customer to maximize the value of each customer to the business" (Gilmour 2003). Despite this simple concept, much money has been wasted by banks on unsuccessful attempts to introduce effective CRM.

A feature of banks is that they have such large databases and that they are so data-intense that any investment they decide to make in CRM has to be significant if it has to have any impact at all. Retailers and financial services companies, on the other hand, can dabble with CRM and make a difference with a comparatively much smaller investment.

According to Gilmour (2003), a reason for financial institutions not implementing CRM initiatives successfully is that they are traditionally wedded to product – centric business models. Although they have created a broad array of customer interaction points, such as multiple call centers, web sites, ATM's and co-branded credit card infrastructures, it has proved a complicated procedure for banks to shift their focus from a product-driven approach to a more customer-focused one.

A key CRM challenge for many companies has been to focus the organisation on the customer as well as on the product. In order to achieve this, businesses need to analyse customer behaviour and apply the knowledge gained to segmentation and propensity models. Sales processes should be driven by the results of new research into customer preferences and then adapted so that links can be established between previously independent salesforces. For a CRM strategy to be effective, companies may need to construct a new structure involving both people and process around a customer segmentation policy.

Nykamp (2001) says "a lot of organisations are still trying to be all things to all people...but if they try to initiate a programme for every customer segment at once, it's going to take too long for them to build workable strategies and it will take a long time for the results to be felt. Instead, you should choose your target carefully – it could be a segment comprising technology savvy customers, or it might be a segment made up of older investors who are not so technologically knowledgeable but who feel alienated from all other financial institutions – whatever it is, you pick your target and you run with it."

- Customer Value Metrics

  Gilmour (2003) is of the opinion that customer value metrics drive business decisions. The CRM challenge here is to identify which customers are profitable and then take action to grow and retain these relationships. Customers should therefore be segmented on the basis of profitability.

  In terms of marketing, companies should target their efforts to build relationships, not just to push products. The best way to achieve this is for financial institutions to develop and measure marketing efforts on customer segments, behaviours, transactions and preferences rather than as a response to product promotions. Efficient technology is another key driver of good CRM practice.

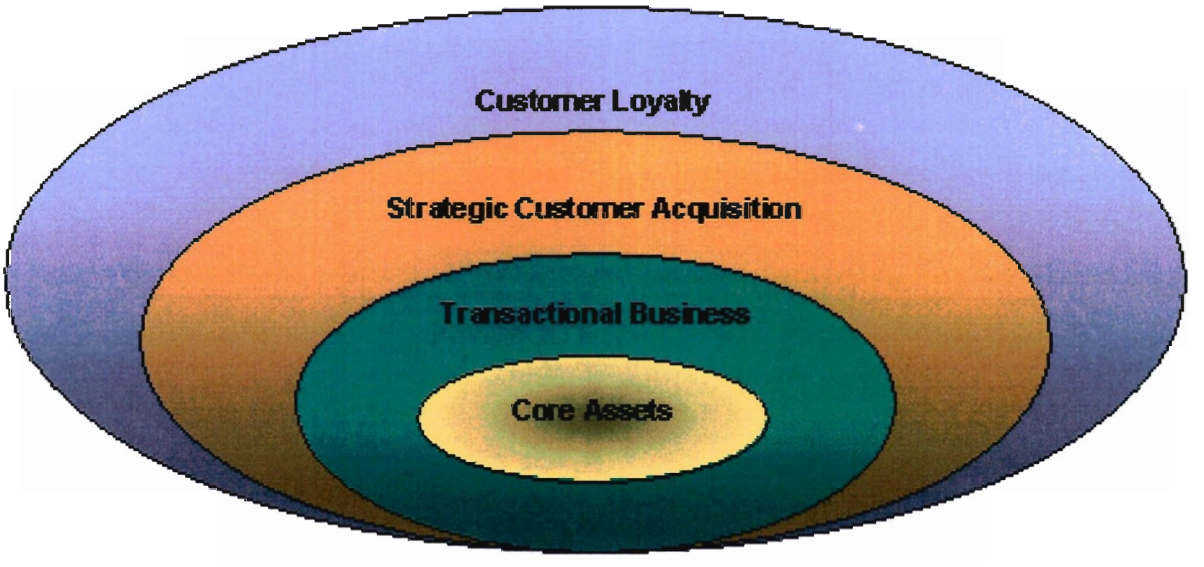
- The Customer Differential

  According to Nykamp (2001), "strategically attracting and developing a customer base – in other words gaining what I call the customer differential – is the single greatest determinant of business success."

  Nykamp (2001) states that financial services companies are clearly going to have to differentiate their service offering if they are going to stand out from the crowd. Differentiation requires a broader analysis of the customer's total experience – to grow, financial services companies need to be able to sell and build relationships, not just open product

accounts. Expectations among customers are rising due to the competitiveness of the marketplace, the onset of the information age as well as due to corporate consolidation. As the market gets more competitive, corporations are increasingly forced to cut costs. However, CRM technology solutions continue to evolve and become more cost effective.

Fig 2.1 The CRM "Big Picture"



Source: Credit Risk International Journal: April 2003: 37

2.1.1 The Organisation of Chapter Two

The objective of this chapter is to formulate an organizational process framework that will enable retailing organizations, with a financial services arm, to better identify, manage and improve customer value. It will allow such companies to adopt a focused customer relationship management approach across the life cycle – from marketing to account origination to account management and thereafter the generation of repeat business, through customer retention, with the view to sustained profitability and competitive advantage.

It commences with an overview of the theory of optimisation, which briefly covers aspects within the component parts of the framework. It then deals with the fundamentals of strategy crafting theory relative to the proposed organizational process framework. Thereafter it deals, in a more in-depth manner, with each component of the model culminating in an analysis of a strategic tool that can be used in strategy implementation as well as the theory of strategic options and strategy selection.

2.1.2 Theory of Optimisation

According to Ash (2003), as the competitive landscape in the credit industry evolves and the pace of technological innovation increases, today's creditors must be nimble and have a comprehensive understanding of the needs of their customers and prospects in order for their businesses to thrive. They must develop proactive strategies and be able to react quickly to changes in the business environment.

Darsie (2003) states that technology is currently available to design and complete sets of test strategies simultaneously in the form of champion and challenger strategies. This approach allows creditors to determine the optimal combination of test strategies in one experiment, dramatically shortening the learning curve and outperforming the competition.

- **What is optimisation?**

  Ash (2003) explains that the New World Dictionary defines optimisation as follows "to make the most of; to obtain the most efficient or optimum use of". Interpreting this in relation to the credit world, organizations must make the most of the various decisions in the credit life cycle – for example collecting the greatest amount of delinquent rands, maximizing response to credit offers, optimising usage of credit lines or maximizing customer retention.

  However, organizations do not possess unlimited resources in order to address life cycle decisions; instead finite resources are available in virtually all decision areas. These resources should be allocated in a way that maximizes the results subject to resource limitations.

- **The benefits optimisation**

  Darsie (2003) is of the opinion that optimisation can enable significant improvements in the credit world and can be utilized for virtually any area that requires a decision. Table 1 tabulates a list of potential benefits that can be derived from the application of optimisation techniques.

Table 2.1 Optimisation Benefits

Increased response rates	**Lower delinquency and loss rates**
Escalated approval rates	**Improved cross-sell and up-sell rates**
Decreased operating costs	**Higher collectability and recovery rates**
Greater utilization of credit lines	**Amplified revenue and profit rates**
Better customer retention rates	**Elevated conversion rates**

Source: Credit Risk International Journal: April 2003: 35

The magnitude of benefit received is dependent upon several factors:

- the number of accounts impacted by the optimisation;
- the specific decision areas where optimisation is applied – for example account origination or marketing or delinquent collections;
- the degree of automation applied to the decision area. Manual involvement in the decision making process will dilute the effect of optimisation;
- the current level of efficiency. If the organization is very efficient, the benefit will be smaller than if it is less efficient;
- the level of technical sophistication and expertise. Optimisation is a complex process that requires an organization to reach higher levels of technical sophistication and analytical expertise to achieve the full benefit.

It is important for organizations in the credit industry to operate at high levels of efficiency to succeed in a price-driven market and there are many opportunities to improve the overall performance of an organization.

- **Fundamentals of successful optimisation**

Organizations desiring to operate at high levels of efficiency to optimise decision strategies must have the fundamentals of risk and marketing management in place. According to O'Connor (2003), the following core activities are essential aspects of the component parts of the customer relationship management framework. O'Connor (2003) goes on to tabulate these fundamental components and briefly elaborating on each.

- data elements – the most basic aspect of optimisation is simply having the core data elements necessary to address a specific issue. Databases must be reviewed to ensure that the proper data elements are on hand to address the decisions that are being considered;
- database/reporting systems – the data elements must be stored in a data repository where they can be accessed by reporting tools and periodically refreshed;

- analytics – the organization must understand and interpret customer behaviour and trends. This is an ongoing process as customer behaviour is fluid. Analytical expertise, reporting and data mining tools must be in place;
- scoring models – an organization must use the most predictive combination of models to measure risk, response, revenue or any other objective that is to be measured;
- business knowledge/expertise/experience – experienced and knowledgeable staff will allow creditors to push more quickly to optimal solutions while avoiding problems that inexperienced persons would not be aware of;
- decision engine software – the key to successful optimisation is the design and implementation of statistically efficient test strategies;
- enabling software tools – this is necessary to execute the decision strategies within the various host information technology systems, such as collection systems, predictive dialing systems and application processing systems;
- the human element – an organization must deploy and utilise personnel efficiently if it expects to optimise results.

The approach to optimisation should be realistic, methodical and thorough and there are no short cuts. Improved performance is the result of significant analysis and commitment to the process.

In order to formulate a strategy of effective customer relationship management encapsulating a fully integrated approach to include all the component parts of the customer life cycle, the fundamentals of strategy crafting need to be considered.

2.2 Crafting a Strategy

"A company's strategy represents management's answers to such fundamental business questions as whether to concentrate on a single business or build a diversified group of businesses, whether to cater for a broad range of customers or focus on a particular market niche, whether to

develop a wide or narrow product line, whether to pursue competitive advantage based on low cost or product superiority or unique organizational capabilities, how to respond to changing buyer preferences, how big a geographic market to cover, how to react to newly emerging market and competitive conditions, and how to grow the enterprise over the long term." (Thompson & Strickland 2001: 10).

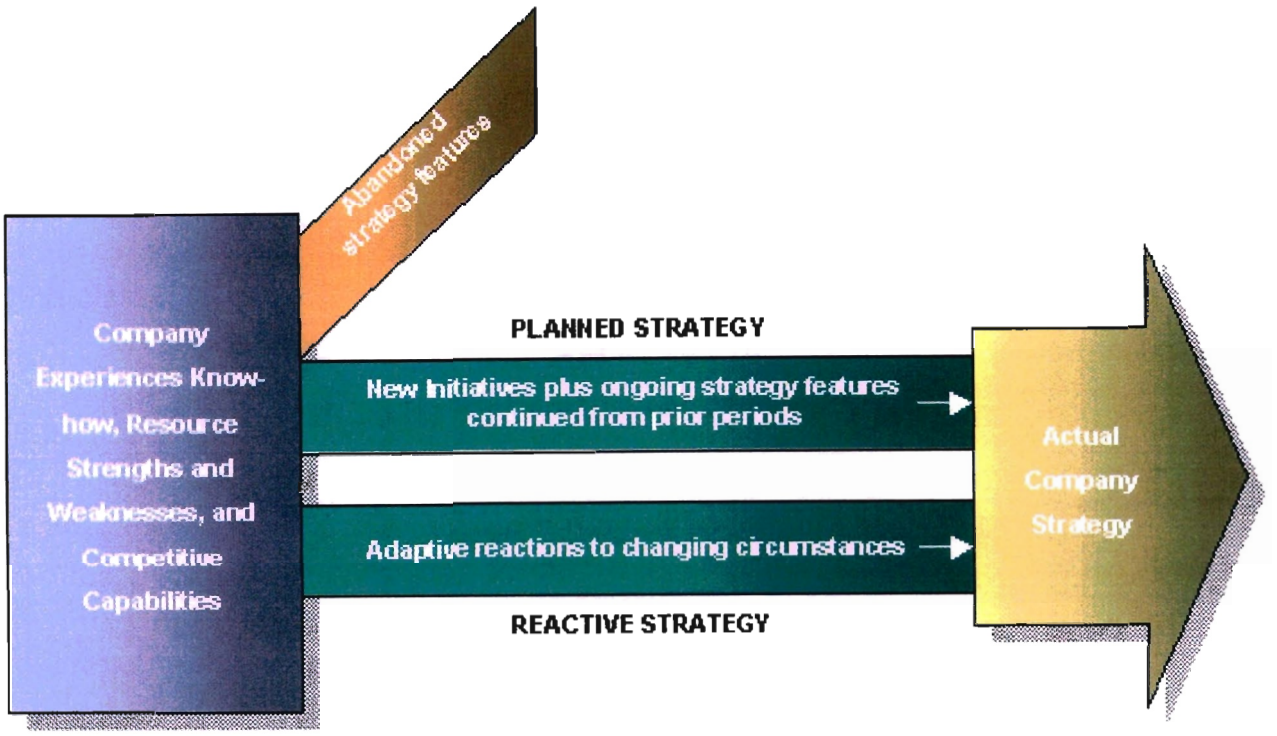
"Strategic management is defined as the set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company's objectives" (Pearce and Robinson 1991:3). According to Aaker (1994:12) "Strategic planning, also termed strategic market planning, focuses on the market environment facing the firm. Thus the emphasis is on not only projections but also in-depth understanding of the market environment, particularly the competitors and customers. The hope is not only to have insight into current conditions but also to anticipate changes that have strategic implications.

According to Thompson and Strickland (2001) strategy making brings into play the critical managerial issue of *how* to achieve targeted results relative to the organization's situation and prospects. The organization sets objectives, which form the ends, and strategy forms the means. The "how to" is typically a blend of (1) deliberate and purposeful actions, (2) as – needed reactions to unanticipated developments and new or changing market conditions and competitive pressures, and (3) the collective learning of the organization during its existence.

Pearce and Robinson (1991) are of the opinion that strategic thrusts provide managers with information that helps them to determine whether the overall strategy is progressing as planned or needs to be adjusted. As depicted in figure 2.2 the strategy crafting process involves developing an intended strategy; adapting it as events unfold (adaptive/reactive strategy); and linking the firm's business approaches, actions and competitive initiatives closely to its competencies and capabilities. A company's strategy is something managers shape and reshape as events unfold

outside the company and as the company's competitive assets and liabilities evolve in ways that increase or decrease its competitiveness.

Fig 2.2 Strategy in Action



Source: Thompson and Strickland (2001): 12

2.2.1 Strategy and Entrepreneurship

An important element in strategy crafting is astute entrepreneurship – actively searching for opportunities to do new things or to do existing things in new ways. The faster the company's business environment is changing, the more critical it becomes for managers to be good entrepreneurs in making both predictions and timely strategic adjustments.

For a company to be successful, its strategy and business model have to be well matched to the company's present and future environment (Thompson and Strickland 2001). This will not happen unless managers display entrepreneurship in guiding company activities in whatever new directions are dictated by market conditions and customer preferences.

This requires studying market trends, listening to customers and anticipating their changing needs and expectations, scrutinizing the business possibilities that emerge from technological developments, building the firm's market position through acquisitions or new product introductions, and seeking ways to strengthen the firm's competitive capabilities. Good strategy making is inseparable from good business entrepreneurship and the one cannot exist without the other.

According to Miller and Dess (1996), to be successful over the longer term, a business must hold some advantage relative to its competition and such competitive advantage can take one of three forms that reflect basic customer value: (1) differentiation, (2) cost leadership and (3) quick response. A firm that holds one of these advantages is in a strong competitive position and since businesses strive to achieve performance above the level of normal profits, the pursuit of competitive advantage has become a central theme of strategic management at the business level.

How fast managers adapt to changing market conditions, how boldly they pursue new business opportunities, how much they emphasize out - innovating the competition and how often they champion actions to improve organizational performance are good indicators of a company's entrepreneurial spirit. Entrepreneurial strategy makers are inclined to be either first - movers or rapid followers, responding quickly and opportunistically to new ways of building the enterprise or strengthening its market position and capabilities.

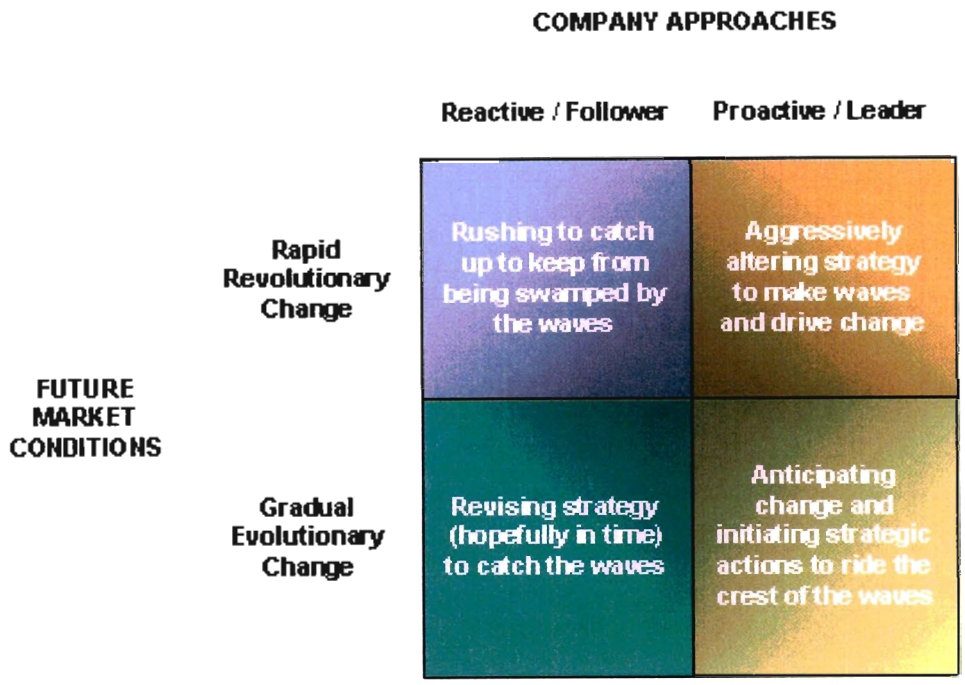
2.2.2 Why Company Strategies Evolve

According to Thompson and Strickland (2001), every company faces situations whereby it has to adapt its strategy as a consequence of shifting industry and competitive conditions. The march of external and internal events, make it commonplace to initiate fresh strategic moves and business approaches of one kind or another or in one part of the organization or another.

Pearce and Robinson (1991) explain that an implication of viewing strategic management as a process is the necessity for feedback from institutionalization, review and evaluation to the early stages of the process. Feedback is the collection of post implementation results to enhance future decision-making. The strategic management process must be regarded as a dynamic process characterized by constantly changing conditions that affect interrelated and interdependent strategic activities.

Thompson and Strickland (2001) go on to state that on account of this, an organization's strategy re – forms over time as the number of changes and adaptations begin to mount. It is thus necessary for a company's strategy to change, sometimes gradually and sometimes rapidly, sometimes reactively (when new developments dictate a response) and sometimes positively (when new opportunities arise and new capabilities emerge). Consequently, strategy making is an ongoing process and not a one – time event.

Fig 2.3 Evolving Strategies



Source: Thompson and Strickland (2001): 17

Fig 2.3 illustrates the strategic postures a company can adopt in preparing for future market conditions and coping with the waves of change in the marketplace. In most industries, there are pioneering entrepreneurial companies that seek to be proactive leaders in reshaping their strategies and there are cautious, conservatively managed companies that adopt a reactive follower approach. Companies can adjust their strategies and prepare for future market conditions at varying speeds and in varying ways – the path that each company takes is unique.

If managers decide to change strategy so fast and so fundamentally that their business model undergoes major overhaul every year, questions need to be asked. Is rapid strategy change being legitimately driven by rapid – fire technological change, quickly changing market conditions, volatile buyer behavior, or other hard – to – foresee developments? On the other hand it could be on account of poor entrepreneurship, faulty situation analysis, and inept strategizing. In most situations, the core elements of well - crafted strategies ought to have a life of several years, even though

they may have to undergo modest revision to keep them in tune with changing circumstances.

According to Mintzberg (1987), whether through quantum revolutions or cycles of convergence and divergence, however, organizations seem to separate in time the basic forces for change and stability, reconciling them by attending to each in turn. Many strategic failures can be attributed either to mixing the two or an obsession with one of these forces at the expense of the other

2.2.3 Implementing and Executing Strategy

Miller and Dess (1996) state that strategy implementation involves a broad range of efforts aimed at transforming strategic intentions into action. The resulting stream of actions constitutes the firm's realized strategy and reflects what an organization has done and ultimately determines how the organization will fare. Miller and Dess add that strategy implementation skills are not easily mastered and of the three elements of the strategic management process (strategic analysis, strategy formulation and strategy implementation), the most difficult is strategy implementation predominantly on account of resistance to change.

Pearce and Robinson (1991) state that to ensure strategic planning is successful, the strategy must be translated into carefully implemented action embracing the following fundamental principles:

- Clear guidelines for daily activities of the firm's members.
- Strategy and the firm must become one.
- Managers must direct and control actions and outcomes and adjust to change.

Thompson and Strickland (2001) state that the managerial task of implementing and executing the chosen strategy entails assessing what it will take to develop the needed organizational capabilities and to reach the targeted objectives on schedule. Thompson and Strickland (2001)

highlight some critical steps in the strategy implementation phase, which they describe as a hands-on, close-to-the-scene administrative task:

- Building an organization carrying out the strategy successfully.
- Allocating company resources – so that organizational units charged with performing strategy – critical activities and implementing new strategic initiatives have sufficient people and funds to do their work successfully.
- Establishing strategy – supportive policies and operating procedures.
- Putting a freshly chosen strategy into place.
- Motivating people in ways that induce them to pursue the target objectives energetically and, if need be, modifying their duties and job behavior to better fit the strategy requirements of successful execution.
- Tying the reward structure to the achievement of targeted results.
- Creating a company culture and work climate conducive to successful strategy implementation and execution.
- Installing information, communication, and operating systems that enable company personnel to carry out their strategic roles effectively day in and day out.
- Instituting best practices and programs for continuous improvement.
- Exerting the internal leadership needed to drive implementing forward and to keep improving on how the strategy is being executed.

Good strategy execution involves creating a strong "fit" between the way things are done internally and what it will take for strategy to succeed. The stronger the methods of implementation fit the strategy's requirements, the better the odds that performance targets will be achieved. The most important fits are between strategy and organizational capabilities, strategy and reward structure, strategy and internal support systems, and between strategy and the organization's culture.

2.2.4 The Factors That Shape a Company's Strategy

According to Pearce and Robinson (1991), numerous external factors influence a firm's choice of direction and action. These factors include those that are external to the firm and can be divided into three interrelated subcategories: factors in the remote environment, factors in the industry environment and factors in the operating environment.

According to Harrison and St. John (1998) the remote environment comprises factors such as economic, political, technological, social and ecological factors. The environment presents firms with opportunities, threats and constraints, but rarely does a single firm exert any meaningful reciprocal influence. Miller and Dess (1996) are of the opinion that developments in the general environment often provide opportunities for expansion in terms of products and markets and could also pose threats to entire industries. The example they quote is the impact of interest rates on the sale of "big ticket" items such as homes and automobiles.

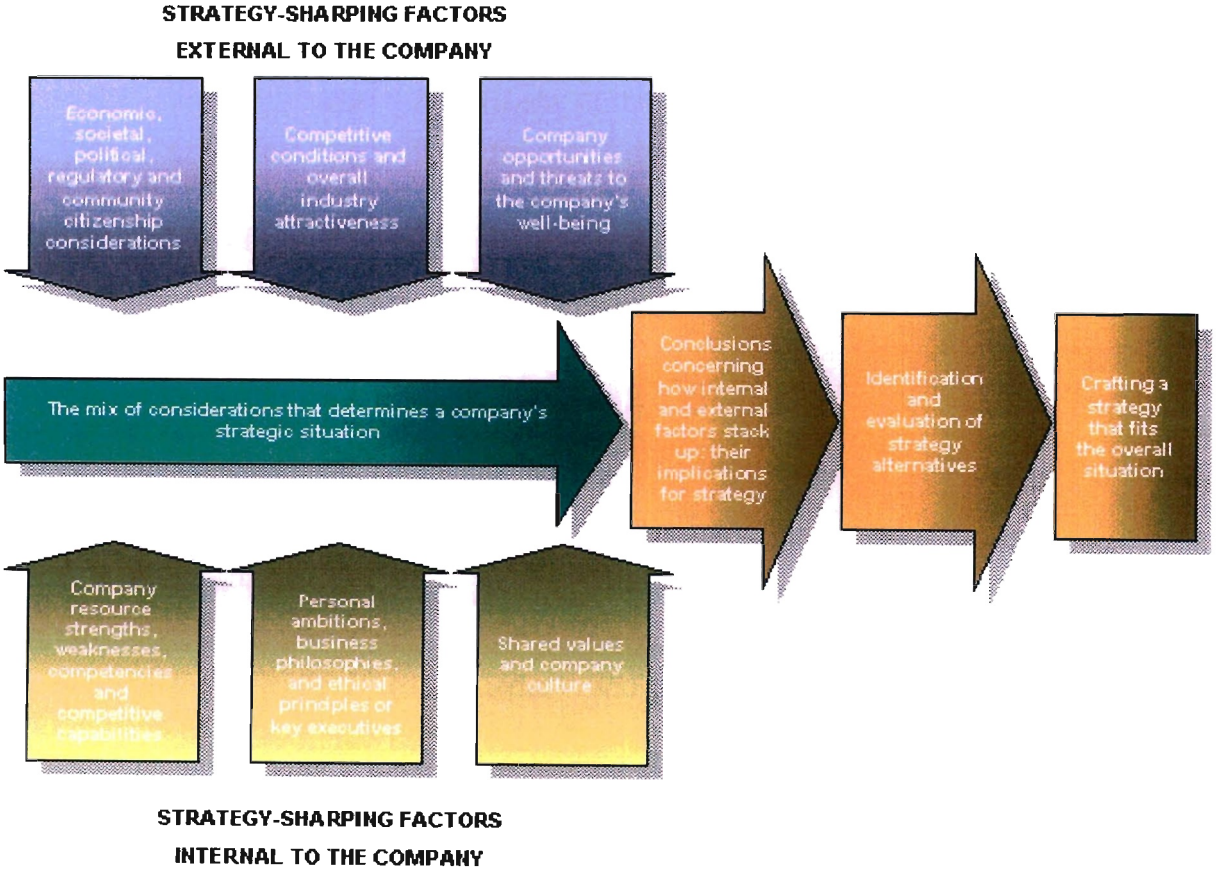
Pearce and Robinson (1991) state that Michael Porter's Book *Competitive Strategy* propelled the concept of industry environment into the foreground of strategic thought and business planning and the cornerstone is based on the five forces that shape competition in an industry in the form of the bargaining power of customers, the bargaining power of suppliers, the threat of substitutes, the threat of new entrants and rivalry among existing firms. To establish a strategic agenda for dealing with these contending currents and to grow despite them, a company must understand how they work in its industry and how they affect the company in its particular situation.

According to Pearce and Robinson (1991), the operating environment, also called the competitive or task environment, comprises factors in the competitive situation that affect a firm's success in acquiring needed resources or in profitably marketing its goods and services. Among the most important of these factors are the firm's competitive position, the composition of its customers, its reputation among suppliers and creditors

and its ability to attract capable employees. The operating environment is typically much more subject to the firm's influence or control than the remote environment and as such can be more proactive in dealing with the operating environment than in dealing with the remote environment.

"Many situational considerations enter into crafting strategy. Even in the same industry, situational factors differ from company to company that the strategies of rivals turn out to be distinguishable from one another rather than imitative. This is why sizing up all the various situational factors, both external and internal, is the starting point of strategy crafting" (Thompson and Strickland 2002:58).

Fig 2.4 Factors Shaping the Choice of Company Strategy



Source: Thompson and Strickland (2001): 6

Thompson and Strickland (2001) identify the following strategy shaping factors and summarise their effect in the following comprehensive way.

- Societal, Political, Regulatory, and Citizenship Considerations
  Organizations generally operate within the broader community of society. Enterprises are very often constrained by what is legal, by what complies with government policies and regulatory requirements, by what is considered ethical, and by what is in accord with societal expectations and standards of good community citizenship.

- Competitive Conditions and Overall Industry Attractiveness
  Industry competitive conditions and overall attractiveness are big strategy – determining factors. When competitive conditions intensify significantly, a company must respond with strategic actions to protect its position. The industry environment, as it exists now and is expected to exist later, thus has a direct bearing on a company's best competitive strategy option and where it should concentrate its efforts. A company's strategy can't produce real market success unless it fits the industry and competitive situation.

- The Competitive Market Opportunities and External Threats
  Both business opportunities open to a company and the threatening external developments that it faces, point to a need for strategic action. A company's strategy must focus on capturing the best growth opportunities, especially the ones that hold the most promise for building sustainable competitive advantage enhancing profitability. Strategy must address providing a defense against external threats to the company's well – being and future performance and must involve crafting offensive moves to capitalize on the company's most promising market opportunities as well as crafting defensive moves to protect the company's competitive position and long – term profitability.

- Company Resource Strengths, Competencies, and Competitive Capabilities

  A critical strategy – shaping internal consideration is whether a company has or can acquire the resources, competencies, and capabilities needed to execute a strategy proficiently. The best path to competitive advantage is found where a firm has competitively valuable resources and competencies, and where rivals do not have matching or offsetting resources and competencies, and where rivals can't develop comparable capabilities except at high cost or over an extended period of time.

- The Personal Ambitions, Business Philosophies, and Ethical Beliefs of Managers

  Managers' choices are typically influenced by their own vision of how to compete and how to position the enterprise and by what image and standing they want the company to have. Both casual observation and formal studies indicate that managers' ambitions, values, business philosophies, attitudes towards risk, and ethical beliefs have important influences on strategy. Managerial values also shape the ethical quality of a firm's strategy.

- The Influence of Shared Values and Company Culture on Strategy

  The combined effect of a company's policies, practices, traditions, philosophical beliefs, and ways of doing things form a distinctive culture. Typically, the stronger a company's culture, the more that culture is likely to shape the company's strategic actions, sometimes even dominating the choice of strategic moves. Strong cultural influences partly account for why companies gain reputations for such strategic traits as leadership in technology and product innovation, dedication to superior craftsmanship, a flair for financial wheeling and dealing, a desire to grow rapidly by acquiring other companies, having a strong people orientation and being especially a good company to work for, or unusual emphasis on customer service and total customer satisfaction.

2.2.5 Differentiation – A Strategy for Competitive Advantage

Aaker (1984) states that a goal of strategic management is to develop sustainable competitive advantage in the business areas in which the firm is competing or to avoid or neutralize competitors' sustainable competitive advantage. There are three characteristics of sustainable competitive advantage. The first is that it needs to involve a key success factor of the market. Secondly, it needs to be sustainable enough to really make a difference and finally, it needs to be sustainable in the face of environmental changes and competitor actions.

According to Harrison and St. John (1998) in differentiation strategies, the emphasis is on creating value through uniqueness, as opposed to lowest cost. For a differentiation strategy to work, buyers must value the attributes of a product, in terms of its uniqueness, so as to be prepared to pay a higher price for it or choose to buy from the firm preferentially. A firm may charge the same price for a product as competitors, but achieve a much larger share of the market, resulting in higher profits.

Thompson and Strickland (2001) are of the opinion that a differentiation strategy requires the company to study buyers' needs and behavior carefully to learn what buyers consider important, what they think has value and what they are willing to pay for. Based on this the company has to incorporate buyer – desired attributes into its product or service offering that will set it distinctively apart from rivals. Competitive advantage results once a sufficient number of buyers become strongly attached to the differentiated attributes. The more that a company's differentiated offering appeals to buyers, the more customers bond with the company and the stronger the resulting competitive advantage.

Differentiation enables a firm to

- Command a premium price for its product and/or
- Increase unit sales (because additional buyers are won over by differentiating features) and/or

- Gain buyer loyalty to its brand (because some buyers are strongly attracted to the differentiating features and bond with the company and its products).

The view of MacMillan and McGrath (1997) is that, most profitable strategies are built on differentiation: offering customers something they value that competitors don't have. Most companies however, in seeking to differentiate themselves, focus their energy only on their products or services. Companies, however, have the opportunity to differentiate themselves at every point where they come in contact with their customers – from the moment customers realize they need a product or service to the time they no longer want it and decide to dispose of it. MacMillan and McGrath (1997) have developed a two-part approach to the formulation of differentiation strategies. The first "Mapping the Consumption Chain" captures the customer's total experience with a product or a service. The second "Analyzing Your Customer's Experience" shows managers how directed brainstorming about each step in the consumption chain can elicit numerous ways to differentiate even the most mundane product or service.

2.2.5.1 Achieving a Differentiation – Based Competitive Advantage

According to Johnson and Scholes (1999), a differentiation strategy seeks to provide products or services unique or different from those of competitors in terms of dimensions widely valued by buyers. The aim is to achieve higher market share than competitors by offering better products or services at the same price.

Thompson and Strckland (2001) argue that, whilst a successful differentiation strategy must entail creating buyer value in ways unmatched by rivals, what has to be determined is how to create unique attributes that buyers will consider valuable. In this regard, one of four approaches can be used.

- First is to incorporate product attributes and user features that lower the overall costs of using the company's product. Essentially making the company's product more economical for the buyer to use.
- A second approach is to incorporate features that raise the performance a buyer gets out of the product.
- A third approach is to incorporate features that enhance buyer satisfaction in non-economic or intangible ways.
- A fourth approach is to compete on the basis of capabilities – to deliver value to customers via competitive capabilities that rivals don't have or can't afford to match. A capability has differentiating competitive value when it allows a firm to perform an activity that delivers value to customers in ways rivals cannot match.

2.2.6 Fundamental Criteria for Good Strategy

The following elements are a means to evaluate the success of strategy formulation and implementation.

- <u>The Goodness of fit Test</u>

  A good Strategy has to be well matched to the industry and competitive conditions, market opportunities and threats, and other aspects of the enterprise's external environment.
- <u>The Competitive Advantage Test</u>

  A good strategy should lead to sustainable competitive advantage. The bigger the competitive advantage that a strategy helps to build, the more powerful and effective it is.

- <u>The Performance Test</u>

  A good strategy boosts company performance. Two kinds of performance improvements are the most indicative of a strategy's caliber; gains in profitability and gains in the company's competitive strength and long – term market position.

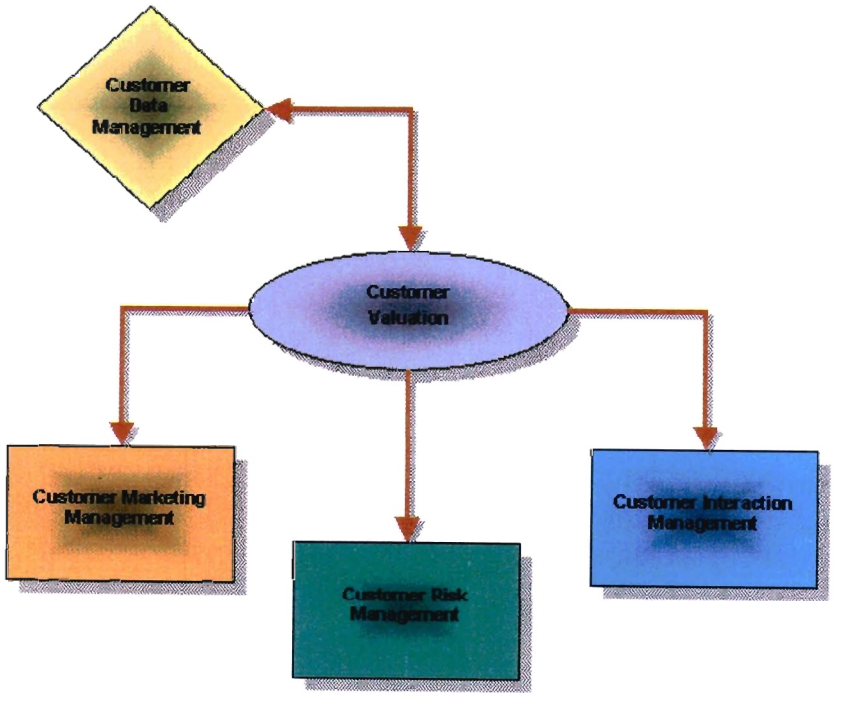
2.3 The Customer Relationship Life Cycle Model

Taking a more customer-centric approach can benefit the entire customer life cycle. Differentiated customer treatment that is consistently applied across an enterprise is the goal of customer relationship management. The differentiation of customer treatment is based upon a firm's understanding of customer value. Customer valuation is both an art and a science, as financial services institutions must not only rely just on past behaviour, but on predictions of future behaviour as well.

Managing customer relationships involves solving business problems in five critical areas, and linking solutions across these areas.

Fig 2.5 illustrates the broad framework comprising the major component parts of customer relationship management relative to the customer life cycle. Each of the component parts comprise sub-sections relevant to the overall objectives of the life cycle model and will be covered when dealing with each of the major components of the model.

Fig 2.5 Customer Life Cycle Model



Source: Fair, Isaac Brochure: 0709 BR 0999 550

A brief overview of each component is as follows:

- Customer Data Management

  Most CRM efforts begin with the need to break down the "silos" within an institution. Constructing a coherent view of the customer means aggregating and organizing data that may presently exist in separate databases run by different units.

- Customer Valuation

  Customer relationship management pivots on a better understanding of customer needs and customer value. This view must include not only all of a customer's existing relationships, but also how that customer's present and potential profitability should impact treatment across those relationships. When the top 20% of customers can produce more than 80% of profits – up to 120-150%, according to First Manhatten Consulting Group – it's crucial to identify high-value customers and give them appropriate treatment. Targeted programmes are required to increase the profitability of all customers.

- Customer Marketing Management

  Marketing drives effective customer relationship management. The more diverse financial services institutions are seeking more effective ways to cross-sell products, build loyalty, stem attrition and increase revenues. It is no longer feasible to offer every new product you provide to every customer that you have. Marketing must be more efficient and strategic, approaching customers with products that they want – often before they have even expressed a desire for them.

- Customer Risk Management

  As the potential to offer new products to existing customers grows, it's vital to be able to control contingent liability. Often the greatest challenge is providing guidance to portfolio or product line

managers on how they should treat customers who have other relationships with the institution. Key decisions involving limits, loan amounts and collection priorities need to be made in a co-ordinated fashion, so that a relationship can be built while controlling the exposure to risk.

- Customer Interaction Management

  A lost opportunity during a customer contact can mean losing a customer altogether. When a customer calls to ask about charges on their statement, investigates new products at a web site or sends an e mail indicating an intention to close their account, there must be a response with offers or information geared towards that customer's value and needs. High value customers need to be identified and must be retained with products or pricing that will satisfy them.

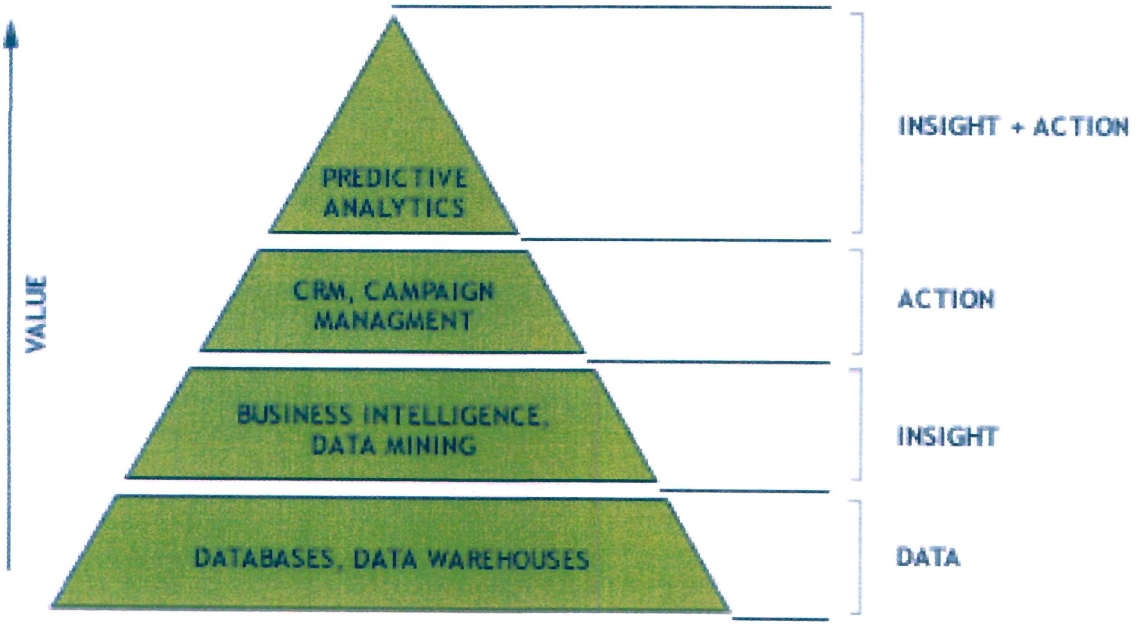
2.3.1 Predictive Analytics and Data Mining as Driving Forces

A fundamental strategic imperative underlying and supporting the five component parts of customer life cycle relationship management is predictive analytics and data mining technology.

It has been stated (*Sightward* 2002, Internet web site 1) that to thrive in today's competitive marketplace, businesses are rapidly moving toward customer-centric business strategies. No longer simply product focused, companies are attempting to discover – and take action – on customers that are likely to exhibit a desired behaviour. That behaviour may include the likelihood to open or close an account, make a purchase, buy related products, etc. Traditionally, businesses have relied on historical contexts to draw general inferences about what is likely to happen in the future. The targeting methods employed have generally included human intuition, course segmentation and/or no method at all. Other commonly used methods and tools used include Recency, Frequency & Monetary, or RFM analysis, traditional descriptive statistical packages and product-centric analytics such as collaborative filtering.

(*Sightward* 2002, Internet web site 1) reveals that predictive analytic applications, on the other hand, incorporate sophisticated software that allows businesses to seamlessly bridge the gap between descriptive analytics and actionable forecasts. By applying specific business objectives, predictive analytics allows businesses to not only model and score, but also to deliver actionable forecasts based on modeling. Forecast lists are typically exported to call center, campaign management, and direct mail, and CRM systems for offer delivery and/or interaction with customers. The results have a positive and measurable impact on Return on Investment.

Fig 2.6 Predictive Analytics



Source: Internet Website: Sightward 2002 – 2003

According to (*Data Mining Strategies* 2002, Internet web site 2), data mining is essentially the process of unearthing knowledge embedded in the internal and external data of an organization, and then using that knowledge to more effectively grow and manage the business. It comprises processes designed to identify and interpret data for the

purpose of discerning actionable trends and formulating strategies based on those trends.

(*Data Mining and CRM* 2003, Internet web site 3) reveals that as firms scrutinize their spending on marketing activities, they begin to focus on their data mining capability. How can they learn more about customers, use that information to make appropriate offers to customers, and understand which offers succeed. Once a firm begins to use customer information to make decisions, they may begin to develop more sophisticated means of using customer data. Data mining, data exploration and knowledge discovery are all terms that create an image of the demanding and sometimes tedious search to uncover insights that are neither obvious to competitors nor easy for competitors to duplicate. Customer relationship management depends on data analysis activities to uncover directions and opportunities and highlight warning indicators for CRM initiatives. CRM uses data mining to understand how to reach out to and communicate with customers.

- **Descriptive Analysis**

  According to (Data Mining and CRM 2003, Internet web site 3), not all data mining relies upon complex statistical analytics. Segmentation and clustering techniques are commonly used to group customers by shared characteristics to highlight patterns that can be used in developing marketing plans.

  Basic segmentation is often used to group customers by easily identified, mutually exclusive characteristics such as demographics or product ownership or usage. Segments can be as simple as females versus males or females over 55 years versus those under 55 years. As long as the grouping leads to insights, which can be used to drive marketing initiatives, it can be a segment.

  "Clusters" is often used to describe mutually exclusive sub-segments according to pre-selected characteristics, usually those

thought to be key indicators of consumer behaviour. Large firms often use geo-demographic clusters to target brand marketing. Some firms use "value clusters" to drive marketing activities based on the current or potential value of a customer group.

- **Predictive Modeling**

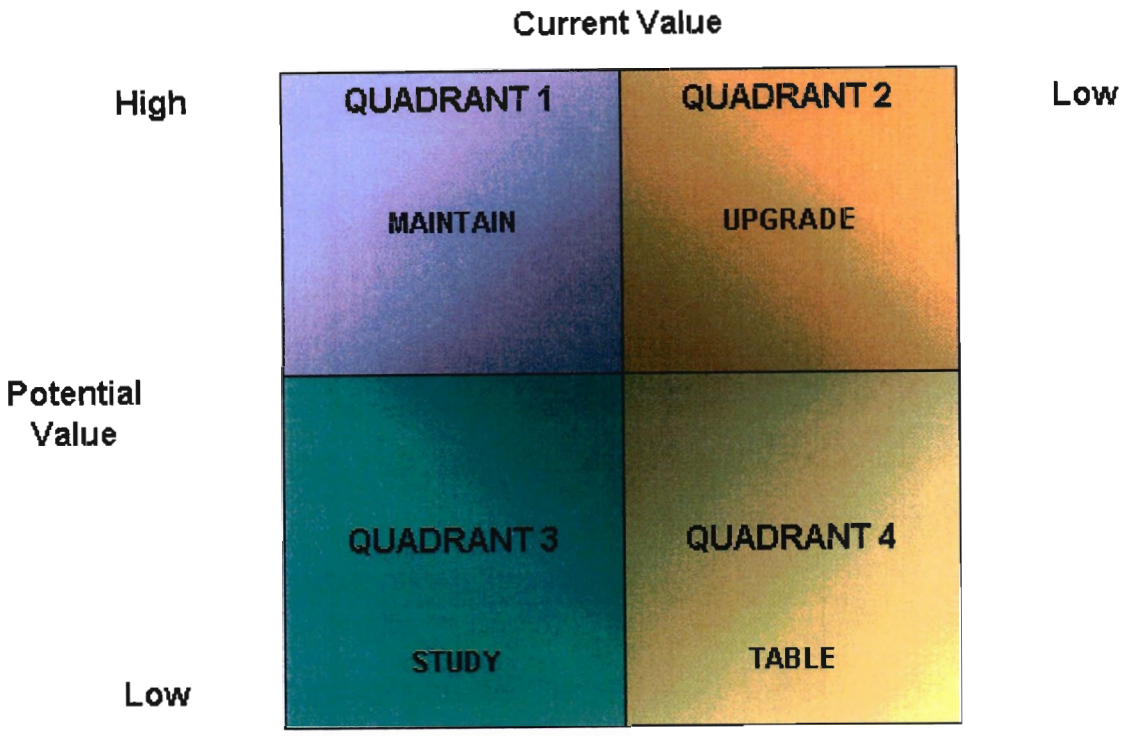
  The article (*Maximise Customer lifetime value with Predictive Analytics* 2003, Internet web site 4) explains that predictive modeling is a powerful data-mining tool using statistical methods to compare and contrast customers on a wide variety of factors. Predictive modeling determines which factors are highly correlated and measures the degree of correlation and statistical reliability. The result of a predictive model is a mathematical formula or score that may be applied to customers to predict likely behaviour.

- **Using Predictive Models**

  According to (*Data Mining and CRM* 2003, Internet web site 3) models can be used to predict response to a targeted offer. Individual customers may be scored on their likelihood to respond to an offer. The model scores may be used to run economic and what-if scenarios. Risk models may be used to determine the likelihood of default or non-payment and they typically work in conjunction with credit bureau data.

  The article (*Data Mining and CRM* 2003, Internet web site 3) illustrates how a simple segmentation, requiring significant effort understanding customer value, may be one of the most effective ways to use descriptive analyses and predictive modeling. One approach us to create a two-by-two matrix and assign customers to a quadrant based upon their current and potential value. CRM initiatives may be organized around the customers in each quadrant.

Fig 2.7 Current Value / Potential Value Matrix



- Quadrant 1: High current value/High potential value – Maintain.
  Depending on the industry, the most profitable 10% of customers may represent 50% and 80% of a firm's profits, so losing a customer from this group may be very costly. On-going retention or loyalty efforts should be aimed at the customers in quadrant 1.

- Quadrant 2: Low current value/High potential value – Upgrade.
  These customers may increase value by cross-selling and account management efforts. Perhaps these customers have not received appropriate offers in the past or they may be delaying purchases. Efforts should be aimed at increasing the depth and breadth of the relationship of each quadrant 2 customer with the firm.

- Quadrant 3: High current value/Low potential value - Study
  In some segmentation matrices, the recommended strategy for this quadrant is to milk these customers for current revenue. The preferred approach is to determine which customers can be

converted to profitable clusters in the future and to determine how they can be converted.

- Quadrant 4: Low current value/Low potential value – Table.
  A reasonable assumption is that you cannot focus on every segment at once, so the approach should be to table quadrant 4 customers while the firm works at improving relationships with customers in other quadrants. Some experts recommend proactively ending relationships with quadrant 4 customers, others focus on gathering information on these customers with the view to trying to convert unprofitable customers to profitable ones.

The combination of good customer information, data mining, and technology enables companies to better understand their customer base and communicate with them more effectively. Once a firm is actively using customer information to make decisions about how, when and what to market to customers, they often increase the volume of targeted customer contacts. This increase leads many firms to look for new ways to automate mining and marketing processes to make the most of their newfound learnings about customers

2.4 Critical Areas of Customer Relationship Management

The following components of the lifecycle model form an integral part of successful customer relationship management. While each component will be covered in detail separately, there needs to be a seamless integration of these components in order to achieve higher levels of customer loyalty and improved customer profitability.

2.4.1 Customer Data Management

In today's economy customer data management could be a business's most valuable competitive asset. While competitors, partners and suppliers might have a part of a given company's customer information, the 360- degree views of a company customer relationships is one of the few assets that is uniquely its own.

"Customer Data Management (CDM) is the process that optimizes data quality and content to enable greater returns on customer-centric business investments." (*Hart-Hanks* 2002, Internet web site 5).

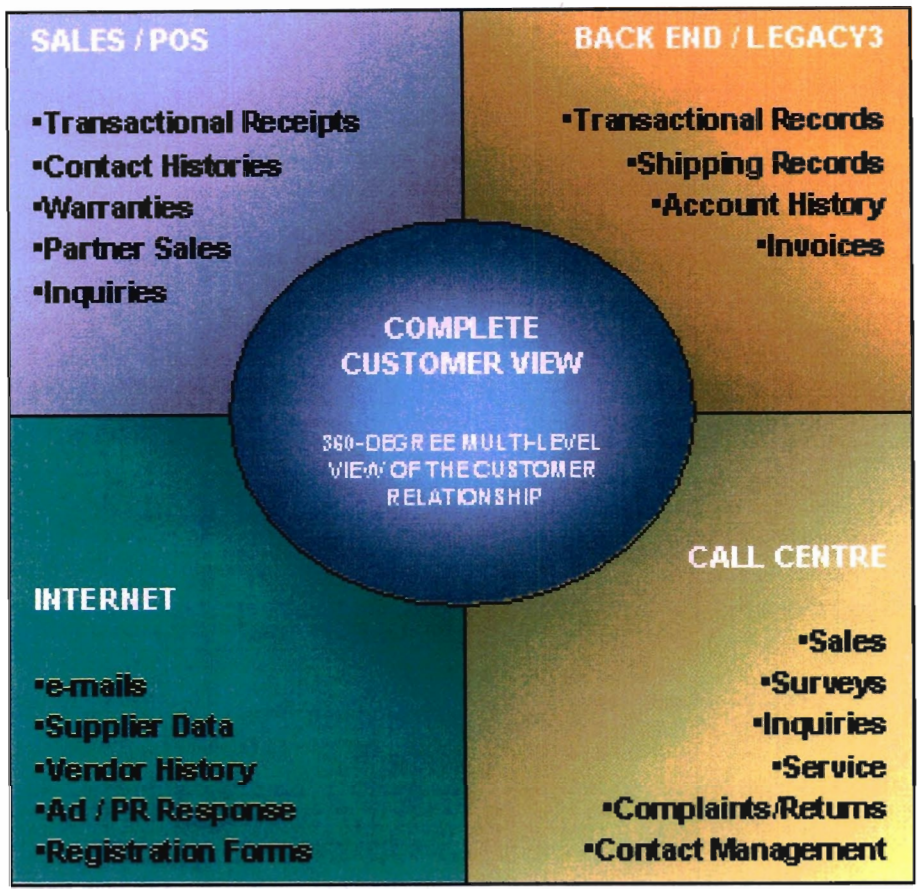
2.4.1.1 Customer Data across the Enterprise

According to (*Harte-Hanks* 2002, Internet web site 5) the value of customer data lies in three unique qualities. Together, these qualities make data a potentially powerful force for defining and directing profitable business at both strategic and tactical levels:

- Unique composition based on history and relationship with a particular business.
- Reliability as first-hand customer intelligence.
- Ability to provide insightful and timely feedback about business actions.

The potential role of customer data cannot be emphasized enough in excellent customer service, realistic marketing-strategies, empowered CRM objectives and, ultimately, sales generation. From its inception in brick-and-mortar, Web, call center, e-mail and direct mail interactions to its population of databases, data warehouses and data marts to its representation on mailing labels, customer intelligence reports and front-office interfaces, data is the lifeblood of the enterprise. A unique, renewable and sustainable advantage, it fuels effective customer interactions, informs business decisions and supports growth initiatives.

Fig. 2.8 The Single, Multi-Level Customer View



Source: Harte – Hanks Journal (2002): 4

(*Harte-Hanks* 2002) reveals that traditionally, customer data has been the domain of information technology, however, evolving technology has changed this. Today real-time technologies, notably in marketing automation and user authentication, business response to customer interactions can be immediate. The ability to collect, share and use data enterprise wide has transferred the management of customer data into the hands of business users and analysts. This has liberated it in many cases from IT departments and revolutionized the role of data in marketing, decision-making and other business critical processes.

Companies that have seen the success of data-enabled marketing programs in driving revenue and cutting costs have adapted or co-opted these programs across other business processes. CRM, which is almost wholly based on customer data, has become the force behind what is a

near-universal business revolution toward customer-centric policies and strategies.

(*Harte-Hanks* 2002) argues that CRM has given rise to entirely customer-centric businesses. Sales force automation stored customer data, but used it chiefly for contact management. With channel development, call center automation and data warehousing, among other technologies, the understanding of customer relationships has grown to encompass the entire enterprise.

An important observation made by (*Harte-Hanks* 2002) is that the 360-degree, multi-level understanding of customers, their relationship with the business and their relationships with each other have dramatically increased the value of customer data in high-level business processes. Now, sales force and marketing automation, e-business and analytics, customer service and support and strategic and tactical planning are all empowered by a constant stream of customer information. The process of producing a 360-degree view of the customer relationship creates a comprehensive customer record based on every point of interaction (POI) for use across the enterprise. An example quoted by (*Harte-Hanks* 2002) of the way in which a company can use enterprise wide customer understanding to create new business advantages is as follows:
A company calculates customer value more accurately if it knows how often a particular customer engages live support (call center data), if he has bought or used a warranty (sales data), if he has bought products at particular branches (POS data), if he has defaulted on payments (account management data) and other variables.

2.4.1.2 The CRM-Customer Data Connection

Foss et al. (2002) reveal that he power of customer data to help increase revenue or reduce costs is its value. CRM is the mechanism that produces this value, in that it mills data to create an understanding that drives organizational learning, which in turn empowers revenue-generating actions.

According to (*Harte-Hanks* 2002, Internet web site 5), industry analyst Gartner defines CRM as a business strategy designed to optimize profitability, revenue, and customer satisfaction. The reason why CRM works is that:

- Customer retention is more valuable than customer acquisition
- Better customer knowledge enables the business to increase customer value

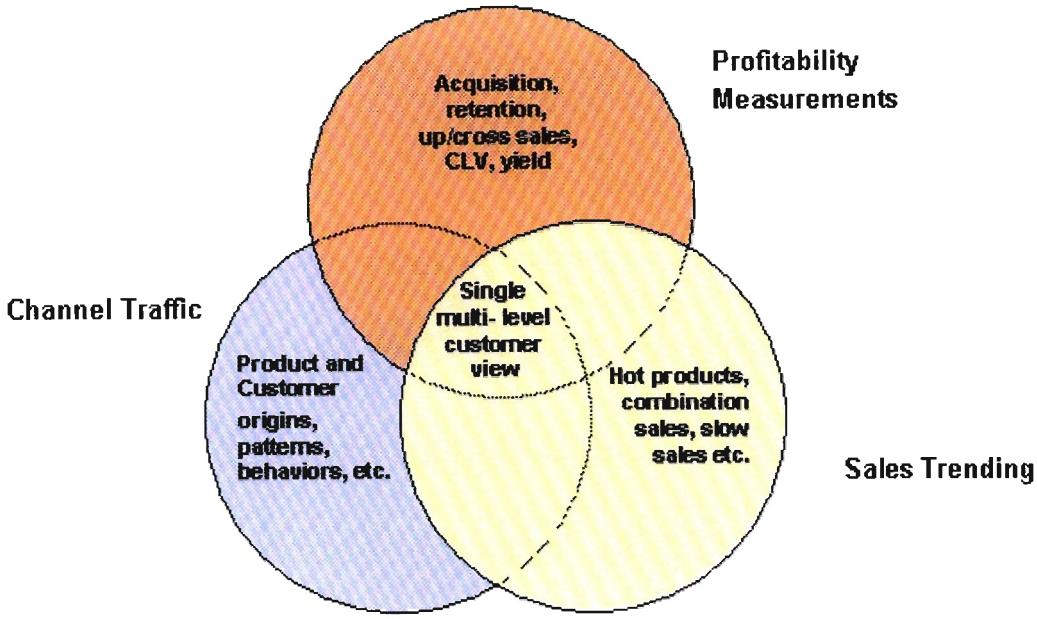
Customer loyalty lowers the initial resistance to investment that many customers' have-barriers such as absence of trust and price sensitivity. With repeated encounters, customer revenues increase (up on average 50% between first and second purchases); price sensitivity decreases with new appreciation of the business and susceptibility to targeted cross-and up-sell efforts increases. The result is higher customer yield, which ultimately drives higher revenue.

In the science of changing first-time buyers into profitable and loyal customers, high service levels, compelling promotions and financial incentives, targeted messaging, personalization and flawless fulfillment and billing are key ingredients. Accurate, complete and relevant customer data is the core of each of these components.

2.4.1.3 Challenges to Customer Data Value

Foss et al. (2002) are of the opinion that data today is available in greater quantities with greater complexity and from more sources than ever. In their efforts to extract opportunity from data quantity, companies too often ignore critical issues of data quality. This can prove costly since data accuracy, completeness and currency can mean the difference between success and failure in every data-dependent initiative and solution. Poor data quality is one of the few factors that can quickly render a well-implemented system obsolete.

Fig.2.9 Enterprise-Wide Data Management



Source: Harte – Hanks Journal (2002): 8

According to (*Harte-Hanks* 2002, internet web site 5), an effective CDM solution combines data cleansing and enhancement with expert professional services to create a single, enterprise-wide and multi-level view of the customer from fragmented, variously formatted and inconsistent records throughout the enterprise. CDM is an ongoing process that continuously provides the highest quality data foundation for all customer data-dependent efforts throughout the enterprise.

The components of an effective CDM lifecycle are:

- Data Conversion - transforms data into standard operation-specific format
- Change Detection – identifies changes at field and record levels, creating consistency between data cycles
- Data Hygiene – standardizes, corrects and verifies all customer name and address information

- Postal and Census Geocoding – assigns corrected and enhanced geographic information to all accounts with new address information
- Relationship Management – identifies relationships between records by comparing new and corrected data with existing records
- Key Management – assigns and maintains unique record keys for persistent customer identification despite significant profile changes
- Relationship Enhancement – applies business rules and augments records with additional demographic and relationship data for a more robust customer view

Studies have shown that most companies are eager to maintain high data quality. Organizations that relegate CDM to IT staff or data warehouse managers often neglect many of the ways in which poor customer data enters, infiltrates and undermines CRM. Many companies find out the hard way that CDM extends beyond IT's domain. Each touchpoint is a potential source of data corruption.

In this and other ways raw customer data becomes fraught with errors, inaccuracies, inconsistencies, omissions, contradictions and invalid formats.

Given the business issues noted above, it is no surprise that data quality is much more common in theory than in practice, a trend confirmed in a recent META group survey. The research firm's report notes that 92% of surveyed companies believe that improved customer intimacy is an important priority, but only 20% have developed unified customer views. The remaining 80% might never see the raw reality of the customer information in their disparate data sources. Without specific and effective CDM processes, these companies can easily underestimate or ignore the data quality disaster blossoming behind their CRM investments.

2.4.1.4 The Importance of Data Management

Foss et al. (2002) argue that poor data has a gradual and systematic impact, aptly conveyed in the technology acronym, GIGO (garbage in,

garbage out). It requires a proactive and enterprise-level commitment to CDM best practices to prevent data corruption, duplication, omission, inconsistency and other flaws from eroding business practices – from databasing through data warehousing to data mart queries and analytics to front office applications and ultimately to customer interactions.

(*Harte-Hanks* 2002, Internet web site 5) express the view that within CRM, data management issues are a large component of high failure rates among CDM projects, 55% to 70% according to reports from Gartner and META Group. More optimistic reports – such as The Data Warehousing Institute survey that found that only 40% of surveyed projects failed or The Cutter Consortium Survey indicating a mere 23% failure rate for CRM projects – nevertheless indicate that data management issues persist as critical factors in business success. The power of data is also its downfall: if high quality data is a business asset, low quality data is a liability.

Table 2.2 Costs of Poor Data Management

THE COSTS OF POOR CDM
Higher direct marketing expenditures
Difficulties in meeting privacy requirements mandated by law and stipulated by customers
Unsupported strategic and tactical decisions based on flawed analytics
Erosion of customer relationships
Missed sales and marketing opportunities
Conflicting or irrelevant marketing messages
Over or under promoted customers
Insufficient or inaccurate corporate memory
Higher fraud liability

Source: Harte – Hanks Journal (2002): 11

According to Ayers (2003), it is possible that the problem does not lie with CRM technology, but with the way organizations collect and use data. Among all business processes CRM most heavily depends on high customer data quality, since CRM is successful only when it can apply relevant, accurate data to optimize customer relationships. CDM provides a solid underlying data infrastructure for successful CRM through the identification, standardization, deduplication, enhancement, relationship

matching and change management of data from every customer interaction at each customer touch point.

Harte-Hanks (2002) state that any customer-centric database project is deeply impacted by CDM. By ensuring clean, relevant and accurate customer data , CDM provides a single enterprise- wide, multi-level and historical customer view from aggregate information. Also, it empowers accurate customer analytics, predictive modeling and targeted marketing campaigns based on customer buying habits, demographic characteristics, locations and other individual identifiers.

McKendrick (2000) expressed the view that the future of data warehousing has been seen and it is in support of CRM systems. The powerful new means of collecting, analyzing, distributing and using data have spurred a need to collect more customer information for integrated operational, CRM and e-business systems. In a rush to meet this need, however, many businesses neglect issues of data quality.

Saarenvirta (1998, Internet web site 6) makes mention of customer clustering and segmentation as two of the most important data mining methodologies used in marketing and CRM. He continues that marketing decisions are only as good as the data that supports them. While initiatives by nature invoke some risk, decisions supported by invalid, irrelevant and incomplete data have little more than random odds of success. By assigning and tracking persistent, individual customer keys, CDM ensures that customers remain completely visible to the company, even if significant identity elements – such as names, addresses and relationships – change over time.

Companies can diagnose readily poor data management when they pay high postal penalties for bad addresses and identify inconsistent data across systems. More challenging is the recognition of seemingly minor mistakes, such as small billing errors, redundant mailings to the same household and the inability to share data between accounting and sales

departments spring from the single systematic problem of poor CDM. These, along with declining sales, rising overhead, increased employee frustration and poor customer service, are all potential symptoms of bad CDM and caustic agents to the company's bottom line.

Table 2.3 Data Management and CRM

HOW DOES CUSTOMER DATA MANAGEMENT IMPROVE CRM?	
CRM	**Role of Customer Data Management**
Improve Sales Effectiveness	▸ Reveals preferences and buying trends through full customer history that reduce sales cycle ▸ Produces better trending, opens new cross-/up-sell opportunities through relationship grouping ▸ Empowers more effective sales management with better customer and sales tracking ▸ Underlies more accurate forecasting ▸ Enables better tracking as customers turn from prospects to buyers and back to prospects ▸ Empowers channel sales with 360-degree relationship view ▸ Supports better team sales with consistent information across all channels, team touch points and customer data sources
Increase Customer Satisfaction	▸ Supports customer service based on entire customer picture ▸ Lets service focus on most loyal and profitable customers based on all accounts and relationships ▸ Reduces customer frustration with inconsistent messaging, duplicated efforts across departments and data inaccuracy between departments ▸ Empowers personalization, targets actions based on proven interests. Real-time CDM immediate one-to-one marketing responses
Increase Revenues	▸ Increases value of data assets ▸ Supports more productive marketing and sales efforts ▸ Empowers more profitable strategies and tactics ▸ Supports higher customer yield (benefits less costs), higher profitability, higher lifetime values, perpetuated sales cycles
Improve Communications	▸ Enables better targeting with a more accurate customer view ▸ Reduces mailing duplications to individuals and households ▸ Promotes tailored messaging and promotions based on full picture of interactions, tendencies and preferences ▸ Eliminates "data compartmentalization" that produces incomplete, inaccurate and fractured customer views
Improve Management Effectiveness	▸ Empowers strategic planning with single, enterprise-wide customer view ▸ Supports more accurate and real-time analytics, CDM enables faster, more relevant feedback / evaluation action cycles ▸ Supports real-time customer-centric tactics by associating customer actions with customer view in real-time
Decrease Costs	▸ Reduces marketing and sales costs (see sections above) ▸ Improves company's ability to let customer self-service across multiple channels, while maintaining responsiveness levels ▸ Promotes operational retention, reduces customer acquisition costs ▸ Reduces operational efficiencies due to duplicate, inaccurate and incomplete customer records ▸ Decreases liabilities due to bad data in accounting and shipping ▸ Reduces mailing and shipping costs ▸ Reduces burden of redundant data on storage infrastructure

Source: Harte – Hanks Journal (2002): 13

2.4.1.5 Maximizing Data Value with CDM

Stone et al. (2003) recommends that a detailed understanding be built of the issues around the 360 degrees view of the customer, prior to making commitments to build such a view. They are of the opinion that customer-centric companies today face a compound data management challenge. While companies are collecting record amounts of customer data from an unprecedented variety and quantity of sources, customers are becoming increasingly intolerant of perceived abuse – including inefficiencies, indiscretions and errors related to their data.

This situation has dual implications. On the one hand, CRM based on solid data management can make customer data a company's most valuable unique business asset. On the other hand, poor CRM can repel customers with unprecedented efficiency. This dual nature of data is why a data warehouse without a data management solution is a disaster in the making and why a CRM program backed by data of an unknown quality can easily diminish as increase the value of information assets.

Foss et al. (2002) argue that truly enterprise-wide data quality requires two specific efforts: CDM must create a high quality of data and ensure that data is consistently available throughout the enterprise.

Harte-Hanks (2002) is of the opinion that to take advantage of new opportunities, companies must look closely at their existing data as well as their unique data requirements, understanding the business drivers for data quality, how data is used and who uses it.

Critical CDM features that support continuous and effective CRM are:

- Tight incorporation of organizational data requirements that dictate business logic behind data cleansing and matching processes
- A unified customer view built of data from all customer touch points throughout the enterprise

- Robust data cleansing functionality for diverse data types, including a variety of non-name/ address data
- Intrinsic support for international data formats, character sets and geographic information
- Storage of processed data in an open file format accessible to all systems throughout the enterprise
- Ability to track a timeline of dynamic customer relationships through unique customer key management

Table 2.4 CDM the Foundation of CRM

CDM AS THE FOUNDATION OF CRM

CUSTOMER

High quality data lets the company accurately and consistently identify individual customers and customer groups

RELATIONSHIP

Data consolidation and standardization enables the company to build and maintain a 360-degree multi-level view of customer relationships with each other and the business

MANAGEMENT

Relevant, accurate and timely data helps the company assess customer expectations, responses and values and to create compelling interactions

Source: Harte – Hanks Journal (2002): 15

The single multi-level customer view is the keystone of enterprise-wide CRM. Achieving this level is often hampered by independent legacy data sources that house parallel, yet disparate customer records with inconsistent, duplicate and erroneous data. Eliminating this barrier involves a consolidation of customer data throughout the enterprise to

form a single customer-centric data repository that includes detailed account and transaction data from all channels, promotion history across all touch points and complete customer interaction histories.

2.4.2 Customer Valuation

Panda (2003) has expressed the view that CRM is the establishment, development, maintenance and optimisation of long term mutually valuable relationships between consumers and organizations. The way companies interact with their customers has changed dramatically over the past few years. A customer's continuing business is no longer guaranteed. As a result companies have found that they need to have a better understanding of their customers and to be able to quickly respond to their needs and wants. Also, companies have realized that they have to respond in a much quicker manner. It is no longer possible to wait until the signs of customer dissatisfaction are obvious before action must be taken. To be successful, companies must be proactive and anticipate what a customer desires.

According to Fox and Stead (2001), successful CRM focuses on understanding the needs and desires of the customers and is achieved by placing these needs at the heart of the business by integrating them with the organisation's strategy, people, technology and business processes.

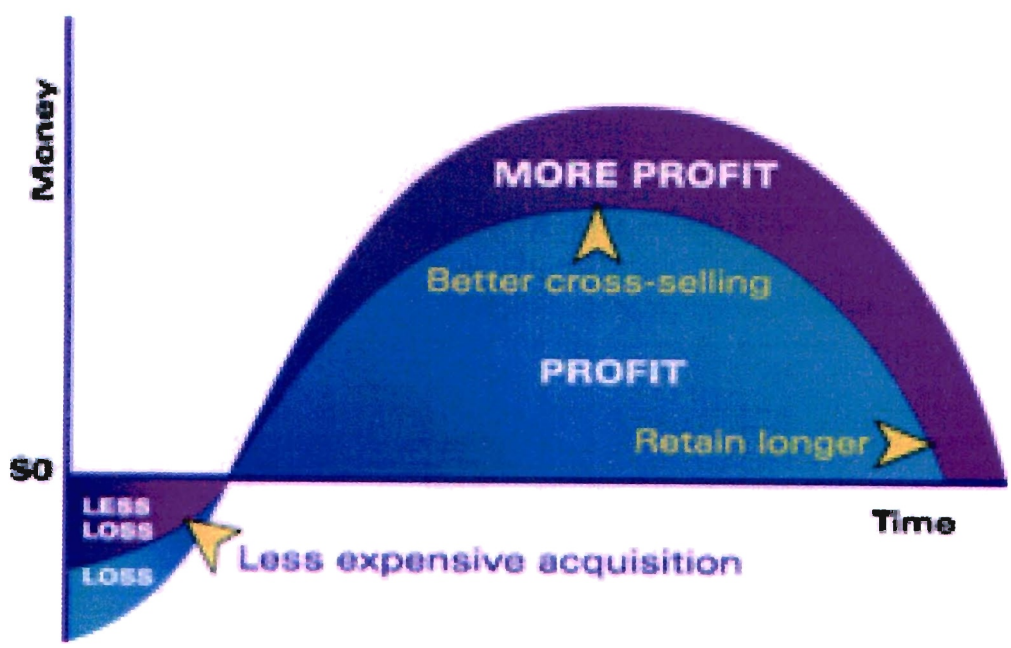
"How profitable would your business be if you could predict what your customers would do next - using the large amounts of customer data already collected? What is required is redefining the approach to customer relationship management " (Cody 2000, Internet web site 7).

Sullivan (2002, Internet web site 8) provides a perspective on the concept of one-to-one marketing. Focusing on successful one – to – one relationships has become a business imperative. Maximizing the lifetime value of customers has become vital to maximizing the organization's overall value and profitability. According to Cody (2000, Internet web site 7), a recent development in many companies has been to employ

operational CRM systems to better communicate with their customers. However, successful CRM means far more than being better connected to customers – it means learning from those connections to enable more profitable interactions by predicting what customers will want next – and inspiring loyalty by helping them get it. It requires tracking customer behaviour and using that data to maximize a customer's profitability and loyalty throughout the entire life cycle, from customer acquisition to retention.

Cody (2000, Internet web site 7) argues that it is a fact: loyal customers are profitable. They purchase more; they cost less to sell to; and studies show they will refer on average five other people to your company. The question is how to identify and cultivate loyal customers? The answer lies in the implementation of analytical CRM solutions that employ data mining and analysis techniques, which will help to determine and deliver precisely what customers want.

Fig. 2.10 Customer Life Cycle and Customer Value



Source: Internet Website: Serverworld: 1

2.4.2.1 Factors Impacting Customer Value

Thearling (2000, internet web site 9) lists that following factors having an impact on customer value.

A number of forces are working together to increase the complexity of customer relationships:

- Compressed marketing times. A successful company needs to reinforce the value it provides to its customers on a continuous basis.
- Increased marketing costs. Everything costs more – printing, postage and special offers. If you do not provide the special offer, your competitors will.
- Streams of new product offerings. Customers want things that meet their exact needs, not things that sort of fit.
- Niche competitors. Your best customers also look good to your competitors. They will focus on small, profitable segments of your market and try to keep the best for themselves.

Thearling (2000, internet web site 9) argues that successful companies need to react to each and every one of these demands in a timely fashion. The market will not wait for your response, and customers that you have today could no longer be there tomorrow. Customers and prospective customers want to interact on their terms, and multiple criteria will have to be considered when evaluating how to proceed. Sullivan (2002, internet web site 8) is of the opinion that the following will have to be automated:

- The Right Offer
- To the Right Person
- At the Right Time
- Through the Right Channel

The right offer means managing multiple interactions with your customers, prioritizing what the offers will be while minimizing irrelevant offers. Identifying the right person means moving towards highly segmented

marketing campaigns that target the individual needs and wants. The right time is a result of the fact that interactions with customers now happen on a continuous basis. By choosing the right channel requires ensuring that the most effective medium for a particular interaction is chosen.

Thearling (2000, internet web site 9) explains that data mining, by its simplest definition, automates the detection of relevant patterns in the database. For example, a pattern might indicate that married males with children are twice as likely to drive a particular sports car than married males with no children. As a marketing manager for an auto manufacturer, this somewhat surprising pattern might be quite valuable.

Data mining uses well-established statistical and machine learning techniques to build models that predict customer behaviour.

2.4.2.2 Relevance of Data Mining to a Business Process

According to (*Marketing Automation* 2000, internet web site 10), analytical models involve a process of segmentation or differentiation of the customer population into groups with some commonality. Thearling (2000, internet web site 9) expresses the view that for data mining to impact a business, it needs to have relevance to the underlying business process. The issue that must be addressed is that the results of data mining are different from other data-driven business processes. In most standard interactions with customer data, nearly all of the results presented to the user are things that they knew existed already, for example a report showing the breakdown of sales by product line and region. Such a report is straightforward for the user to understand because they intuitively know that this kind of information exists already in the database.

Data mining, on the other hand, extracts information from a database that the user did not know existed. Relationships between variables and customer behaviours that are non-intuitive are the jewels that data mining hopes to find. Because the user does not know beforehand what the data

mining process has discovered, it is a much bigger leap to take the output of the system and translate it into a solution of a business problem.

At this stage interaction and context become important. Marketing users need to understand the results of data mining before they put them into actions. Because data mining usually involves extracting "hidden" patterns of customer behaviour, the understanding process can get a bit complicated.

In order to extract customer value, it is critical to know how to use the output of data mining. The simplest way is to leave the output in the form of a black box and if the database is scored, this can form, for example, a marketing list and the marketing offering can be in the form of a catalog or alternatively a pre approved credit limit. This facilitates automation and can be a very effective approach. Mailing costs can often be reduced by an order of magnitude without significantly reducing the response rate.

- **Data Mining and Customer Relationship Management**

  Thearling (2000, internet web site 9) deals with the above aspects as well as the concept of scoring in the following comprehensive manner. To be successful, database marketers must first identify market segments containing customers or prospects with high-profit potential. They then build and execute campaigns that favorably impact the behaviour of these individuals.

  The first task, identifying market segments, requires significant data about prospective customers and their buying behaviours. In theory, the more data there is, the better. In practice, however, massive data stores often impede marketers, who struggle to sift through high volumes of data to find the valuable pieces of information.

  After mining the data, marketers must feed the results into campaign management software that, as the name implies, manages the campaign directed at the defined market segments. The separation of

the data mining and campaign management software introduces considerable inefficiency and opens the door for human errors. Tightly integrating the two disciplines presents an opportunity for companies to gain competitive advantage.

- **Scoring**

According to Thearling (2000, internet web site 9), data mining builds models by using inputs from a database to predict customer behaviour. This behaviour might be, for example, attrition at the end of a magazine subscription, cross-product purchasing, willingness to use an ATM card in place of a more expensive teller transaction, and so on. The prediction provided by a model is usually called a score.

Fair et al. (1992, internet web site 11), states that accounts can be differentiated from one another by many account attributes. In considering delinquent accounts, the differentiation can include, among others items, the level of delinquency, whether payment was ever made, time since account commenced, whether the account is over its credit limit or not and so on. Fair et al. (1992) continue to explain that adaptive control systems provides one additional means of differentiation of accounts: the measure of the risk of continued delinquency that is presented by the account. This is done through the use of the risk calculation tool known as behaviour scoring. Behaviour scoring is a tool that establishes the probability that an account will remain in, or return to, a satisfactory condition.

A score (typically a numerical value) is assigned to each record in the database and indicates the likelihood that a customer whose record has been scored will exhibit a particular behaviour. For example, if a model predicts customer attrition, a high score indicates that a customer is likely to leave, whereas a low score indicates the opposite. After scoring a set of customers, these numerical values are used to select the most appropriate prospects for a targeted marketing campaign.

2.4.2.3 The Three Stages of Increasing Customer Lifetime Value

Analytical CRM can help companies maximize customer profitability and loyalty in each of the three main stages of the customer life cycle: customer acquisition, customer value maximization and customer retention.

- **Customer Acquisition**

  According to Cody (2000, internet web site 7) companies need to ensure that they realize a return on their investment in marketing expenditure. One way of achieving this is through analyzing customer data from purchases and transactions, the Web, Call Centres, responses to marketing campaigns and third-party sources to make predictions. It can use analytical CRM technology to determine its best sales prospects by analyzing previous direct marketing campaigns. For example, a credit card company completes dozens of direct mail campaigns every year. Instead of mass mailing to one million names and receiving 60,000 responses – only 10,000 of which have adequate credit histories to become customers, the company can analyze previous campaigns to discover the type of potential customer that should be targeted.

  Using predictive modeling, the company can determine what type of individual will most likely respond to a direct marketing campaign. It can use that knowledge and a technique of logistic regression to build a model that determines the probability of response, and send mailers only to those individuals who are 50 percent, 60 percent or even 90 percent likely to respond.

  The credit card company also wants to target customers that are credit worthy. To accomplish this they can use a decision tree strategy embracing a credit-scoring model that would select individuals who fit both criteria: a good credit risk and likely to respond.

Although the company planned to send out one million mailers, analysis suggests that the company will receive the optimal return on its direct mail investment by sending mailers to only 750,000 of those one million individuals. Using this strategy the company may receive 9,000 acceptable applications out of the 750,000 mailed. This contrasts to the 60,000 with only 10,000 qualified responses. While the company might reach fewer prospects, it also spends significantly less on mailing itself.

- **Increasing the Value of Customers**

  Cody (2000, internet web site 7) is of the opinion that cross - selling can be one of the most powerful revenue-enhancing tools, however, companies need to be cautious of going to the opposite extreme whereby it can turn customers off by inundating them with product offerings. With customer data analysis, a company can determine what additional products a customer is likely to buy and market only those products to the customer, thus turning a potential annoyance into a convenient, enjoyable experience for the customer – and a revenue-enhancing experience for the business.

  By using analytics to segment the customer database, the customer group that is most likely to respond to a cross-selling offer can be identified and by combining this target segment with information on the previous behaviour of these individuals, their buying experience can be personalized.

  To understand and predict, a retailer must develop a complete picture of each customer, which means collecting and analyzing individual customer data in addition to demographic and transaction data. This information combined with the company's product information, creates models of behaviour to segment or classify customers and buying behaviours.

  An additional element of maximizing customer profitability is identifying not only good but also bad customers. Here the process can also be

applied. For example, using data from past interactions, companies can use analytic techniques such as logistic regression to build a scoring model that predicts fraud, and thus avoids losses even before they occur. Scoring models based on the same principle can be built to determine and target non-profitable customers for potential elimination or very high value customers for retention programs.

- **Retaining Good Customers**

  Cody (2000, internet web site 7) states that studies have shown that keeping current customers costs five to seven times less than finding new ones. Many of today's industries experience high customer turnover, which costs them millions per year in potential revenues. For instance, it is typical for telecom companies to experience 30 percent turnover in one year.

  By analyzing the profiles of customers who have left in the past, companies can develop models to predict which customers are likely to leave and when. Such models can also help a company determine which customers generate the most profits and therefore will cost the company more if they leave. The company can then create targeted retention strategies that help avoid customer attrition.

2.4.2.4 Combining Data Mining and Campaign Management

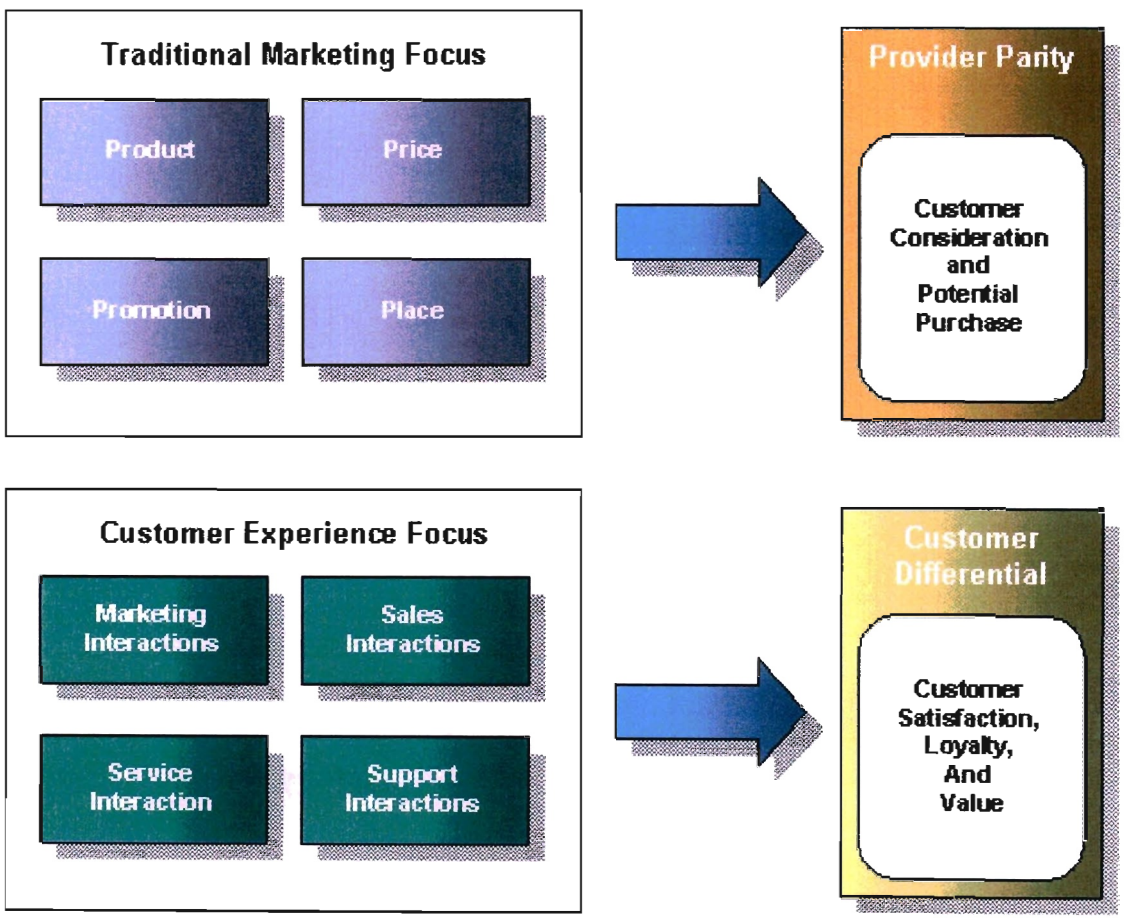
The closer data mining and campaign management work together, the better the business results. Today, campaign management software uses the scores generated by data mining models to sharpen the focus of targeted customers.

2.4.3 Customer Marketing Management

CRM is essentially a focus on providing optimal value to your customers – through the way you communicate with them, how you market to them, and how you service them – as well as through the traditional means of product, price, promotion and place of distribution. " Customers make buying decisions based on more than just price and more than just

product. Customers make buying decisions on their overall experience, which involves product and price, but also includes the nature of their interactions with you." (Nykamp 2001:4) If you can consistently deliver on these marketing, sales, service and support interactions, the reward will be ongoing customer loyalty and value; and therein lies significant competitive advantage.

Fig. 2.11 Shift in Focus



Source: Nykamp (2001): 5

2.4.3.1 The CRM Process

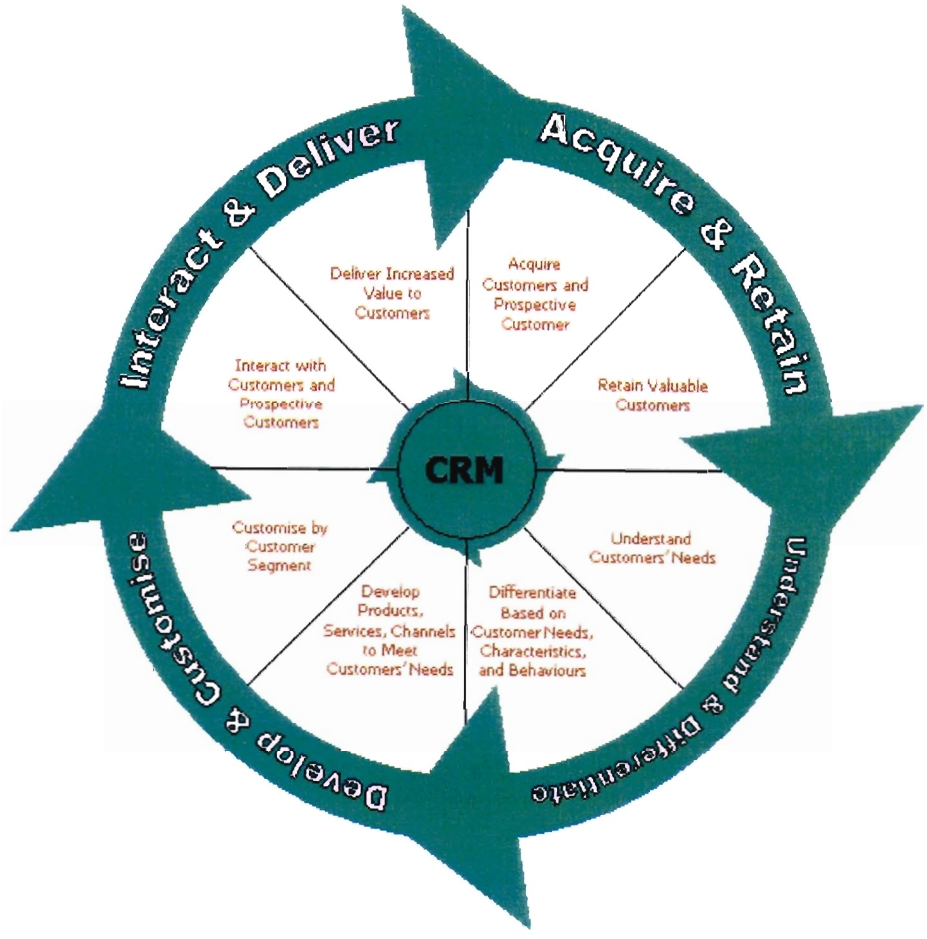
There is a universal, underlying cycle of activity that should drive all CRM initiatives. All initiatives and infrastructure development should somehow be linked to this core cycle of activity, as shown in figure 2.12.According to Nykamp (2001), as a cycle, the stages are interdependent and continuous.

The fact that they are interdependent means that you cannot implement some stages without the others, given that:

- Customization of products and services for customers and understanding of who your customers are
- Interaction and delivery of increased value to customers requires development and customization of products and services to meet their needs
- Retention of customers requires this delivery of increased value

The cycle is continuous in that relationships by their nature involve an ongoing series of interactions. Nykamp (2001), proposes the following model with regard to the CRM process embracing four critical areas.

Fig 2.12 The CRM Process



Source: Nykamp (2001): 6

As the cycle is repeated with any customer or group of customers:

- CRM strategies and initiatives become increasingly sophisticated
- Customers will take notice of what is being done for them
- There will be benefit from increased customer satisfaction, loyalty and profitability provided that the cycle is continued and there is continued investment in customer relationships. As there is progress from one stage to the next, insight and understanding is gained that supports and enhances subsequent efforts

As shown in the cycle, for any organization, business starts with the acquisition of customers. Successful CRM initiatives are highly dependent on a solid understanding of customers.

- **Understand and Differentiate**

  In order to have successful relationships with customers they must be understood – what they value, what services are important to them, how and when they prefer to interact, and what they want to buy. Customer understanding involves.

  - Customer profiling – A process that identifies customer demographic and geographic characteristics such as age, size of household and proximity to the nearest retail location.
  - Customer Segmentation – Here the objective is to identify logical, unique groups of customers that have similar characteristics and demonstrate similar behaviours relative to the purchase and use of your products.
  - Primary Research – This effort is undertaken to understand customer needs and attitudes relative to your products, services and organization as a whole.
  - Customer Valuation – This requires the ability to quantify how and how much each customer group contributes to the

organization's current profitability as well as its future potential value.

- This understanding should become increasingly rich and increasingly useful with ongoing interaction with customers.

- **Develop and Customize**

In the product – oriented twentieth century, manufacturers developed products and services and defined distribution networks, then searched for customers.

In the customer – focused twenty–first century, product and channel development has to follow customer's lead. This is the primary basis for competition and competitive differentiation today. The following are examples:

- Financial services, where conveniences of ATM's and electronic banking channels benefit the financial services provider as well as the customer
- Travel, where Web, toll – free phone, wireless – based reservations and electronic ticketing have offered customers greater flexibility as well as reduced bottlenecks and provider costs
- Business – to – business suppliers where online procurement systems allow businesses to place just – in – time orders for core products or services

- **Interact and Deliver**

Interactive, interaction interactivity – these are overused words in today's electronic world, so it is important to define what is meant by interaction.

The word interactive has somehow become synonymous with "electronic" or "online." Most websites today are far less interactive than their offline counterparts. Customer touch – points have been

automated around efficiency rather than interaction. Therefore attempts to personalize those automated, mechanized touches with a customer – by acknowledging them by name at the checkout counter or on their return visit to a website – are met with limited enthusiasm by customers. To foster relationships, organizations need to ensure that all areas of the organization:

- Have access to relevant, useful customer information, which can range from a customer's product or service preferences to their desired means of receiving communications from the organization.
- Are trained in how to use this customer information in order to customize their interactions with customers based on both customer needs and potential customer value.

- **Acquire and Retain**

The more organizations interact with customers and learn about them, the easier it is to pinpoint those of greatest value to the organization. An understanding of the most valuable customer segments can make these acquisition efforts increasingly effective, because customers can be targeted using the right channel, right media, right product, right offer right timing and most relevant message.

Beyond acquisition, successful customer retention involves getting it "right" on an ongoing basis. Successful retention of customers is based on an organization's ability to consistently deliver on three
Principles:

- Maintain interaction; provide an ongoing forum for two – way dialogue and never stop listening
- Continue to deliver on the customer's definition of value
- Remember that customer's change as they move through different life stages; be alert for changes and be prepared to modify your service and value proposition as they change

As progress is made through the different stages, insight and understanding is gained that enhances subsequent efforts. Development initiatives become increasingly sophisticated as does the implementation of CRM processes and the resulting differentiation in the marketplace.

2.4.3.2 Marketing Automation for Retail

According to (*Advanced Marketing Automation for Retail* 2000, internet web site 12), the question that most retailers are asking, in times of strong competition, is – How can you consistently beat your profitability goals – and your competitors? The answer is to understand your customers better and faster than anyone else, and use that knowledge to target them more effectively than anyone else.

It obviously appears very simple but unfortunately it is not. While information about customers is plentiful, customer intelligence than can be acted on remains elusive. Customer data pours in from every conceivable channel, however, being able to assemble a coherent picture of customers from all that data whereby a profitable marketing strategy can be built can be a formidable challenge.

Sullivan (2002, internet web site 8) expresses the view that in order to achieve the above, marketing automation solutions must provide three key functions:

- **Campaign and Customer Analysis.**
  A comprehensive marketing automation solution must provide quantitative tools to analyze customers to help craft the right offers.
- **Campaign management.**
  At the heart of any marketing automation solution is the capability to effectively automate essential campaign processes, including managing all communication with customers across multiple channels, tracking responses, and consolidating and reporting results.
- **Consolidated view of the Customer through Data Warehousing.**

Campaign analysis and automation functions draw on a customer-centric data warehouse that pulls customer data from all appropriate back office systems, channels and third-party data. This data warehouse supports a customer-orientated, cross-functional view needed for creating truly effective campaigns.

2.4.3.3 The Evolution to Analytics-Based Marketing

The white paper (*Advanced Marketing Automation for Retail* 2000, internet web site 12) deals with the evolution that has taken place from mass marketing. According to the white paper, in four decades there has been a shift from mass marketing – push as much product to the world – to a targeted customer focus – identify unique customer niches and cater to their unique needs. The paper covers the four generations of marketing automation.

Marketing automation systems are struggling to make a corresponding transition. As the discipline of marketing evolved, the implementation of marketing automation has evolved through several distinct generations.
The first generation of marketing automation, originating in the 1960's but not receiving wide acceptance until the 1980's and early '90s, leveraged computer technology to automate the operational tasks associated with marketing campaigns: aggregating contact lists, generating customized direct mailing letters and tracking sales leads. These products enabled marketers to segment, target and reach customers more efficiently. This generation of operational point solutions improved the effectiveness of simple campaigns with turnaround times of several months.

The second generation of marketing automation took a more holistic, cross-functional focus, considering campaign management in context with overall business processes. This generation of cross-functional solutions reduced the marketing department's reliance on IT, supported faster campaign turnaround cycles and made progress in integrating sales and service channels across all touch points.

The third generation of marketing automation takes data integration a step further and:

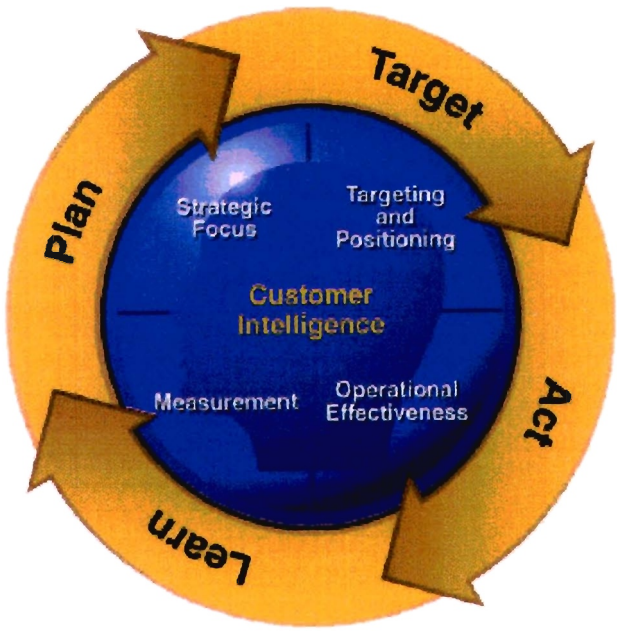
- Supports a customer-centric view that provides a consistent, coherent view of the customer across all touch points.
- Integrates call center systems alongside electronic channels.
- Feeds campaign performance results back into the system to support continuously improving, closed-loop marketing.

The fourth generation of marketing automation is the critical underpinning for today's merchandising environment, with higher expectations, pressure for faster turnaround times at lower costs and narrower windows of opportunity. The generation of automation:

- Introduces advanced analytics to turn business data into customer intelligence, in real time.
- Optimizes each customer contact by tailoring promotions and contact channels to best suit the customer's expectations.
- Enables more opportunistic marketing than ever by responding to triggers that indicate a change in the customer's state, as derived by demographics or analytics. Did the customer just move to a different climate? Make a purchase without the add-on options? Buy two items that indicate a potential need for a third?

The next step is to consider how fourth-generation marketing automation supports a comprehensive, closed-loop marketing process that leverages customer intelligence to transform marketing from an automated operational function into a more profitable intelligence-based relationship management function.

Fig.2.13 Closed-Loop Marketing Process



Four Phases Diagram – Advanced Marketing Automation for Retail 2000

2.4.3.4 Four Phases of Intelligence-Based Marketing Automation

The white paper (*Advanced Marketing Automation for Retail* 2000, internet web site 12) proposes a four-phase closed-loop marketing process based on marketing automation. Given that large retailers and financial services providers commonly provide hundreds of different campaigns in a single year, marketers have to maximize and optimize their performance results at every stage of the process. Fourth generation marketing automation solutions will result in a seamless integration of the three key functions of automated retail marketing mentioned in section 2.4.3.2 above. Retailers can leverage the breadth of this functionality to maximize campaign returns. According to the white paper *Advanced Marketing Automation for Retail*; systematic and profitable marketing incorporates four key phases.

- **PLAN the most effective Marketing Initiatives**

  The marketer's first task is to plan maximally effective marketing campaign offers and strategies, in alignment with the overall corporate goals. This requires a clear, top-down picture of the business issues at play. From an enterprise-wide perspective, what is the best way to

increase customer retention, brand and product awareness and demand?

The planning process is where business strategy merges with marketing content. What product offers should be included in the campaign and what risk-based strategy should be adopted in the case of credit offerings. The planning process must be framed within a company-wide strategic vision. Fourth generation marketing automation supports that holistic perspective, enabling organizations to plan complex campaign strategies and operations within the context of corporate level objectives. An important component in achieving this is having access to a central data repository that holds validated, up-to-date campaign and customer information. This knowledge can then be incorporated to make campaigns more personal, relevant and effective, and integrates reference data from previous campaigns to help gauge cost and anticipate results.

- **TARGET Campaign Activities to Precisely Defined Customer Segments**

  Targeting is crucial to effective customer relationship management, not only in improving your chances of reaching high-value customers, but in ensuring that you don't waste scarce resources on attempting to sell to the wrong people. To anticipate customer needs, improve customer retention and identify opportunities to cross-sell and up-sell, marketers have to understand the unique characteristics of each market segment in an increasingly fragmented marketplace.

  The targeting phase asks:

  - How should customer segments be defined?
  - How are customers moving between segments over time?
  - Which customers are most likely to leave?
  - Which customers are good candidates for cross-selling and up-selling?
  - Which communication channel should we use?

- What are the characteristics of a good customer?
- Are we recruiting high-value customers or low-value customers?

Effective targeting allows organizations to:

- Increase customer retention by identifying "at risk" customers and implementing targeted loyalty programs.
- Refine marketing campaigns to target those most likely to buy.
- Quantify shifts in behaviour, predict long-term value and identify prime cross-sell and up-sell opportunities.

Fourth generation marketing automation dynamically integrates sophisticated data mining techniques into the targeting function. Data mining returns tremendous bottom-line impact as it turns data into predictive information, information into knowledge and knowledge into greater business value.

- **ACT on Marketing Plans with Maximum Operational Effectiveness**

  Automated campaign management tools streamline the customer contact processes of a campaign, including pulling lists, establishing control and test groups to monitor and evaluate campaign strategies, scheduling campaign activities and tracking results.

  Fourth generation marketing automation dramatically improves operational effectiveness by introducing an extra layer of intelligence to essential tasks of campaign management, communications and reporting.

  Marketing Automation relative to campaign management provides inter-alia:

  - Integrated prioritization and scheduling for complex multi-channel campaigns.

- Efficient selection, screening and filtering of internal and purchased contact lists to produce clean, non-duplicated target lists, without reliance on the IT department.
- Coordination and optimization of outbound and inbound communications over multiple channels for hundreds of thousands of customers.
- Dynamic response handling to automatically update customer contact history, response tracking and analytical processes.

- **LEARN from Campaign Experience**

Obtaining customer information is one thing; effectively integrating it into future marketing campaigns is another. Effectiveness of a campaign should be able to be measured against the goals established in the plan phase and the information obtained should be used to improve future campaigns. Advanced marketing automation provides for the measuring of responses via central database and in so doing enables the process of incremental improvement over prior campaigns. It also allows for the creation of numerous test groups in order that subtle changes in marketing strategy can be monitored and evaluated against each other.

The learning capability allows organizations to reach far beyond customer reactions to specific campaigns. With the right software, historical customer data, purchased customer data and customer transaction data from every channel can be analyzed. This information can be used to better understand drivers of customer profitability, build accurate predictive models of customer behaviour and implement a more targeted – and more profitable – campaign the next time.

Integrating the Four Phases of Marketing Automation

Each of the four stages – plan, target, act and learn – is integral to the total marketing automation value chain.

- Once there is understanding about the customer base, customers can be segmented into groups and can be targeted with tailored service and marketing activities,
- Using analytics, shifts in behaviour can be identified, long-term value predicted and cross-sell and up-sell opportunities can be identified.
- This customer intelligence forms the basis for highly targeted market campaigns and offers.
- Automate and streamline implementation for complex, multi-channel, multi-stage campaigns.
- Glean responses and trends from marketing campaigns and then cycle them back into the system to fine-tune its effectiveness.

The payoff from these technology investments is significant – shorter marketing cycle times, better odds of getting your message out to customers ahead of the competition, reduced costs by replacing scattershot campaigns with truly targeted ones and rising return on investment as the results of each campaign are immediately applied to the next.

2.4.4 Customer Risk Management

"Consumer Credit is broadly understood to mean any of the many forms of commerce under which an individual obtains money or goods or services on condition of promise to repay the money or pay for the goods or services, along with a fee (interest) at some specific future date or dates" (Lewis 1992:1)

There is more to consumer credit than a simple definition and it has become an enormous industry. In the United States in 1989, the total amount of outstanding consumer credit was over 700 billion dollars.

Today consumer credit is an essential enterprise and a major task of this industry is to make credit widely available, so that as many people as

possible can have the opportunity to make use of this powerful tool. This is not only a socially desirable goal, but also an equally valuable economic one.

Lewis (1992) is of the opinion that inherent in the idea of credit, since it involves a promise to repay monies at some date in the future, is the idea of risk. The future is not predictable with perfect accuracy, so we must accept the fact to which both logic and experience testify, that not all debts will be paid as agreed. At best an imperfect prediction and estimate can be made of the degree of risk that is involved in a particular request for credit, and then to accept only those risks, which can be considered low enough so that, over a great many applications for credit, our enterprise will prosper.

2.4.4.1 Early Approach to Credit Assessment

A persistent myth in the credit industry is that loans are only made on the Three C's of Credit: Character, Capacity and Collateral. This has some foundation of fact in that in older and simpler times, when the population of the world remained fairly stable and people did not move around in any frequency, applicants for credit were well known to the individuals to whom they made application. These credit grantors had a fairly good idea of the individual's personality and general character. Also the credit grantor had a good estimate of the reliability of the income and of ability of the applicant to pay his debts, and he could assess the value of collateral offered.

Capacity is now no easier to measure. The fact that an individual has a good income is no guarantee of capacity; the stated income may be false(or exaggerated) or he may have undisclosed debts. Today the bulk of consumer credit is granted without collateral, so this aspect has also lost its significance. Essentially, there is nothing left of the "Three C's" of credit and thus irrelevant. The criticisms of this method of assessing credit is that it is judgmental in nature in that it leans heavily on subjectivity and

in the event of high volumes of applications it is impossible to apply criteria in a consistent manner.

2.4.4.2 Credit Risk Evaluation

Cundiff (2001) has expressed the view that credit is an integral part of commerce, and the management of credit risk has evolved from individuals' interpreting broad corporate policy to sophisticated methodologies that enforce consistent analysis and decisions. There are significant differences in the sophistication of credit risk management techniques in different types of organizations such as manufacturing, retail, leasing, insurance and banking. For example, the mission critical nature of credit in the financial services sector has given rise to substantial information technology infrastructure investments surrounding the credit granting process.

Srinivasan (1999) states that emphasis must be placed on engineering credit risk processes using technology as a tool. To be truly effective, the technology framework must be capable of supporting rapid changes in credit risk management processes.

The problem central to the granting of credit is the estimation of risk. If risk is estimated poorly, the entire enterprise can fail either because of excessive default or lack of business. If an organization can estimate risk better that a competitor can, then the competitor's business is in danger, since the organization can offer better terms to more people than the competitor is able to. Credit scoring is the tool designed to give credit management the ability to measure risk and to take action best suited to each risk that is identified.

Before the introduction of revolving credit, most credit was granted for relatively short periods. Consequently the decision to grant or not to grant credit, a decision made at the time of the application was submitted, was regarded by many as the only credit decision. In fact, a number of credit decisions are made during the lifetime of an account. These decisions

have become more apparent since the development of revolving credit as well as traditional credit on long terms.

Lewis (1992) states that first decision made at the time of application remains the one of great importance. Credit scoring was originally developed to evaluate the risk presented by applicants, and this is still the major use of credit scoring systems.
Other credit decisions that can be aided by scoring techniques have been present all along. One is the decision as to how to collect a delinquent account. The art of collections has been developed in many ways by many people throughout history. Most organizations of any size have collection departments and these have policies on how collections are to be handled. A second collections problem concerns accounts that are over their credit limit though not delinquent. The question is how should these accounts be treated?

Another set of decisions involves the credit limit itself. What limit is to be assigned to each newly accepted applicant, and under what conditions is that limit to be raised or lowered? In revolving credit accounts, the time comes when account is to be considered for renewal. This is a decision to which scoring can be applied.

Credit decisions are also involved in the area of marketing, which is not usually considered a credit responsibility. In the prior section on Marketing-automation for retail, the importance of segmentation was covered. The role of credit decision-making is that it forms a part of the segmentation process by "pre-screening" customers based on performance and identifying them for credit based offerings.

- **Motivation for Change**

  According to Cundiff (2001) the changing environment necessitates that management look at a broader view of risk preference. In response to the portfolio view of risk management, credit is taking on increasing importance in today's market and at any given point in time,

the credit manager is really managing a portfolio of credit risk. The portfolio perspective is quite different from the individual credit transaction. It allows credit to be viewed from the standpoint of pooled risk. As the need to grow markets in the face of increasing competition continues, the portfolio perspective is likely to grow significantly in importance in the future.
Lewis (1992:10) states, " When the idea of replacing the traditional judgmental procedure for making credit decisions with scoring was first offered to the credit establishment it was not received with conspicuous enthusiasm."

Since the recommendation was coming from people with a background in Mathematics, computers and Operations Research, but definitely not credit, people in the credit field were more than a little hesitant. Their concern was with how people with a science background could possibly know about the complicated business of credit and develop a way of making credit decisions that was better than the traditional methods that had proven successful for so long.

A judgmental process is, by its very definition, unexplainable. The exact process through which a credit analyst, however "expert" he may be, reaches a decision is impossible to put into words; and that is "judgmental by its very nature. "The only way that credit judgment can be taught is in the apprentice mode. The apprentice sits at the feet of the master and tries to do things in the same way, with the master passing to the student what experience he can verbalize." (Lewis 1992:11) This is a costly process and one that cannot be undertaken when the volume of decisions is large and the "masters" do not have the time to teach the students.

A typical credit application may ask as many as fifty separate pieces of information. Some applications can call for up to 150 items and also some questions can be answered with a Yes or a No, but most have a variety of answers. Even if there are as few as two possible answers to

50 questions, there are countless different combinations of information that might appear, and for each combination a decision may have to be reached.

With traditional methods it is impossible for any individual to handle immense diversity except in the most general of terms, which is why the apprentice can never exactly duplicate the decisions of the teacher. Credit scoring on the other hand, addresses exactly this diversity. Furthermore, it is fully explainable. All factors that go into its construction are open to examination, all methodology of computation can be reviewed to any depth that may be desired, and the way that the enormous amount of alternatives have been considered is available for anyone to see.

Obviously, a credit-scoring table does not produce inconsistent results. The same facts will produce the same score every time (if calculated accurately), no matter what it does.

2.4.4.3 History of Credit Scoring

The growth of the use of credit scoring has been a component of the change in American Business brought about by increased awareness of the value of scientific analysis of problems of all sorts, not only those associated with credit. As a result, management have become increasingly aware that technical methods must be evaluated carefully and that traditional methods will have to accept the challenge of new ideas and, if these new ideas prove to be more effective than the methods of the past, those past methods must disappear.

According to Gomez (2001) Credit Scoring models have been used in the consumer credit industry for quite some time and based on the success of these models in assessing and calibrating risk, business credit providers are increasingly using scoring systems in decisioning.

"Finance companies, typically, had well entrenched operations and recognized no pressing need for change. However, slowly but surely these

companies began to consider the ideas of scoring and adopt them, at least as a component of the credit decision process." (Lewis 1992:19)

Not far behind the finance companies were retailers. One of the first was Montgomery Ward and Co., Inc., then one of the country's major mail order firms. Wards, as it was known, had millions of credit customers and a very large volume of applicants for credit accounts. In the mid-1960's each of the large branches had its own credit department, but the installation of centralized billing computers made it possible for the company to consider centralized credit This required a means for making credit decisions that were much faster than the traditional methods that were acceptable at the branch context. It was natural for Wards to look into credit scoring, and when they did they entered the field in a big way. As this area grew in the next twenty years they became one of the most efficient credit operations in the world.

The major credit cards of today, Visa and Master Card, did not come into prominence until early 1970's. In the beginning there was enormous competition and cards were issued without a fee. As a result people applied for cards from many banks at the same time. This put tremendous pressure on the banks to process all these applications with reasonable speed. Traditional credit evaluation simply could not cope with the volume. This encouraged the major card issuers to consider using scoring as a part of their procedure to speed up the decision process.

The wholesale granting of credit cards led to very large losses by some of the issuers. These losses, in many ways more than the high volume, motivated credit grantors to look into credit scoring.

Graves (2000) is of the opinion that significant advances in technology have allowed automated credit decision "engines" to render the traditional credit granting process obsolete. Graves (2000) goes on to add that to understand the ramifications that these new technologies will have on the lending industry, it is necessary to briefly review the evolution of consumer

credit scoring and its parallels with automated decisioning. Credit scores or numeric risk indicators are nothing more than a numerical assessment of the degree of risk associated with a transaction. According to Graves, the concept of credit scores, or measurable probabilities of a particular action taking place, has evolved from what many viewed as a "mystical" process to what is now a statistical science.

The performance of a scoring system is measurable and can be monitored by various suites of reports such as population stability reports, characteristic analysis reports and vintage analysis reports.

According to Lewis (1992) a question that arose as far back as the 1960's was: in the case of revolving credit, where an account remains open for an extended period, and where the information given on the application loses its pertinence as time passes, how is that account's continued credit performance to be predicted? The answer lies in the development of what is called "Behaviour Scoring"

Behaviour scoring is a risk estimator similar to application scoring, but uses for its development data the actual behaviour of credit account holders, rather than information provided on the original application. While behaviour scoring is not yet widely used as application scoring, Lewis (1992) is of the opinion that it is probable that it will become the dominant scoring procedure in the coming years. Behaviour scoring is certainly more powerful than application scoring as a risk predictor in the case of scoring customers who already have been on the books of an organization (repeat customers).

Banasiak (2001) expressed the following viewpoint on Behaviour Scoring. In a changing business marketplace, it is more important than ever to maintain a competitive advantage, particularly when it comes to back-end (collections) decision automation. Credit and collection managers are continually faced with having to create better decision efficiency to accurately and effectively determine the creditworthiness of their

customers. Change in decision strategy is inevitable due to changes in portfolio, market or economic conditions. Leading companies are prospering as a result of using a knowledge-based decision strategy to make faster and better portfolio management decisions. The driving force of their success is integrating information and technology with a validated and maintained statistical-based scoring solution.

2.4.4.4 Managing Credit Risk

The view of Srinivasan (1999) is that the management of credit risk has three major dimensions – the transaction level credit decision, the management of the credit risk portfolio and value-added services.

Srinivasan continues to explain that the transaction level credit decision represents the traditional view of credit. The subsequent granting of credit initiates the acceptance of risk by the organization. The objective in managing individual credit transactions is largely to determine the risk-return tradeoff in granting credit to each customer. The risk tolerance or preferences of the organization are driven by a number of factors such as competitiveness of its markets, its cost of capital and the profitability of its products and services.

The view of Cundiff (2001) is as follows: The concept of risk management may include tracking and analysis of a number of risk dimensions. The common approach is to stop looking at individual customers one at a time and instead segment them by logical grouping that incorporates common behaviours and risk factors. Within a given portfolio, each customer represents a given level of risk and opportunity. These differences may be based on risk of non-payments, slow payments or the possibility of bad debts and the cost associated in the recovery of such bad debt. By setting up a customized credit policy for each portfolio, specific credit policies can be established that allow an organization to maximize return relative to the risk profile of the overall portfolio. Monitoring the portfolio risk can lead to proactive actions to influence the composition of the portfolio, tightening of credit standards and allocation of appropriate reserves or provisions. Through portfolio analysis, the credit department can also help sales and

marketing understand where the best opportunities may exist to grow the business.

2.4.4.5 Credit Scoring and Risk Management

"Credit risk management has become core to the performance of latter-day lenders. However, many businesses lack an understanding of the function. Operational heads may assume that the risk management team is performing optimally. But what if it is not?" (Amber 2003).

According to Jackson (2003) in many retail banks, credit scoring has become an integral part of the credit risk function and a crucial competence for the effective management of the bank's risk and profit objectives. The advancement of credit scoring within retail banks has brought with it a need for a risk analytics team that has a far greater capability and strategic awareness than was previously required. The responsibilities of the risk analytics team must encompass:

- Scorecard development, monitoring and refinement.
- Strategy design and decision system management.
- Portfolio monitoring.
- Development of forward-looking risk management information.

This increase in scope, from both an organizational and a deliverable perspective, means that the risk analytics function has become a significant and essential component in the development of value-creating strategies and initiatives within retail banks, according to Amber (2003).

Jackson (2003) argues that in many cases, the difficulty in evaluating the performance of the risk analytics function stems from credit risk being perceived as an "expert" area that cannot be managed through the banks normal structure and as a result the analytics function is often self-managed, internally focused, and distant from the organization as a whole. The risk analytics team has a tendency to become isolated from the bank's

business areas and, as a result, the importance of incorporating credit risk analytics into key business decisions is often overlooked.

Table 2.5 Dual-Matrix Decision Strategy

Bureau Score	Client Risk Grade (Behavioural Scoring Model)				
	1	2	3	4	5
000 - 049	Refer R 5	Refer R -20	Decline R -65	Decline R -80	Decline R -110
050 - 090	Approve R 15	Refer R -10	Decline R -20	Decline R -45	Decline R -85
100 - 149	Approve R 20	Refer R 10	Refer R -5	Decline R -30	Decline R -50
150 - 199	Approve R 30	Approve R 25	Refer R 3	Refer R -20	Decline R -5
200 +	Approve R 45	Approve R 20	Approve R 5	Approve R -15	Refer R -25

Source: Credit Risk International Journal: January – February 2003: 47

Table 2.5 is an example of an acquisition model for a retail bank. This shows how flawed models can be damaging to the business. The white area highlights a decision strategy where customers are approved for credit facilities, however, these customers would be value destroying. This could negatively impact the performance of a specific credit portfolio as well as put unplanned pressure on the customer credit management and collection function.

Barell (2003) is of the opinion that, traditionally, the area of direct marketing and credit scoring has been opposed. Direct marketers are judged on how successful their campaigns are in terms of response rates, whilst credit managers look to ensure that new customers present low risk in terms of an organization's bad debt levels. Barell (2003) continues to explain that credit pre-screening is the term given to the application of credit data prior to marketing to individuals. The theory requires the criteria that is applied in the usual application process to be mirrored during the marketing process and individuals that would normally be rejected should be removed before they are approached. Risk scoring is applied where scorecards are calculated at individual level, providing a score in terms of

propensity towards future risk for all individuals in a given population. The population is then ranked from low risk to high risk, usually in the form of a numeric score and based upon retrospective analysis of previous application and outcome information. Meaningful decisions can then be made applying a minimum score cut-off strategy.

2.4.5 Customer Interaction Management

Nykamp (2001) is of the opinion that each customer's unique purchase cycle, needs, characteristics, and behaviours present a wide range of customer interaction opportunities. Nykamp (2001) lists these opportunities as being:

- Tied to specific stages of the purchase cycle – Opportunities to provide site personalization and customized service are much greater as the relationship with a customer strengthens.
- Inbound and Outbound – some interactions are initiated by the customer and others initiated by the provider.
- Cross-Channel and cross-media – Certain interactions lend themselves to direct channels and media whilst others lend themselves to an indirect information-serving environment.
- Situation-driven – An example is sending information to prospective customers based on their request for information. Another would be recognizing a customer's channel and media preference and driving marketing efforts accordingly.

Nykamp (2001) is of the opinion that the customer's experience across all aspects of the organization- whether its field sales, marketing, point-of-sale, call centre, web site, customer care, advertising or public relations drives customer satisfaction. Customer satisfaction can foster loyalty; in turn a customer's loyalty forms the basis of a valuable relationship with the organization.

Bibelnieks and Haydock (2000) express the view that it is important to capture customer information from as many touchpoints as possible and

store it in the data warehouse so that by organizing the data, a consolidated view of the customer can be obtained. This also facilitates data mining and the development of predictive statistical models.

2.5 Company Resources and Competences Analysis

According to Johnson and Scholes (1999), the difference in performance in different companies in the same industry is seldom explainable by differences in their resource base. Superior performance will also be determined by the way in which resources are deployed to create competences in the organisation's separate activities, and the processes of linking these activities together to sustain excellent performance. It is the view of Johnson and Scholes (1999), that these are the competences which underpin the organisation's ability to outperform competition. Core competences need to be difficult to imitate in order that they can provide long-term advantage.

Thompson and Strickland (2001), state that strategic cost analysis focuses on a firm's cost position relative to its rivals. Every company's business consists of a collection of activities undertaken in delivering and supporting its product or service. The combined cost of all these various activities, define the company's internal cost structure and determines whether its overall cost structure relative to its rivals is favourable or unfavourable. The task of strategic cost analysis is to compare a company's costs activity by activity against the costs of rivals and to learn which internal activities are a source of cost advantage or disadvantage.

Johnson and Scholes (1999) state that although an organisation will need to achieve a threshold level of competence in all of its activities, only some will be core competences. These are the competences, which underpin the organisation's ability to outperform competition.

An organisation's competences can be understood by means of the following:

- Value Chain Analysis; and
- Bases of Competences

2.5.1 Value Chain Analysis

According to Porter (1985) the primary analytical tool of strategic cost analysis is a value chain identifying the separate activities, functions and business processes that are performed in designing, producing, marketing, delivering, and supporting a product or a service. Thompson and Strickland (2001) state that a company's value chain shows the linked set of activities and functions it performs internally. Johnson and Scholes (1999) describe value chain analysis as the activities within and around an organisation, and relates them to an analysis of the competitive strength of the organisation. Quite often there are links between activities such that the manner in which one activity is done can affect the cost of performing other activities. According to Porter (1985), a company's value chain and the manner in which it performs each activity reflect the evolution of its own particular business and internal operations, its strategy, the approaches it is using to execute strategy, and the underlying economics of the activities themselves.

According to Johnson and Scholes (1999), it was Michael Porter who argued that an understanding of strategic capability must start with an identification of these separate value activities. The activities within the value chain are divided into two distinct sections namely, primary activities and support activities.

<u>Primary Activities</u>

Johnson and Scholes (1999), explains the concept of primary activities as follows. These are directly concerned with the creation or delivery of a product or service and can be grouped into the following areas:

- Inbound logistics – activities concerned with receiving, storing and distributing the inputs to the product or service.
- Operations – activities that transform these various inputs into the final product or service.
- Outbound logistics – activities that collect, store and distribute products or facilitate the provision of services to the customers.

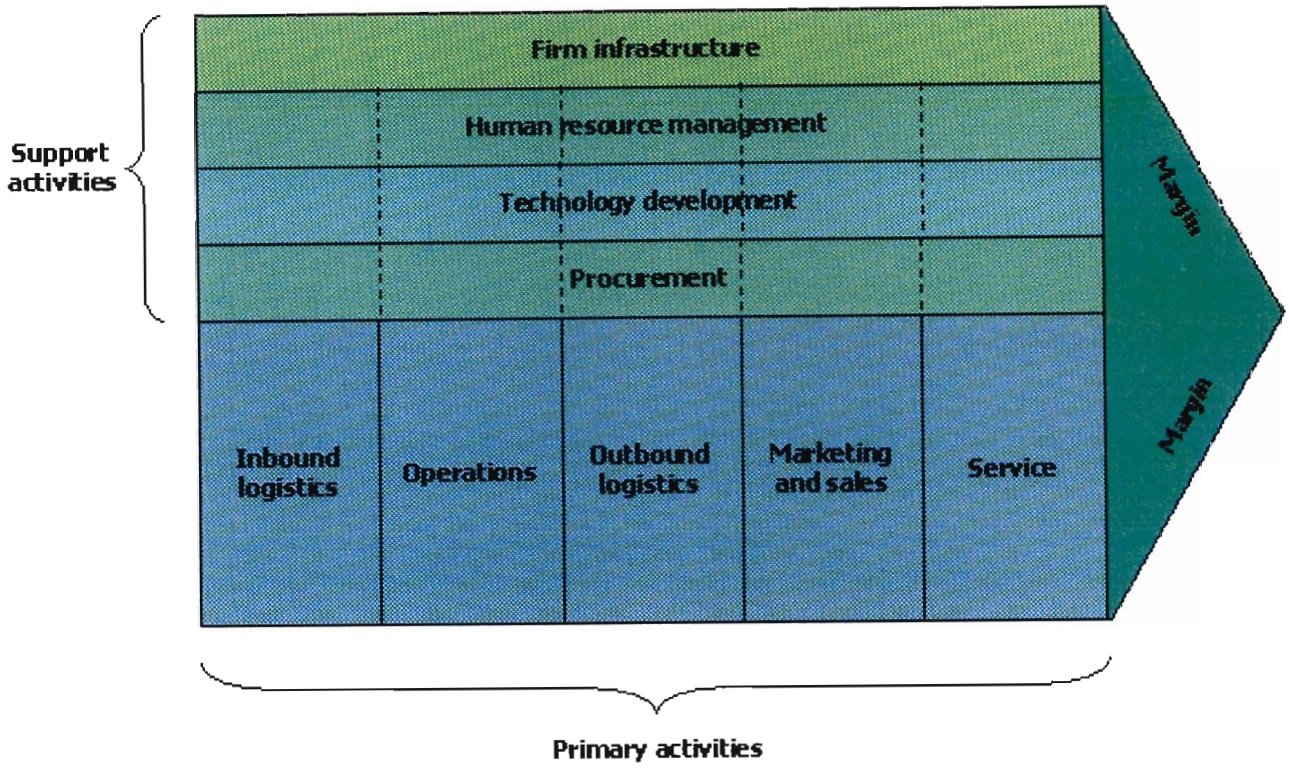
- Marketing and Sales – activities that provide the means whereby consumers/users are made aware of the product or service and are able to purchase it.
- Service – this includes all those activities, which enhance or maintain the value of product or service .

Secondary Activities

Johnson and Scholes (1999), explains the concept of support activities as follows. The activities that help to improve the effectiveness or efficiency of primary activities and are as follows:

- Procurement – the processes for acquiring the various resource inputs to the primary activities.
- Technology development – All value activities have a "technology", even if it is simply know-how. The key technologies may be concerned directly with the product or with processes or with a particular resource. This area is fundamental to the innovative capacity of the organisation.
- Human Resource Management – This is a particularly important area and is concerned with those activities involved in recruiting, managing, training, developing and rewarding people within the organisation. This, in turn, determines whether the organisation is rigid or innovative.
- Infrastructure – The systems of planning, finance, quality control, information management etc. are important to an organisation's performance in its primary activities. Infrastructure also consists of the structures and routines of the organisation which sustain its culture, and also determine the level of rigidity or innovation in the organisation.

Fig.2.14 The Value Chain



Source: Johson and Scholes 1999: 158

In most instances, it is rare for an organisation to undertake all the value activities, as there is usually a specialization of role and any one organisation is part of a wider value system that creates a product or a service. It is indeed, this process of specialisation which often underpins excellence in creating value for money.

2.5.2 Bases of Competences

Although a threshold competence in all of these activities is necessary to the organisation's successful operation, it is important to identify core competences within this. Johnson and Scholes (1999) define core competences as those competences that critically underpin the organisation's competitive advantage. These will differ from one organisation to another depending on how the company is positioned and the strategies it is pursuing.

The following bases of competences will be specifically covered as they are relevant with regard to this research.

Value Added Effectiveness

According to Johnson and Scholes (1999), effectiveness is a measure of the level of value which can be created from a given level of resources. The assessment of effectiveness is essentially related to how well the organisation is matching its products or services to the identified needs of its chosen customers and the competences which underpin this effectiveness. In determining the kind of value-added features that need to be provided to perform effectively, the following key question must be answered: what are the critically important features and the core competences which underpin these features? For example

- How well matched are the product or service features to the requirements of customers? Is the added cost of providing unique features more than recovered through the value customers place on its uniqueness? Are these features easily imitated by competitors?
- Are the services which support the product matched with client expectations and do these represent perceived value?
- Are the systems for communicating with customers before, during and after purchase adding value to the relationship?

Managing the Linkages

Johnson and Scholes (1999) are of the opinion that whilst core competences in separate activities may provide competitive advantage, these may be imitated by competitors over time. Core competences are likely to be more robust if they relate to management of the linkages within the organisation's value chain. Management of the linkages within the value chain are likely to provide "leverage" and levels of performance that competitors will find difficult to match. Johnson and Scholes(1999) define leverage as " the measure of improvement in performance achieved through the management of linkages between separate resources and activities. An example is as follows

- The management of the linkages between a primary activity and a support activity may be the basis of a core competence. It may be key investments in systems and infrastructure or the processes of innovation which provide the basis on which a company outperforms competition.
- The extent to which human resource development is in tune with new technologies has been a key feature in the implementation of new technology. If innovation is to lead to competitive advantage, then this will rarely be achieved if innovation is not embraced by people in the organisation and other parts of the value chain.

2.6 Developing Strategic Options

Many planning experts believe that the general philosophy of doing business declared by the firm in the mission statement must be translated into a holistic statement of the firm's strategic orientation before it can be defined in terms of long-term strategy.

2.6.1 Strategic Choice

According to Pearce and Robinson (1991), a long-term or grand strategy must be based on a core idea about how the firm can best compete in the marketplace. The popular term for this core idea is a generic strategy. Porter (1985), developed a scheme whereby long-term strategy should derive from a firm's attempt to seek competitive advantage based on one of three generic strategies:

1. Striving for overall *low-cost* leadership in the industry.
2. Striving to create and market unique products for varied customer groups through *differentiation*.
3. Striving to have special appeal to one or more groups of consumer or industrial buyers, *focusing* on their cost or differentiation concerns.

2.6.2 Grand Strategies

Grand strategies, often called master or business strategies, provide the basic direction for strategic actions. They indicate how long –range objectives will be achieved. Pearce and Robinson (1991) define grand strategy as a comprehensive general approach that guide's a firm's major actions.

According to Pearce and Robinson (1991), the 12 principal grand strategies are concentrated growth, market development, product development, innovation, horizontal integration, vertical integration, joint venture, concentric diversification, conglomerate diversification, retrenchment/turnaround, divestiture and liquidation. Any one of these strategies could serve as a basis for achieving the major long-term objectives of a single firm.

In terms of this research, only certain grand strategies will be elaborated upon.

2.6.2.1 Market Development

Pearce and Robinson (1991) state that it consists of marketing present products, only with cosmetic modifications, to customers in related market areas by adding channels of distribution or by changing the content of advertising or promotion. According to Johnson and Scholes (1999) market development allows firms to practice a form of concentrated growth by identifying new uses for existing products and new demographically, psychologically or geographically defined markets. Frequently, changes in media selection, promotional appeals and distribution are used to initiate this approach.

2.6.2.2 Innovation

According to Pearce and Robinson (1991), it has become increasingly risky not to innovate. As a result, some firms find it profitable to make innovation their grand strategy. These firms seek to reap the initially high profits associated with customer acceptance of new or greatly improved products. The underlying rationale of the grand strategy of innovation is to

create a new product life cycle and thereby make similar existing products obsolete.

While most growth-orientated firms appreciate the need to be innovative occasionally, a few firms use it as their fundamental way of relating to markets.

2.6.2.3 Horizontal Integration

According to Pearce and Robinson (1991), when a firm's long term strategy is based on growth through acquisition of one or more similar firms operating at the same stage of their production-marketing chain, its grand strategy is called *horizontal integration.* Such acquisitions eliminate competitors and provide the acquiring firm with access to new markets.

2.6.2.4 Retrenchment/Turnaround

For any of a large number of reasons, a firm can find itself with declining profits. Some possible reasons for this include, economic recessions, production inefficiencies, and innovative breakthroughs by competitors. Pearce and Robinson (1991), are of the opinion that in many cases, strategic managers believe that such a firm can survive and eventually recover if a concerted effort is made over a period of a few years to fortify its distinctive competences. This grand strategy is known as retrenchment and is typically accomplished in one of two ways:

1. Cost Reduction – Decreasing workforce through employee attrition and eliminating elaborate promotional opportunities.
2. Asset Reduction – includes the sale of land, buildings and equipment not essential to the basic activity of the firm and the elimination of "perks," such as the company airplane and executives' cars.

According to Pearce and Robinson (1991), since the underlying purpose of the retrenchment strategy is to reverse current negative trends, it is often referred to as a turnaround strategy. Shendel, Patton and Riggs (1976),

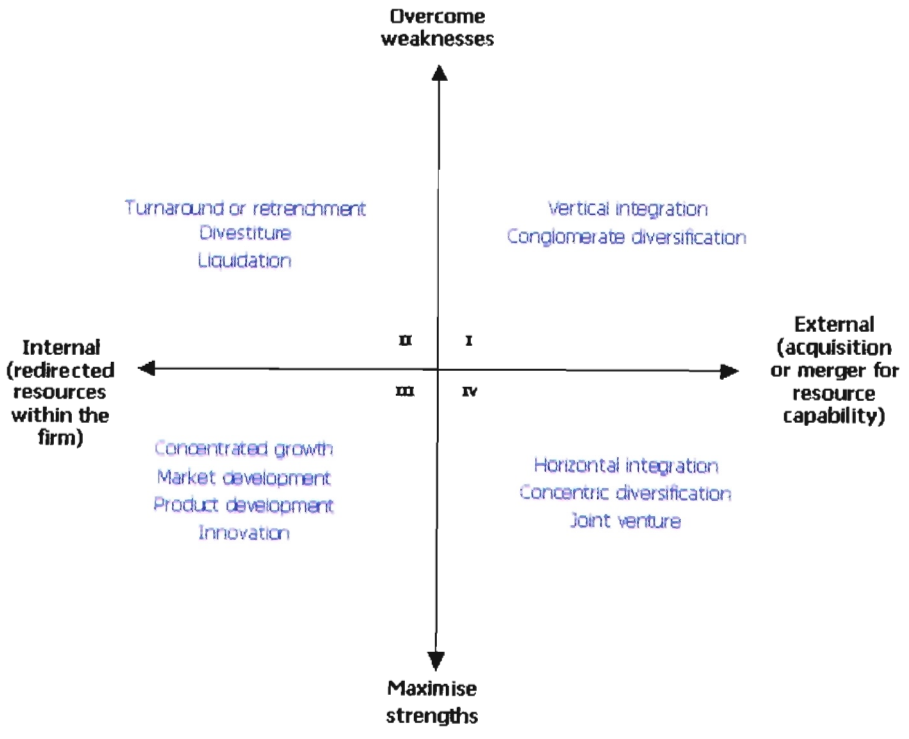
096275

found that turnaround was almost always associated with changes in top management. Bringing in new managers was believed to introduce needed new perspectives on the firm's situation, to raise employee morale, and to facilitate drastic actions, such as deep budgetary cuts in established programs.

2.6.3 Strategy Selection

An analysis of an organisation's internal strengths and weaknesses and environmental opportunities and threats is commonly known as a SWOT analysis. SWOT analysis is a systematic identification of factors and of the strategy that represents the best match between them. It is based on the assumption that an effective strategy maximises a firm's strengths and opportunities and minimises its weaknesses and threats. Accurately applied, this simple assumption has powerful implications for the design of a successful strategy.

Fig.2.15 Swot Analysis Diagram



Source: Pearce and Robinson (1991): 184

Pearce and Robinson (1991) use a SWOT analysis diagram as represented in fig.2.14, to explain the process of strategy selection.

According to Pearce and Robinson (1991), key external opportunities and threats are systematically compared with internal strengths and weaknesses in a structured approach. The objective is identification of one of four distinct patterns in the match between a firm's internal and external situations. These patterns are represented by the four quadrants in fig 2.14.

Quadrant 1 is the most favourable as the firm faces several environmental opportunities and has numerous strengths that encourages pursuit of those opportunities. This situation suggests growth-oriented strategies to exploit the favourable match.

Quadrant 4 represents the least favourable situation, with the firm facing major environmental threats from a position of relative weakness. This situation calls for strategies that reduce or redirect involvement in the products markets examined by means of SWOT analysis.

In quadrant 2, a firm with key strengths faces an unfavourable environment. In this situation, strategies would use current strengths to build long-term opportunities in other products-markets.

A firm in quadrant 3 faces impressive market opportunity but is constrained by internal weaknesses. The focus of strategy for such a firm is eliminating the internal weaknesses so as to more effectively pursue the market opportunity.

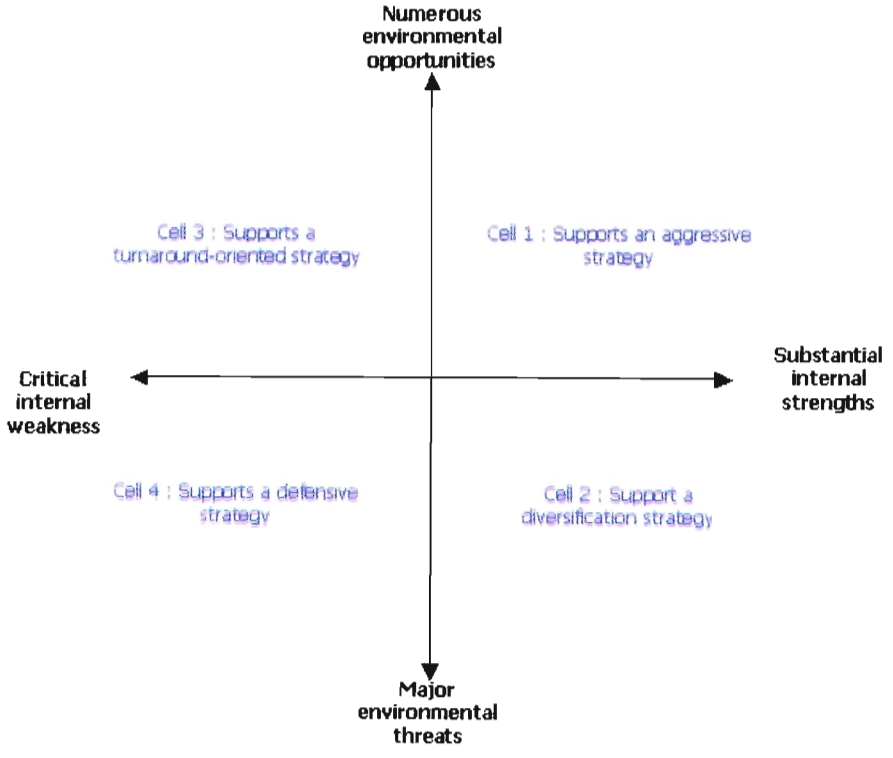
Overall, SWOT analysis highlights the central role that the identification of internal strengths and weaknesses plays in a manager's search for effective strategies. The careful matching of a firm's opportunities and threats with its strengths and weaknesses is the essence of sound strategy formulation.

2.6.3.1 Strategy Selection and The Grand Strategy Selection Matrix

Once SWOT analysis has assisted with the identification of internal strengths and weaknesses and the matching of these with external opportunities and threats, the next step is to use this as a basis for an appropriate grand strategy/s.

According to Pearce and Robinson (1991), the basic idea underlying the grand strategy selection matrix, fig.2.15, is that two variables are of central concern in the selection process: (1) the principal purpose of the grand strategy and (2) the choice of an internal or external emphasis for growth and/or profitability.

Fig.2.16 Grand Strategy Selection Matrix



Source: Pearce and Robinson (1991): 258

Pearce and Robinson are of the opinion that strategy selection is better guided by the conditions of the planning period and by company strengths and weaknesses. Grand strategy selection seeks to match a concern over

internal versus external growth with a desire to overcome weaknesses or maximise strengths.

In quadrant 1 (fig.2.15), a firm's views its position as being over committed to a particular business with limited growth opportunities. One possible solution is vertical integration, enabling the firm to reduce risk by reducing uncertainty about inputs or access to customers. Another possible option is conglomerate diversification which provides a profitable investment alternative without diverting management's attention from the original business.

The option available in quadrant 2 adopts a more conservative approach to overcoming weaknesses. Here firms choose to redirect resources from one internal business activity to another. This approach maintains the firm's commitment to its basic mission, rewards success, and enables further development of proven competitive advantage. A possible strategy is retrenchment, involving the pruning of the current activities of a business. In some cases, retrenchment can serve as a turnaround strategy whereby the business gains new strength from streamlining its operations and the elimination of waste.

According to Pearce and Robinson (1991), a common business adage is that a firm should build from strength. A premise of this is that growth and survival depend on an ability to capture a market share that is large enough for essential economies of scale. For firm's falling in quadrant 3, there are typically four possible strategies. The most common is concentrated growth involving market penetration. Here the firm seeks to solidify its position by reinvesting resources and reinforce its strengths. With regard to the option of innovation, the firm's strengths are in creative product design or unique production technologies. As a result, sales can be stimulated by accelerating perceived obsolescence.

Maximising a firm's strengths by aggressively expanding its base of operations usually requires external emphasis. Quadrant 4 lists the

preferred option as horizontal integration because it makes possible a quick increase in output capability. Moreover, in horizontal integration, the skills of the managers of the original business are often critical in converting the newly acquired facilities into profitable contributors to the parent firm. In this way, a firm's management expands a fundamental competitive advantage of the firm.

2.6.3.2 Making the Right Choices

According to Harrison and St. John (1998), corporate-level strategy focuses on the selection of businesses in which the organisation will compete and on the tactics used to enter and manage those businesses and other corporate-level resources. The three broad approaches to strategy are concentration, vertical integration and diversification, which is divided into two broad categories, related and unrelated.

Johnson and Scholes (1999), state that there is an important relationship between corporate-level strategy and SBU strategy. Corporate-level strategy will affect the strategies being followed by SBU's; and in turn the strategies being followed by SBU's can be enhanced or damaged by strategies at a corporate level. Clarity of purpose of an organization, encapsulated in its mission or strategic intent can play an important role in influencing strategic decisions, again both at the corporate and business unit level.

Johnson and Scholes (1999), are of the opinion that the bases of strategic choices need to take account of the environment in which the organisation operates: for example, corporate aspirations or SBU competitive advantage may be eroded as technology changes or as new competitors enter markets.

2.7 Conclusion

The objective of chapter two was to address three critical aspects. Firstly, the objective was to analyse the fundamentals of strategy crafting to emphasize the need for adopting a specific approach to strategic management and the issues that impact on strategy setting. The intention

was also to highlight the fact that successful strategy setting requires not just the formulation of strategy, but also the importance of implementation and execution. This was also to provide a backdrop against which to view the formulation of a strategy based on customer relationship life cycle management, as a means of adopting a customer centric approach to differentiating as a means of achieving competitive advantage within a retail furniture environment.

The second critical aspect was to argue the importance of focusing on a value creating approach to achieving sustainable profits through achieving customer value. This could be adopted by formulating a strategy around the component parts of the customer life cycle model and through integrating the component parts by means of innovative automated processes, whereby the overriding consideration should be the creation of the customer differential. This essentially is strategically attracting a customer base.

The third critical component is deciding upon a particular approach that will be used to drive the strategy in order to achieve the corporate-level objectives. A starting point is to apply a process of evaluating organizational strengths, weaknesses, opportunities and threats with the view to assessing the strategic positioning of the organization. This will then facilitate the process of making strategic choices.

Chapter 3 Case Study

3.1 Introduction

Relyant Retail is a national retailer of furniture, bedding and appliances operating within a furniture retail environment. Given the competitive nature of the industry, a primary focus has to be consumer satisfaction and providing superior customer service with compelling value propositions. The essence of chapter two was customer relationship management within the context of the customer life cycle and how automated decision systems and predictive technology can be used as means of gaining competitive advantage. Chapter two covered these issues against a backdrop of strategic management theory, principles and tools relevant to customer relationship management within the context of the customer life cycle model.

The focus of chapter three is a case study of Relyant Retail, examining the evolution of its strategic choices and covering in particular its current strategy with a particular emphasis on its approach to customer management.

3.2 Background to the Case Study

A feature of retailing, and in particular furniture retailing, is the strong focus on sales. Within the furniture retail industry the extension of credit is a vital vehicle to facilitate sales. Retailers often fail to balance their strategy with the view that they are not purely retailers, but to some extent they are part bankers and as such they need to ensure that they have the necessary tools in place to assess whether credit applicants have the propensity to pay off their debt as well as tools to be able to manage their customer base for competitive advantage.

The objective is to explore how the introduction of automated decision systems with predictive capabilities into furniture retailing will contribute towards value creation and shareholder confidence.

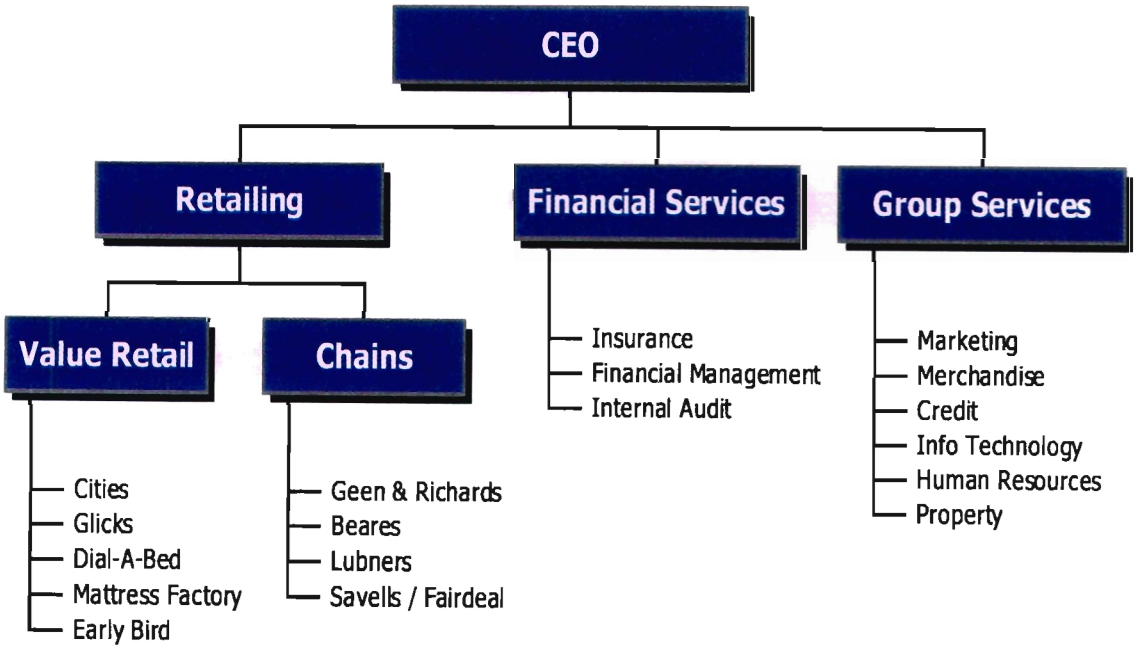
3.3 Company Profile

Relyant Retail Limited (Relyant) focuses on a broad spectrum of consumers – firstly targeting the mass consumer market through its credit chains and secondly through its value retail brands. The nationwide network of household brand name stores aims to provide consumers with quality furniture, bedding, appliances and superior service. Complementing this, its service division offers TV and household appliance repairs throughout the country. Its financial services division offers a range of products designed for the mass consumer market.

Relyant operates a total of 512 retail stores (78 value retail stores and 434 credit chain stores), as well as 86 service depots. The Group employs a total of 6 998 people.

Relyant's shares are listed on the JSE Securities Exchange South Africa under the Cyclical Services – General Retailers sector.

Fig. 3.1 Relyant Organogram



3.3.1 Company Vision

Relyant's vision is to be "Recognised as Africa's First Choice Furniture and Appliance Retailer"

First Choice

Unbeatable customer value and service; rewarding careers; superior and consistent shareholder returns.

3.3.2 Company Core Values

Relyant core values embrace the following as "guiding principles for running our business"

- Have a passion customer service – we keep customers for life
- Act with integrity, fairness and respect to all, always
- Provide rewarding careers for achievers in an environment free of discrimination
- Make the right things happen with a sense of urgency
- Embrace the new South Africa

3.3.3 Company Core Purpose

Relyant's "enduring business purpose" is to enable ordinary people to:

- Achieve extraordinary results (Relyant people)
- Furnish their homes with quality products at affordable prices (Relyant customers)

3.3.4 Portfolio Analysis

The Relyant Group portfolio comprises two distinct trading divisions:

- Value Retail (cash retailers)
- Chains (mainly credit retailers)

The brands within the value retail portfolio comprise, The Cities, Glick's, Dial-a-Bed and Mattress Factory.

The brands within the chains portfolio comprise, Geen & Richards, Beares, Lubners and Savells/Fairdeal.

The Value Retail division is focused primarily on the upper end of the market, targeting customers in the Living Standards Measure groups (LSM 7 – 10) and 84% of its sales are for cash. In fact, only The Cities offer credit and their credit sales are approximately 30% of total sales.

More than 80% of the chains sales are on credit and are mainly focused on the middle market (LSM 4 – 8).

Fig 3.2 Value Retail Profile

Value Retail

Value Retail (cash retailers)	
The Cities	furniture, appliance, sleep
Glick's and Forty Winks	furniture and bedding
Dial-a-Bed	specialist bedding retailer
Mattress Factory	specialist bedding and bedroom furniture retailer

	The Cities	Glick's and Forty Winks	Dial-a-Bed	Mattress Factory
LSM target market (1)	7 to 10	Upper 7 to 10	Upper 6 to 10	6 and 7
Number of stores	24	16	14	24
Number of employees	558	270	159	166
% of Group turnover	17	8	4	4
% cash sales	68	100	100	100
Average deposit rate (%)	22			
% no deposit deals	4			
Average terms (months)	20			
% gross debtors arrears	8			
"A" grade payers (2) %	87			

1 LSM = Living Standards Measure

2 Percentage of gross debtors less than 2 instalments in arrear

Fig 3.3 Chains Profile

Chains	Financial Services	Services

Chains (mainly credit retailers)	
Geen & Richards	
Beares	furniture, appliances and bedding
Lubners	
Savells / Fairdeal	

Geen & Richards	Beares	Lubners	Savells / Fairdeal	Relyant Loans	Relyant Insurance	Relyant Life Assurance	Early Bird Services
7 to 9	Upper 5 to mid 7	Upper 4 to 5	3 and 4	3 to 7	3 to 10	3 to 10	3 to 8
46	150	98	140				86
533	1666	934	1697	150	17	3	560
8	21	12	19	4			3
19	19	21	10				100
22	18	17	17				
22	24	23	18				
22	21	21	21				
8	10	10	16				
86	83	82	72				

1 LSM = Living Standards Measure

2 Percentage of gross debtors less than 2 instalments in arrear

3.4 Company Background

Relyant has been in existence for the past five years and was formed as a result of a merger in 1998. Two furniture retailers, Amalgamated Retail ("Amrel" - a part of the South African Breweries Group) and Beare Group ("Beares" – a part of McCarthy Retail Limited) merged to form an enlarged independent furniture and appliance company with the name changed to Relyant Retail Limited with effect from Thursday, 1 October 1998.

- **The SAB disposal**

  SAB disposed of its entire shareholding of 22 365 549 Amrel ordinary shares, representing a 67,9% holding in the ordinary share capital of Amrel, to a consortium, comprising institutional investors and other investors ("the consortium"), for a cash consideration 2 200 cents per Amrel ordinary share.

- **The Beares Acquisition**

  Pursuant to the SAB disposal, Amrel acquired, the Beares business as a going concern. The purchase consideration of R390,1 million was settled by way of an issue of 17 733 682 fully paid Amrel ordinary shares at 2 200 cents per Amrel ordinary share to McCarthy Retail Limited (McRetail) and the granting of an option to McRetail to subscribe for 8 500 000 Amrel ordinary shares at a price of 2 200 cents per Amrel ordinary share on or before 30 June 2001.

- **Rationale for the Beares Acquisition**

  The acquisition of Beares was intended to create an enlarged furniture retail group with a critical mass of 673 stores in southern Africa, which would benefit from the rationalization of brands, a significant reduction in costs and enhanced effectiveness of advertising spend which would result in a "low cost base" retailer with the potential to improve operating margins and a cost-to-income ratio that would be comparable with those of the leading players in the industry. It was intended that the merged entity would achieve significant growth in earnings by focusing on productivity as opposed to the sole pursuit of growth in

turnover, whilst maintaining a low risk policy in terms of the granting of credit through the exercise of tight financial control.

It was envisaged at the time of the merger, that Relyant would have a market share of approximately 11% of the total market, including independents. Relyant would be one of the largest players in the industry in terms of stores and market share and would have expanded insurance operations giving it the opportunity to offer additional insurance and financial services products to the largest account base in the industry. In addition, the Early Bird services division, would give it the competitive edge in setting service standards in the industry.

At the time of the merger, Beares was considered to be a leading South African retailer of new and used furniture, household appliances, television, audio and video equipment targeting customers in the LSM groups 3 to 7. At the time Beares traded out of 426 outlets throughout South Africa, Botswana, Namibia, Lesotho and Swaziland and employed 6 900 people. The predominant brands within Beares comprised Beares, Furniture Game, Price Furnishers, Target, Savells, Bargain Shop, Prefsure (insurance) and Firstpref (finance)

3.4.1 Amrel and Beares Pre-Merger

In order to have a perspective of the formation of Relyant and the subsequent organisational performance, it is necessary to provide a brief background on each of the two entities.

3.4.1.1 Amrel

Amrel was a division of the SAB group and the decision to dispose of Amrel was a part of SAB's unbundling strategy and to dispose of non-core assets. Whilst Amrel was not a spectacular performer in terms of earnings growth and being an industry leader, it had begun to initiate some important strategies that filtered through into the foundation of Relyant's strategy. Some of these strategies were:

- The Group optimising asset management by utilizing world-class techniques and business processes, assisted by appropriate information technology systems.
- To produce returns that exceeds the weighted average cost of capital.
- A two-pronged strategy to increase total income as one thrust and a parallel thrust to reduce costs.
- To reduce the number of brand names from nine to only five.
- A cornerstone strategy of being one business, operating through market-focused chains, supported by shared specialised services.
- Differentiation should occur only in those areas, which are important to customers – product, price, place, and service.
- The introduction of a empirically derived application (credit granting) scorecard.
- The introduction of a focused credit management structure with a move towards centralisation of functions.

3.4.1.2 Beares

The Beare Group was consistently a steady contributor to McCarthy Retail profits, in the period 1993 to 1997. McCarthy Retail was the result of a merger between McCarthy Group and Prefcor Holdings, of which the Beare Group was a division. The merger was finalised in October 1992, effective 1 July 1992.

The contribution of the Beare Group to operating income before interest and tax in 1994 and 1995 was 45,9% and 42,1% respectively and its contribution to income before taxation in 1996 and 1997 was 46% and 39,5% respectively (McCarthy Annual Reports).

"A most significant milestone was the sale of the company's interest in Firstpref Retail Sales to the newly created F.N.B. Furniture Bank for the sum of R 425 million" (McCarthy Annual Report, 1995:8). This transaction

essentially entailed the sale of the Beare Group debtors' book to F.N.B. with the view of creating the first Furniture Bank in South Africa.

Unfortunately, this transaction did not realise the level of success that was anticipated and ultimately resulted in the Beare Group no longer being a steady contributor to McRetail profits and in fact in the 1998 financial year turned in a loss before taxation of R 204 million.

The impact of the decision to sell the Beare Group's debtors' book to F.N.B was summarised by Brian McCarthy, in his Chairman's Report, in the 1998 McCarthy Retail Annual Report. According to McCarthy, the turning point in the group's fortunes occurred in June 1995 when it was agreed that with the sale of the group's share in Firstpref Finance (Pty) Limited (the company financing the furniture debtors' book) to partners First National Bank whereby Beares would continue to approve and grant the credit whilst the bank would be responsible for the collections and assume management control of the book.

According to McCarthy, as a result of this structure, certain senior members of Beares' management allowed a culture of "over trading" to develop within the furniture division which led to the acceptance of an inordinately high level of marginal business. Towards the end of 1996, it became apparent that there were significant problems arising from the state of the debtors' book, which the bank had inherited, as well as on account of the quality of business "written" by Beares during the bank's governance, a situation the banks systems found difficult to cope with. It was agreed by both parties that it was essential that McCarthy Retail repurchase its share of Firstpref and once again assume full management control of the book, with this decision becoming effective 1 April 1997.

The state of the book continued to deteriorate, and was considerably worse than initially anticipated and these problems were compounded by the fact that a certain amount of unacceptable risk business continued to be put on the book for some months after the debtors book reverted to

McCarthy. This ultimately led to the closure or rebranding of 50 stores and the retrenchment of approximately 2000 people. Also arising from this was the introduction of an up to date information technology system, a more "user friendly" in store system and a complete re-look at all aspects of credit management. Beares' net assets were sold with effect 1 July 1998 at a discount of R 127, 6 million to Amrel with McCarthy retaining 33,3 % ownership of Amrel.

The events described above can be summarised as follows:

- Amrel having a history of under-performing brands, however, with the potential to be successful and the beginning of important strategic imperatives being put in place.
- Beares with evidence of being successful, however, the sale of its debtors' book being a major setback and a culture of irresponsible credit granting resulting in a significant deterioration in organizational performance and causing a turn of fortune for McCarthy Retail, a major company.

It is against the above background that Relyant Retail was formed and clearly the Relyant leadership and management faced major challenges to steer the company on a path of success.

3.4.2 Review of Relyant's Initial Strategy

In light of the pre-merger background the initial strategy adopted by Relyant was two fold:

- Implement a major two year restructure programme
- Reposition the Group for success in the future

The major thrust of the restructure programme was as follows:

- The closure of 140 stores, 60 warehouses and the rebranding of 50 retail outlets.

- The reduction in the number of retail brands from 13 to 7, each focused on a clearly defined target market.
- The retrenchment of 2 500 people, representing some 25% of the workforce.
- The restructuring of commissions payable to approximately half the sales staff in line with market norms.

The strategies formulated to reposition the Group for success included interalia:

- A focus on customer service
- Becoming a low cost retailer
- Being Customer/Merchandise led
- Brand repositioning
- The introduction of stringent credit granting and intensive credit follow-up procedures throughout the Group
- The implementation of a common systems platform in all stores and service departments
- The introduction of performance benchmarks throughout the Group.

A high level review of the above strategic intent over the following two years is as follows.

3.4.2.1 Financial Year 2000

In terms of the brand repositioning initiative, a major market research project was conducted by international consultants, the Monitor Group, which focused on customer segmentation and completed in February 2000. Arising from this was a decision to reposition Furniture City in the Value Retail segment and with the acquisition of Appliance City and the creation of a specialist bedding chain, Sleep City, the three brands were incorporated to form a new concept and called "The Cities". In addition to this, two of the brands, Savells (ex Beares) and Fairdeal (ex Amrel) who served similar target markets in similar LSM groups were merged into a

single brand Savells Fairdeal, under a single management team. This resulted in cost savings as well as critical mass of some 177 stores.

The Low Cost Retail Strategy was used to drive the Relyant vision of being the First Choice retailer of furniture and appliances in Africa. This in essence entailed implementing a Group-Wide productivity programme, aimed to reduce the cost base by R50 million through an Activity Based Costing project.
The Customer/Merchandise Led initiative involved forming strong partnerships with both local and foreign manufacturers and suppliers. In year 2000, partnerships were formed with Vodacom, in respect of a "cellular business" arrangement as well as with Educom, marketing an education computer that can plug into a television set.

In terms of credit management, automated brand application scorecards were implemented across the group in an effort to standardise credit-granting decisions. The credit granting process remained store based. A third regional credit centre was opened in Cape Town, to handle the collection of delinquent accounts, indicating a move towards centralisation of the collection process and also seeking to benefit from cost efficiencies and productivity.

During financial year 2000, the Group decided to enter the micro-lending market, in line with a decision to grow the financial services portfolio. The approach was to open "Relyant Loans" kiosks within certain Relyant Furniture brand stores. Twenty kiosks were opened with the view to expanding this to 72 outlets during the course of a year.

3.4.2.2 Financial Year 2001

According to the Relyant Retail Annual Report of 2001, CEO Chris Wells reported that the two major thrusts of the initial strategy viz. a major restructure programme and the repositioning of the Group for success in the future, had been completed.

The impetus of the restructure programme was the closure of non-performing stores as well as the closure of warehouses, the rebranding of certain retail outlets and the rationalisation of brands from 13 to 7. With this there was the retrenchment of 25% of staff.

Whilst most of the initiatives listed earlier, to reposition the Group for success were completed, a significant strategy adopted was the acquisition of the Renaissance Group that included the following brands:

- Glick's
- Dial-a-Bed
- Mattress Factory
- Bruce The Bed King

All of the above brands concluded sales primarily for cash.

The objective of the strategy was to "balance" the retail mix, resulting in the creation of two distinct divisions, namely Chains (predominantly credit sales) and Value Retail (predominantly cash sales)

Within the realms of strategy for each division, the focus for the chains would be operational excellence embracing:

- Productivities (increased sales per square meter)
- Limited growth (given the overtraded nature of the industry)
- Close or turnaround poor performing stores
- Distinctive merchandising/marketing
- Outstanding customer service

The focus for Value Retail was as follows:

- Large destination stores
- Lifestyle shopping experience
- Widest range of quality, exclusive merchandise

- Giving outstanding value and service (convenient location) – value centres close to major shopping malls

An important strategy beginning to emerge was the focus that was beginning to be placed on credit management. In this regard progress was made with regard to the introduction of application scorecards that were used in the credit assessment process for the purpose of evaluating risk. These were introduced with each brand utilising its own brand specific scorecard and the relevance being that the development was based on historical data of the brand, hence strengthening its predictive capability.

In addition to the use of application scoring systems for the purpose of risk assessment at credit application stage, a major breakthrough was a decision by the Relyant Management Board to approve the acquisition of the TRIAD Adaptive Control software, a highly sophisticated and strategic account management system.

Other strategic initiatives of relevance were:

- The feasibility of introducing Securitisation as a vehicle of funding. This is a very new concept in South Africa and in particular in the retail industry.
- The sale of 70 % interest in the Relyant micro loans business. This given the fact that it was introduced in the 1999-2000 financial year.
- A decision to increase instalment credit sales terms from 21 months to 24 months as well as an increase in the volume of business where no deposit payment is required.

3.5 Relyant's Existing Strategic Positioning

In light of the prevailing conditions within the external environment that impact on the furniture industry, the competitive forces within the industry and also the industry lifecycle, Relyant has reviewed its strategic positioning and also stated that it would focus on four key strategic initiatives.

In this regard, the following statement was made in the Relyant Retail Annual Report 2002. "The overtraded nature of the industry has led to two non-sustainable practices by furniture retailers, who sell on credit: relatively low margins and advancing credit beyond the customers ability to pay. The need for industry consolidation and rationalisation, therefore, is apparent. Accordingly, it is the belief that the proposed merger between two large furniture retail competitors is in the long-term interest of the industry. In addition, the experience of most credit retailers and micro loan lenders, of increasing arrears in their debtors' book, has resulted in the move to tighter credit granting policies. These, in turn, will lead to lower sales growth and further store rationalisation – particularly for retailers focused on the lower end of the market" (Wells 2002:11)

In response to the external environment and industry forces, the following strategic positioning was adopted:

- Reduce the number of retail brands
- Significantly rationalise its store base
- Restructure to cut costs
- Reduce credit risk through stricter credit granting criteria; and
- Reduce financial risk through the radical reduction of the Group's borrowings.

The four key strategic initiatives as mentioned earlier were as follows:

- The Value Retail Strategy and cash sales
- Focus on retail fundamentals
- Lowering the cost base. And
- Credit Management excellence

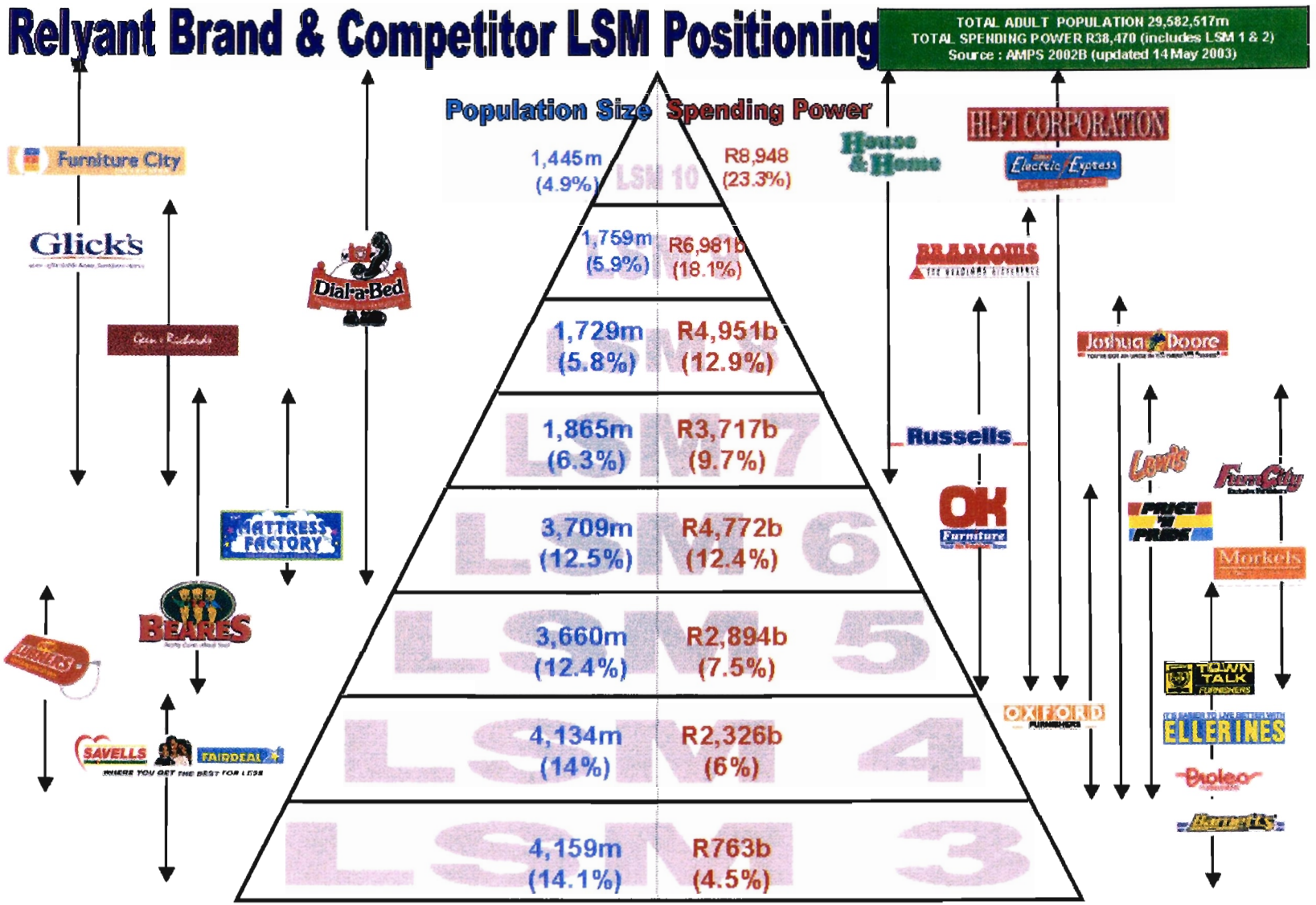


Fig 3.4 Relyant Brand Positioning

INTERNET DATA
SOURCE : SAARF AMPS 2002B

UPDATED 29 APRIL 2003

	LSM 1	LSM 2	LSM 3	LSM 4	LSM 5	LSM 6	LSM 7	LSM 8	LSM 9	LSM 10	TOTAL
TOTAL ADULT POPULATION	3,005,719	4,114,180	4,159,942	4,134,607	3,660,042	3,709,029	1,865,252	1,729,339	1,759,068	1,445,340	29,582,518
NUMBER OF HOUSEHOLDS	924,425	1,278,674	1,319,289	1,333,259	1,192,739	1,226,275	636,125	619,438	650,666	559,159	9,740,049
TOTAL ADULT POPULATION BY PROVINCE											
Eastern Cape	32.7%	20.6%	14.9%	12.5%	12.5%	11.3%	9.0%	6.5%	5.7%	5.4%	14.6%
Free State	2.9%	3.7%	10.4%	9.8%	8.4%	6.8%	5.9%	5.4%	5.1%	4.5%	6.7%
Gauteng	0.0%	3.3%	9.4%	21.1%	27.2%	34.5%	32.8%	36.7%	35.4%	37.7%	20.6%
Kwazulu Natal	41.8%	29.2%	19.9%	14.6%	14.3%	14.5%	16.3%	15.7%	16.9%	16.6%	20.5%
Limpopo	13.2%	22.0%	19.5%	13.3%	7.7%	4.2%	3.4%	1.8%	1.9%	1.1%	11.0%
Mpumalanga	6.1%	7.1%	8.9%	8.4%	7.3%	5.6%	4.8%	5.2%	5.8%	2.8%	6.7%
Northern Cape	3.0%	11.3%	12.9%	11.7%	9.7%	5.8%	4.6%	3.6%	3.8%	3.4%	6.1%
North-West	0.3%	2.1%	2.4%	2.9%	2.3%	2.1%	2.5%	2.3%	1.2%	1.1%	2.0%
Western Cape	0.0%	0.8%	1.7%	5.6%	10.7%	15.3%	20.7%	22.8%	24.3%	27.3%	9.8%
ETHNIC GROUP											
Black	99.7%	97.6%	96.6%	94.1%	86.6%	69.8%	43.3%	22.8%	11.7%	5.2%	74.9%
Coloured	0.3%	2.4%	3.3%	5.6%	10.9%	16.8%	20.8%	16.9%	13.5%	6.2%	8.5%
Indian	0.0%	0.0%	0.1%	0.1%	1.2%	4.5%	8.1%	9.5%	9.1%	4.7%	2.6%
White	0.0%	0.0%	0.0%	0.2%	1.3%	8.9%	27.8%	50.8%	65.7%	84.0%	14.0%
GENDER											
Female	58.4%	54.3%	50.1%	50.0%	51.9%	49.2%	51.4%	49.0%	50.0%	49.8%	51.6%
Male	41.6%	45.7%	49.9%	50.0%	48.1%	50.8%	48.6%	51.0%	50.0%	50.2%	48.4%
AGE GROUP											
16 - 19	15.3%	15.5%	13.5%	12.3%	12.0%	11.0%	10.3%	11.7%	10.5%	11.7%	12.7%
20 - 24	13.6%	17.2%	16.5%	15.3%	14.2%	14.7%	13.4%	8.3%	7.4%	7.5%	14.0%
25 - 34	17.6%	24.4%	23.7%	29.5%	29.1%	28.2%	25.9%	25.2%	22.8%	16.1%	25.0%
35 - 44	17.9%	15.1%	20.8%	19.7%	19.9%	21.3%	19.8%	19.3%	20.9%	23.6%	19.5%
45 - 49	6.3%	5.1%	7.7%	6.5%	7.0%	6.6%	7.0%	7.8%	9.1%	11.5%	7.0%
50 - 54	6.6%	5.9%	4.7%	4.4%	5.1%	4.6%	4.7%	4.9%	6.3%	7.4%	5.3%
55 - 64	10.8%	8.4%	6.8%	5.4%	6.8%	7.6%	8.3%	10.1%	12.1%	13.1%	8.2%
65 +	12.0%	8.5%	6.3%	7.0%	5.9%	6.0%	10.7%	12.7%	11.0%	9.0%	8.2%
INCOME											
Average H/H monthly income	R 826	R 1,071	R 1,323	R 1,745	R 2,426	R 3,692	R 5,844	R 7,994	R 10,730	R 16,004	R 51,855
Average H/H spending power PM (R's)	763m	1,369m	1,745m	2,327m	2,894m	4,772m	3,717m	4,951m	6,981m	8,948m	38,470b
AVERAGE LEVEL OF EDUCATION											
Highest level achieved											
Artisans Certificate Obtained	0.0%	0.2%	0.0%	0.3%	0.3%	1.0%	1.6%	3.1%	3.9%	2.5%	0.9%
Matric	6.9%	9.4%	15.8%	21.3%	27.6%	37.0%	41.1%	42.5%	43.4%	42.7%	25.0%
No Schooling	21.5%	16.6%	13.0%	7.7%	3.9%	1.7%	0.5%	0.2%	0.1%	0.0%	8.2%
Primary School Completed	11.2%	10.4%	9.1%	9.1%	7.2%	4.8%	3.8%	1.6%	0.8%	0.4%	7.0%
Professional	0.0%	0.3%	0.6%	0.9%	1.1%	2.0%	2.9%	1.9%	3.0%	3.7%	1.3%
Secretarial	0.0%	0.0%	0.0%	0.0%	0.1%	0.4%	0.3%	0.5%	1.0%	1.2%	0.2%
Some High School	31.4%	40.7%	43.7%	46.2%	46.7%	41.3%	36.5%	34.0%	25.1%	17.5%	39.0%
Some Primary School	28.9%	21.8%	17.2%	12.6%	10.2%	5.4%	1.8%	1.3%	0.6%	0.2%	12.3%
Technical	0.0%	0.0%	0.1%	0.3%	0.6%	0.8%	0.7%	0.8%	1.1%	1.9%	0.5%
Technikon Diploma/Degree Completed	0.1%	0.2%	0.4%	0.9%	1.5%	3.8%	7.0%	8.7%	12.1%	14.4%	3.3%
University Degree Completed	0.0%	0.1%	0.1%	0.4%	0.6%	1.7%	3.5%	5.1%	8.3%	14.8%	2.1%
Other	0.0%	0.1%	0.0%	0.1%	0.1%	0.2%	0.2%	0.4%	0.6%	0.7%	0.2%

3.1 LSM Characteristic Analysis

INTERNET DATA
SOURCE : SAARF AMPS 2002B

UPDATED 29 APRIL 2003

	LSM 1	LSM 2	LSM 3	LSM 4	LSM 5	LSM 6	LSM 7	LSM 8	LSM 9	LSM 10	TOTAL
TOTAL ADULT POPULATION	3,005,719	4,114,180	4,159,942	4,134,607	3,660,042	3,709,029	1,865,252	1,729,339	1,759,068	1,445,340	29,582,518
NUMBER OF HOUSEHOLDS	924,425	1,278,674	1,319,289	1,333,259	1,192,739	1,226,275	636,125	619,438	650,666	559,159	9,740,049
Highest school standard											
Grade 1/2	2.7%	2.2%	1.6%	1.3%	1.0%	0.5%	0.0%	0.0%	0.0%	0.0%	1.2%
Standard 10 / Grade 12	7.0%	10.5%	17.0%	24.2%	31.7%	46.4%	56.3%	61.3%	71.7%	80.2%	33.0%
Standard 4 / Grade 6	9.4%	6.4%	5.5%	5.4%	4.3%	2.4%	1.0%	0.7%	0.3%	0.1%	4.3%
Standard 5 / Grade 7	10.1%	11.1%	8.6%	7.6%	7.1%	4.4%	3.1%	1.3%	0.7%	0.3%	6.6%
Standard 6 / Grade 8	10.1%	9.1%	9.5%	8.7%	8.7%	6.9%	6.0%	4.6%	2.2%	1.1%	7.6%
Standard 7 / Grade 9	8.2%	10.4%	10.2%	9.9%	9.2%	7.4%	5.0%	4.4%	3.2%	1.7%	8.0%
Standard 8 / Grade 10	7.9%	10.6%	12.5%	13.8%	15.0%	15.7%	17.8%	18.2%	14.9%	10.6%	13.4%
Standard 9 / Grade 11	6.2%	10.8%	12.7%	15.1%	14.2%	12.2%	9.2%	8.5%	6.5%	5.7%	11.1%
Standards 1-3 / Grades 3-5	17.1%	12.3%	9.3%	6.1%	4.6%	2.3%	0.8%	0.5%	0.1%	0.1%	6.6%
Z - Other School Level	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.1%	0.0%	0.1%	0.1%
EMPLOYMENT											
Doing Military Service	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Not Working - Housewife	6.3%	4.5%	3.4%	3.8%	5.3%	9.6%	14.0%	16.2%	16.8%	15.2%	7.7%
Not Working - Retired	14.5%	11.6%	8.9%	9.4%	8.7%	8.6%	12.9%	14.4%	13.8%	11.0%	10.8%
Not Working - Student	12.8%	14.8%	14.0%	13.9%	14.2%	14.3%	12.2%	12.2%	10.6%	12.2%	13.5%
Not Working - Unemployed	47.2%	45.4%	42.6%	41.9%	39.2%	29.2%	17.3%	11.5%	6.2%	3.5%	33.8%
Working Full-Time	9.8%	14.4%	18.6%	20.2%	21.0%	28.0%	35.3%	38.5%	45.0%	48.7%	24.1%
Working Part-Time	9.3%	9.4%	12.5%	10.7%	11.5%	10.4%	8.2%	7.1%	7.5%	9.4%	10.1%
OCCUPATION											
Administrative and Managerial	0.0%	0.1%	0.0%	0.0%	0.4%	1.3%	2.3%	4.8%	6.5%	10.1%	1.6%
Agriculture	4.1%	5.7%	3.8%	1.6%	1.3%	1.2%	1.0%	1.8%	1.9%	3.9%	2.8%
Artisans and Related	0.3%	0.4%	0.6%	0.8%	1.8%	2.6%	4.2%	5.4%	6.4%	4.5%	2.0%
Clerical and Managerial	3.2%	3.2%	6.5%	5.9%	7.5%	10.1%	11.1%	11.0%	14.0%	14.8%	7.6%
Not Active	80.9%	76.3%	68.9%	69.1%	67.5%	61.6%	56.4%	54.4%	47.4%	41.9%	65.8%
Other	0.2%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.2%	0.1%	0.5%	0.1%
Production and Mining	5.1%	6.8%	7.6%	8.7%	7.3%	6.2%	4.4%	4.8%	2.7%	1.3%	5.2%
Professional and Technical	0.4%	0.9%	1.5%	2.3%	3.3%	6.3%	9.9%	11.2%	14.7%	17.7%	4.9%
Service	5.5%	5.3%	9.2%	10.1%	9.2%	8.2%	7.2%	4.1%	5.3%	4.2%	7.4%
Transport and Communication	0.3%	1.3%	1.8%	1.5%	1.7%	2.4%	3.3%	2.4%	1.1%	1.2%	1.7%
HOME											
Electricity in home											
Generator	0.0%	0.2%	0.5%	0.4%	0.2%	0.1%	0.1%	0.1%	0.0%	0.1%	0.2%
Yes	11.0%	56.4%	84.8%	96.9%	99.2%	99.6%	99.8%	99.8%	99.9%	99.9%	82.1%
No	89.0%	43.6%	15.2%	3.1%	0.8%	0.4%	0.2%	0.2%	0.1%	0.1%	17.9%
Mains	11.0%	55.9%	84.1%	96.4%	99.0%	99.5%	99.8%	99.7%	99.9%	99.9%	81.9%
Solar	0.0%	0.3%	0.2%	0.2%	0.1%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%
Floor type that covers most floors											
Earth	49.6%	20.1%	4.8%	1.6%	1.0%	0.4%	0.3%	0.1%	0.0%	0.1%	8.9%
Not Earth	50.4%	79.9%	95.2%	98.4%	99.0%	99.6%	99.7%	99.9%	100.0%	99.9%	91.1%
Kitchen sink built in											
No	100.0%	99.6%	97.9%	88.6%	59.3%	15.4%	1.8%	0.8%	0.4%	0.1%	59.6%
Yes	0.0%	0.4%	2.1%	11.4%	40.7%	84.6%	98.2%	99.2%	99.6%	99.9%	40.4%

3.2 LSM Characteristic Analysis

INTERNET DATA
SOURCE : SAARF AMPS 2002B

UPDATED 29 APRIL 2003

	LSM 1	LSM 2	LSM 3	LSM 4	LSM 5	LSM 6	LSM 7	LSM 8	LSM 9	LSM 10	TOTAL
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NUMBER OF HOUSEHOLDS	924,425	1,278,674	1,319,289	1,333,259	1,192,739	1,226,275	636,125	619,438	650,666	559,159	9,740,049
Toilet Type											
Communal Portable Flush Toilet	0.4%	1.9%	1.1%	0.3%	0.2%	0.0%	0.0%	0.2%	0.1%	0.0%	0.6%
Flush Toilet - In House	0.0%	0.3%	5.7%	14.7%	38.5%	77.5%	95.4%	97.8%	99.2%	99.0%	39.8%
Flush Toilet - Outside House	0.0%	0.2%	23.5%	42.9%	47.2%	28.0%	16.6%	20.8%	25.0%	29.5%	23.9%
No Toilet	28.1%	14.7%	4.0%	0.8%	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	5.6%
Non-Flush Toilet	71.6%	82.9%	66.0%	41.4%	15.8%	2.3%	0.5%	0.0%	0.0%	0.0%	36.1%
Dwelling Type											
Caravan	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%
Cluster House	1.9%	1.6%	0.3%	0.1%	0.4%	0.6%	1.0%	1.8%	1.2%	0.6%	0.9%
Compound	1.6%	1.3%	2.2%	1.4%	0.5%	0.1%	0.1%	0.0%	0.0%	0.0%	0.9%
Flat	0.0%	0.1%	0.2%	0.9%	4.4%	15.4%	20.0%	15.5%	8.8%	4.0%	5.5%
Hostel	0.1%	0.4%	2.8%	2.9%	2.0%	0.9%	0.3%	0.0%	0.0%	0.0%	1.2%
Hotel/Boarding House	0.0%	0.1%	0.1%	0.1%	0.2%	0.3%	0.6%	0.1%	0.0%	0.0%	0.2%
House	24.1%	50.5%	68.6%	71.7%	79.0%	76.1%	73.7%	77.5%	85.4%	92.2%	67.2%
Matchbox/Improved Matchbox	0.2%	1.6%	4.2%	4.7%	5.2%	3.2%	1.1%	0.6%	0.0%	0.0%	2.7%
Room in Backyard	0.3%	0.8%	4.0%	5.6%	3.0%	1.1%	0.3%	0.1%	0.0%	0.0%	2.0%
Squatter Hut / Shack	5.0%	13.9%	11.3%	10.1%	4.8%	1.4%	0.2%	0.0%	0.0%	0.0%	6.2%
Town House	0.0%	0.0%	0.0%	0.0%	0.1%	0.7%	2.0%	4.1%	4.5%	3.1%	0.9%
Traditional Hut	66.7%	29.3%	6.2%	2.1%	0.2%	0.0%	0.0%	0.0%	0.1%	0.0%	12.0%
Other	0.1%	0.3%	0.2%	0.4%	0.1%	0.2%	0.5%	0.3%	0.1%	0.2%	0.2%
Dwelling Ownership											
Company Owned	1.0%	1.0%	0.7%	0.5%	0.7%	0.5%	0.5%	0.4%	0.3%	0.2%	0.7%
Owned	90.9%	85.2%	78.1%	76.3%	75.3%	69.9%	68.6%	74.6%	82.7%	89.7%	78.8%
Rented	7.3%	13.0%	20.6%	22.7%	23.0%	29.2%	30.8%	24.8%	16.7%	9.3%	20.0%
VEHICLE											
Own One											
No	99.8%	96.5%	94.3%	90.5%	86.0%	67.5%	34.8%	12.6%	2.5%	0.5%	71.7%
Yes	0.2%	3.5%	5.7%	9.5%	14.0%	32.5%	65.2%	87.4%	97.5%	99.5%	28.3%
Number of Vehicles in Household											
None	99.8%	96.5%	94.3%	90.5%	86.0%	67.5%	34.8%	12.6%	2.5%	0.5%	71.7%
One	0.2%	3.2%	5.5%	7.9%	11.7%	29.0%	54.0%	64.6%	50.2%	23.7%	18.8%
Two	0.0%	0.3%	0.2%	1.0%	1.5%	2.8%	9.5%	18.8%	37.8%	52.6%	7.3%
Three or More	0.0%	0.0%	0.1%	0.5%	0.9%	0.8%	1.7%	4.0%	9.5%	23.2%	2.3%
Transport by:-											
Bus	7.7%	8.9%	8.9%	9.9%	9.2%	10.0%	9.4%	6.2%	4.6%	2.0%	8.4%
Minibus Taxi	28.6%	38.0%	51.4%	56.9%	63.5%	57.0%	37.0%	19.0%	8.8%	3.5%	42.5%
Private Transport	11.1%	14.9%	19.4%	24.6%	31.2%	48.3%	72.3%	87.6%	94.7%	97.8%	39.4%
Train	0.2%	0.7%	2.8%	4.4%	4.4%	5.6%	4.7%	2.6%	1.8%	1.1%	3.0%
COMMUNICATION											
Telephone in home											
No	99.9%	98.7%	98.2%	92.4%	76.9%	58.8%	42.3%	36.3%	23.8%	12.3%	74.3%
Yes	0.1%	1.3%	1.8%	7.6%	23.1%	41.2%	57.7%	63.7%	76.2%	87.7%	25.7%

3.3 LSM Characteristic Analysis

INTERNET DATA
SOURCE : SAARF AMPS 2002B

UPDATED 29 APRIL 2003

	LSM 1	LSM 2	LSM 3	LSM 4	LSM 5	LSM 6	LSM 7	LSM 8	LSM 9	LSM 10	TOTAL
TOTAL ADULT POPULATION	3,005,719	4,114,180	4,159,942	4,134,607	3,660,042	3,709,029	1,865,252	1,729,339	1,759,068	1,445,340	29,582,518
NUMBER OF HOUSEHOLDS	924,425	1,278,674	1,319,289	1,333,259	1,192,739	1,226,275	636,125	619,438	650,666	559,159	9,740,049
Cellphones											
Contract	0.0%	0.1%	0.1%	0.2%	0.5%	1.5%	4.7%	9.9%	17.0%	33.2%	3.8%
Pre-Paid	1.2%	5.3%	7.4%	15.9%	20.0%	31.0%	39.0%	42.4%	45.4%	44.0%	20.3%
Present in Household - No	98.8%	94.6%	92.5%	83.8%	79.5%	67.5%	56.3%	47.8%	37.6%	22.8%	75.9%
Present in Household Yes	1.2%	5.4%	7.5%	16.2%	20.5%	32.5%	43.7%	52.2%	62.4%	77.2%	24.1%
Owned by Company	0.0%	0.0%	0.0%	0.1%	0.2%	0.4%	0.6%	1.3%	2.4%	6.2%	0.7%
Private	1.2%	5.4%	7.5%	16.0%	20.3%	32.2%	43.1%	51.0%	60.0%	71.0%	23.4%
Number of Cells in H/H											
0	97.8%	90.4%	86.0%	73.0%	66.1%	50.2%	34.8%	28.0%	17.8%	7.0%	64.5%
1	2.1%	8.7%	12.2%	22.8%	28.6%	34.9%	42.6%	40.8%	37.8%	29.3%	23.0%
2	0.1%	0.8%	1.4%	3.3%	4.1%	10.4%	16.6%	21.2%	29.2%	34.3%	8.3%
3	0.0%	0.0%	0.3%	0.8%	0.9%	3.3%	4.0%	6.5%	9.5%	17.0%	2.7%
4+	0.0%	0.2%	0.1%	0.1%	0.3%	1.2%	1.9%	3.5%	5.7%	12.3%	1.5%
LIFESTAGES											
At-Home Singles	23.8%	26.6%	25.1%	26.4%	27.5%	23.7%	20.3%	17.8%	17.6%	19.7%	24.0%
Golden Nests	6.5%	6.9%	5.2%	5.1%	6.2%	7.7%	11.7%	16.7%	19.6%	21.7%	8.7%
Left Alones	7.1%	5.9%	4.6%	5.2%	4.9%	5.5%	8.5%	8.1%	6.6%	4.3%	5.8%
Mature Parents	18.7%	13.7%	15.4%	12.9%	13.1%	13.0%	12.3%	13.4%	13.7%	16.9%	14.2%
Mature Singles	3.6%	3.2%	6.0%	5.4%	5.6%	4.3%	3.8%	4.0%	2.6%	1.9%	4.4%
New Parents	7.3%	9.5%	8.1%	8.7%	8.9%	10.9%	12.8%	14.5%	15.0%	14.4%	10.1%
Single Parents	20.9%	18.6%	17.1%	18.5%	16.1%	13.3%	9.5%	5.2%	3.5%	2.3%	14.6%
Starting out Singles	5.6%	8.3%	9.4%	8.3%	8.4%	10.1%	7.5%	6.0%	3.9%	2.6%	7.7%
Young Couples	6.4%	7.3%	9.1%	9.5%	9.2%	11.6%	13.5%	14.5%	17.5%	16.2%	10.4%
INTERNET											
PC present in HH											
Yes	0.0%	0.0%	0.0%	0.0%	0.7%	2.5%	8.8%	22.2%	47.2%	80.2%	9.0%
PC brought new in the past 12 months											
Yes	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%	0.6%	0.9%	2.0%	0.2%
Personally Accessed in Past 7 Weeks											
Yes	0.0%	0.1%	0.2%	0.8%	1.6%	8.2%	7.7%	13.3%	24.4%	43.7%	1,049,781
Personally Accessed in Past 4 Weeks											
Yes	0.0%	0.1%	0.4%	1.0%	1.7%	9.4%	8.6%	14.0%	23.9%	41.0%	1,355,608
Personally Accessed in Past 4 Weeks at											
Home	0.0%	0.0%	0.0%	0.0%	0.2%	2.5%	3.6%	8.8%	24.8%	60.0%	696,766
Office	0.0%	0.0%	0.7%	0.0%	1.4%	9.5%	10.6%	17.8%	27.9%	32.2%	512,573
Elsewhere	0.0%	0.2%	0.8%	4.3%	4.5%	22.5%	13.7%	19.0%	17.7%	17.3%	304,901

3.4 LSM Characteristic Analysis

INTERNET DATA
SOURCE : SAARF AMPS 2002B

UPDATED 29 APRIL 2003

	LSM 1	LSM 2	LSM 3	LSM 4	LSM 5	LSM 6	LSM 7	LSM 8	LSM 9	LSM 10	TOTAL
TOTAL ADULT POPULATION	3,005,719	4,114,180	4,159,942	4,134,607	3,660,042	3,709,029	1,865,252	1,729,339	1,759,068	1,445,340	29,582,518
NUMBER OF HOUSEHOLDS	924,425	1,278,674	1,319,289	1,333,259	1,192,739	1,226,275	636,125	619,438	650,666	559,159	9,740,049
Personally Accessed in Past 4 Weeks to											
Make a Purchase	0.0%	0.0%	0.0%	0.0%	0.4%	8.3%	7.2%	15.8%	15.9%	52.3%	75,698
Chat On-Line	0.0%	0.3%	0.0%	0.6%	1.8%	15.2%	9.7%	13.9%	22.3%	36.1%	202,281
Do Banking Transactions	0.0%	0.0%	0.0%	0.4%	0.4%	2.3%	4.0%	12.7%	24.9%	55.4%	374,736
Listen to a Radio Station	0.0%	0.0%	0.0%	1.9%	0.2%	9.0%	14.9%	17.9%	28.6%	27.5%	69,405
Obtain Information About Business & Financial matters	0.0%	0.0%	1.3%	0.2%	0.7%	8.3%	9.3%	14.1%	21.4%	44.7%	283,869
Obtain Information About Cars/Motoring	0.0%	0.0%	1.6%	0.8%	0.8%	8.5%	10.1%	15.2%	24.7%	38.2%	144,416
Obtain Information About Computer & Technology	0.0%	0.0%	0.0%	0.0%	1.6%	10.4%	10.6%	16.7%	18.3%	42.4%	231,509
Obtain Information About Entertainment	0.0%	0.0%	0.0%	1.1%	2.9%	10.1%	7.1%	18.4%	20.3%	40.1%	197,494
Obtain Information About Health, Fitness & Mediacl Matters	0.0%	0.0%	0.0%	1.2%	1.7%	6.0%	7.9%	15.0%	21.5%	46.7%	161,878
Obtain Information About Sport	0.0%	0.0%	0.0%	1.5%	0.6%	8.7%	8.6%	15.6%	26.6%	38.5%	193,892
Obtain Information About Travel	0.0%	0.0%	0.0%	0.0%	1.2%	9.4%	6.0%	14.9%	24.0%	44.5%	200,196
Obtain News	0.0%	0.0%	0.6%	0.4%	0.8%	12.1%	9.4%	15.1%	25.6%	36.0%	383,132
Read Magazine or Newspaper On-Line	0.0%	0.0%	0.0%	0.0%	1.6%	13.6%	8.2%	16.4%	24.5%	35.7%	212,800
Send E-Mail	0.0%	0.1%	0.2%	0.7%	1.6%	8.4%	8.0%	12.5%	24.9%	43.6%	1,065,168
Source Information on Products & Services I may want to Buy/Use	0.0%	0.0%	0.0%	0.0%	0.2%	10.5%	7.8%	15.6%	16.0%	49.9%	155,466
Obtain other Kinds of Information	0.0%	0.0%	0.0%	0.4%	1.8%	11.4%	7.0%	15.4%	24.9%	39.1%	445,781
Other	0.0%	0.0%	0.0%	3.5%	0.9%	15.5%	7.6%	19.2%	23.1%	30.3%	60,282
DURABLES											
Present in Household											
Electric Hotplate	2.9%	23.0%	47.3%	49.0%	28.3%	16.3%	10.8%	9.8%	9.9%	14.3%	25.1%
Microwave	0.0%	0.1%	0.6%	2.0%	12.1%	44.9%	78.6%	90.2%	96.6%	98.7%	28.3%
Electric Stove	0.0%	1.2%	7.1%	30.7%	72.5%	91.5%	96.8%	97.9%	98.5%	99.2%	48.4%
Stove Other (Gas or Coal)	11.9%	20.1%	26.1%	28.6%	23.0%	12.2%	7.0%	7.0%	6.4%	8.1%	17.7%
Free Standing Deep Freezer	0.7%	4.4%	8.1%	8.4%	11.1%	17.1%	31.8%	50.1%	65.7%	83.6%	19.4%
Refrigerator or Combined F/F	0.3%	9.4%	38.5%	69.2%	88.6%	95.7%	98.7%	98.5%	99.4%	99.7%	62.1%
Front Loader W/M	0.0%	0.0%	0.1%	0.2%	1.6%	7.8%	16.1%	25.2%	33.6%	40.4%	7.7%
Top Loader W/M	0.0%	0.0%	0.1%	0.6%	3.4%	10.9%	23.5%	32.7%	42.7%	48.3%	10.2%
Twin Tub W/M	0.0%	0.0%	0.1%	0.8%	4.6%	18.8%	34.2%	34.0%	22.8%	14.3%	9.2%
Dishwasher	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%	1.0%	3.0%	7.6%	36.2%	2.5%
Tumble Dryer	0.0%	0.0%	0.0%	0.0%	0.2%	2.2%	6.5%	20.0%	40.7%	75.2%	8.0%
Hi-Fi/Music Centre	6.8%	26.1%	40.0%	52.5%	71.7%	75.5%	81.2%	85.9%	91.1%	97.0%	56.1%
DVD Player	0.0%	0.0%	0.1%	0.1%	0.1%	0.9%	2.2%	6.5%	10.0%	20.2%	2.2%
TV	3.3%	30.2%	55.6%	78.3%	91.1%	96.2%	98.5%	98.9%	99.2%	99.8%	69.4%
VCR	0.0%	0.1%	1.3%	6.6%	22.4%	48.7%	69.2%	79.4%	91.0%	96.9%	29.2%
Brought new in the past 12 months											
Electric Hotplate	0.2%	1.9%	1.7%	1.2%	0.8%	0.4%	0.3%	0.1%	0.1%	0.2%	0.9%
Microwave Oven	0.0%	0.0%	0.0%	0.2%	0.6%	2.2%	2.9%	3.0%	2.5%	2.4%	1.0%
Electric Stove	0.0%	0.0%	0.4%	0.9%	1.3%	2.0%	1.8%	1.7%	2.0%	2.3%	1.0%
Stove Other (Gas or Coal)	0.1%	0.1%	0.1%	0.2%	0.1%	0.0%	0.0%	0.0%	0.0%	0.2%	0.1%
Free Standing Deep Freezer	0.0%	0.4%	0.7%	0.2%	0.2%	0.6%	0.4%	1.1%	0.9%	1.4%	0.5%
Refrigerator or Combined F/F	0.0%	1.0%	1.6%	2.4%	2.0%	2.6%	2.8%	2.1%	2.6%	2.4%	1.8%
Front Loader	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%	0.5%	0.7%	0.9%	0.9%	0.2%
Top Loader	0.0%	0.0%	0.1%	0.1%	0.4%	0.5%	0.8%	1.4%	2.0%	2.2%	0.5%
Twin Tub	0.0%	0.0%	0.0%	0.0%	0.2%	0.7%	0.7%	1.2%	0.4%	0.3%	0.3%
Dishwasher	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.2%	0.2%	1.6%	0.1%
Tumble Dryer	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%	0.6%	0.9%	2.0%	0.2%
Hi-Fi/Music Centre	0.7%	1.0%	1.8%	2.6%	2.7%	3.9%	4.1%	3.8%	2.9%	3.7%	2.5%
DVD Player	0.0%	0.0%	0.0%	0.0%	0.0%	0.5%	0.7%	1.9%	2.0%	5.1%	0.6%
TV	0.0%	1.6%	2.3%	2.6%	3.0%	3.3%	3.1%	3.4%	4.2%	5.4%	2.6%
VCR	0.0%	0.0%	0.1%	0.2%	0.7%	2.2%	2.8%	2.6%	2.9%	3.1%	1.1%

3.5 LSM Characteristic Analysis

3.5.1 The Value Retail Strategy and Cash Sales

The essence of this strategy was to balance the Relyant portfolios with a division that generated cash and the action was the acquisition of the Renaissance Group with all its brands generating cash sales. The Value Retail division was positioned to target the upper end of the market (LSM 7 – 10). Furniture City, which originally formed part of the Chains division, was rebranded as "The Cities" after the acquisition of Appliance City and the creation of Sleep City, both of which were consolidated into The Cities. The view of senior executive management was that the impact of the Value Retail strategy would position the Group for success in the future as:

- The balance between both cash/credit sales and the focus on the upper/middle markets enables the Group to benefit when trading cycles favour one segment of the market versus the other;
- The cash sales of the Group had increased to 44% of total sales and this trend is expected to continue, thus enhancing the Group's cash generating ability; and
- There would be more opportunity to differentiate and grow in the Value Retail division than there would be in the mass middle market

3.5.2 Focus on Retail Fundamentals

The focus of this initiative was to enable the business of retailing to be split from Credit Granting and Collections. To this end there was a drive to implement excellence in certain "retail fundamentals" throughout the Group. This consisted of:

- Brand market positioning and differentiation;
- Customer service; and
- Operational excellence

An integral part of the differentiation drive was to be a "marketing / merchandise" led business and to this end these two portfolios were placed under the control of one director.

3.5.3 Low Cost

An on going strategy since the beginning of Relyant was the reduction of cost and improving the cost to income ratio, predominantly driven by the rationalisation programmes pursued since its inception. The reduction of costs has also been pursued through the outsourcing of certain functions as well centralizing those functions that prove to be cost beneficial such as credit management.

3.5.4 Credit Management Excellence

With credit sales per annum of R 1 091,8 million representing 56% of total sales and a gross debtors book of R 1 847,4 million, it is important that credit management is a centre of excellence in Relyant. There has been a focus placed on a move towards centralising the credit management processes and in particular the collections process and more recently aspects of the credit granting process. The intended benefits include stricter control, cost efficiency and consistent application of business processes. In financial year 2002, the implementation of the TRIAD Adaptive Control software began with a carefully planned and orchestrated project.

During the course of 2002, a strategy of continuous improvement was initiated, built around the implementation of automated technology driven systems within certain decision-making areas. This innovation can be considered to be the achievement of an important milestone within the furniture retail industry.

3.5.5 Other Initiatives

In addition to the four key strategic initiatives, another important initiative identified is "People Development". A belief of Relyant is that their people are one of the biggest differentiators of their business. In this regard have instituted the following training and development programmes as means enhancing people performance.

- The Relyant Senior Management Development Programme, which is run in conjunction with the Gordon Institute of Business Science. The objective is to expose candidates to leading edge management practices and case studies with the view to working in groups on a business specific topic as a project and compiling research culminating in a strategy that can be implemented in the business.
- The Relyant Management Development Programme, run in conjunction with the University of Pretoria and Damelin Training Solutions and aimed at developing junior to mid-level management talent.
- The Relyant Sales Development Programme aimed at new recruits joining Relyant for a sales career. The philosophy is that recruiting the right calibre sales staff and training them intensively will result in returns and greater staff satisfaction amongst sales consultants.
- Relyant in store programmes focus on the development of store-based employees and address areas such as sales development, customer service, debtors' follow-up training and life skills training.

3.6 Relyant's Approach to Customer Management

In the five years of Relyant being in existence since the merger in 1998, Relyant has made tremendous strides in this regard. In terms of account origination, Relyant has made the transition from subjective, judgemental based credit assessment decisions to the introduction of risk-based application scorecards. In terms of account management, Relyant has progressed from manual type prioritising of collections to the introduction of automated strategy driven collections and through the introduction of TRIAD, has the capability to introduce risk-based marketing.

3.6.1 Background

Each brand within Relyant has its own management board, comprising representation of functional areas such as finance, operations, marketing, merchandising, credit and human resources. Within the operations and credit functions are field managers who are responsible for a group of stores, typically based upon geographic regions. Each store is controlled

by a branch manager with a number of sales staff reporting to the branch manager. Supporting the branch manager is an office manager, responsible for application processing and collection of certain delinquent accounts. In terms of this structure the Relyant business is decentralised with customer interaction based predominantly at the stores. Supporting the brands are management services such as a Shared Financial Services, Group IT, Group Credit, Group Marketing/Merchandising, Group Human Resources and Group Property.

The information system technology architecture is based on an "in store" distributed network, where all transaction processing is driven by an in store server, whereby daily transaction processing is switched to a central server in batch at each day end. Where inter-branch transactions are processed, these are updated overnight in the respective stores. Information is consolidated at brand level and each brand is treated separately. An implication of this is that one customer can hold an account at two different stores without the individual branches being aware that the customer has an account at the other branch and what the payment behaviour is like at the other branch. This information can only be obtained via an external database such as a credit bureau. The information systems are currently outsourced to a third party processor, Universal Computer Systems (UCS)

3.6.2 Application Processing

All applications are processed by the store where the purchase is made (decentralised). The turn-around time can be immediate but in most cases there are certain checks that have to be concluded and this is done without the customer being present.

All customer information is captured into a computer system and the decision process is automated. In the case of existing or recently paid up customers, details are called up on the system, checked and where necessary updated. Essentially existing or recently paid up customers go through the same application procedure as new customers. A fundamental

procedure within the application processing flow is the confirmation of certain customer credentials such as:

- Identification verification
- Employment confirmation
- Salary confirmation and proof of income

In addition to the above, a credit bureau enquiry is done with every application to establish account payment behaviour within Relyant as well as externally. This process is automated with a direct link from the stores to the credit bureau.

Whilst the decision making process is automated, there is a degree of manual intervention in the event that a credit application is not automatically approved. Office managers or field managers have the authority to override a decision to reject a credit application, depending upon the level of authority that they have.

3.6.3 Relyant Credit Management

Given the fact that the evolution of Relyant was a result of the merger between two established furniture companies, each with a number of different brands, the challenge that Relyant faced was to streamline structures, standardise policies and procedures and implement uniform systems with consistent decision making capabilities. This was particularly the case with the Amrel brands as the different brands within Amrel used different systems and processes.

Up until a few years ago, given the decentralised nature of furniture retail companies, the credit granting decisions and the follow-up of delinquent debtors and collection of outstanding balances (collections) was controlled from the furniture stores. The fundamental philosophy was based on the fact that the transaction typically involved the purchase of a big-ticket item with payments being made over a number of instalments and as such the stores "knew" their customers and had a particular relationship with their

customer base. Whilst this could be justified at some point, as stores grew into national chains, the volume of transactions increased and hence the extent of decision-making increased from a credit granting and collections point of view and this then impacted on consistency and quality of decisions. However, the culture of decision-making being under the control of the stores is still deeply entrenched within the furniture retail industry. Given that within predominantly credit chains, the percentage of credit sales is around 80% and in light of this, the extension of credit plays an important role in achieving sales budgets. As a result of this, there is a great deal of intervention by operations management in the credit management process.

- **Pre-Merger Situation**

  Shortly before the merger, Amrel began to change their structure, process and procedure with regard to credit management and began to introduce a move towards centralisation. They introduced an empirically derived application scorecard, for the purpose of credit granting decision-making, in two of their brands. They also opened two regional credit centers, one in Benoni and one in Durban, for the purpose of credit granting and collections.

  The technology chosen by Amrel to drive the credit granting process proved to be extremely unstable when having to process large volumes of credit applications. This caused tremendous bottlenecks at peak periods such as weekends and month ends and resulted in the processing of credit applications being time consuming. This gave the critics of centralisation ample ammunition to justify their opposition to centralisation and this technology was stopped and credit granting reverted to the stores.

  Beares, on the other hand, had just concluded the development of two, empirically derived, application scorecards for two of their brands just before the merger, but had not as yet implemented these scorecards.

- **Post Merger Situation**

Immediately after the merger, with a new CEO at the helm, the senior executives of operations lobbied for the collection of delinquent accounts to be returned to the stores for follow-up. As a result of this, most of the accounts were returned to the stores with only seriously delinquent accounts remaining in the two credit centres. These accounts were typically those that were 13 months and more in arrear and the reason for this is that there were sunken costs invested in these centres.

For the first year after the merger, there was a state of transition whereby:

- There were numerous store closures;
- There was a rationalisation of brands whereby the number of brands were reduced;
- The debtors' books of certain stores were merged with other stores
- There was a conversion of IT systems to a common platform

All of the above made it difficult to have a structured, consistently applied credit management process in place as well as the relevant accurate management reports in place.

- **Evolution of Credit Management**

Early in 1999, the management team of the Credit Division began a process of strategy formulation for Relyant at a corporate level. The starting point was the formation of a mission statement which was as follows:

MISSION

To consistently be the best credit operation in the furniture retail industry in Africa

The essence of the mission statement was for it to be aligned with the mission statement of Relyant Retail Limited.

Following on this a strategic intent was articulated, also in keeping with the underlying initial strategy of Relyant, which was to be a "low cost" retailer.

The identity of the Credit Division was agreed as Relyant Credit Services. The strategic intent of Relyant Credit Services was compiled as follows.

Fig. 3.5 Relyant Credit Services Road Map

In terms of the strategic intent, credit management was to be built on two predominant pillars, namely, credit granting and collections and both these functions were to be automated using technology and driven by the computer functionality provided by the outsource partner, UCS.

- **The Credit Passing Pillar**

The strategy was to initially have a documented credit policy that would be adhered to "manually" during the period of transition and serve as a source reference in the event of future uncertainty.

In time this would be elevated to the implementation of automated application scorecards to predominantly determine the outcome of a credit application.
There would be an appropriate appeal process in place to review certain applications that were not approved by the scorecard.

The process would be results driven, focusing on account growth and minimizing the extent of bad debt.

- **The Collections Pillar**

  The initial intention was that two credit centres were not adequate and that in due course there should be 4 or 5 centres.

  There would be appropriate policies and procedures in place, particularly during the period of transition, until there were uniform automated collection systems in place.

  The process would be focused in that there would be specific strategies with regard to critical aspects of collections. For example, there was an extremely intense, consistent approach applied to first instalment defaulters.

  The collections process was also to be results driven encapsulating:

  - Reports
  - Benchmarks
  - Incentives
  - Productivity

3.6.4 Account Origination

In January 2000, the first automated application scorecards were introduced in two of the Relyant brands. These were prior Beare Group brands as the scorecard development was on historical data of these two brands. The credit granting process followed a more automated flow as the credit granting process comprised two essential components:

- Policy Rules
- Application scoring

The policy rules embrace the fundamentals of the "manual" credit granting policy document, and have been automated. The policy rule check is the first part of the credit granting process and the second part is where the application scorecard calculates a score for the applicant.

The introduction of application scorecards was a significant shift in the way credit assessment was done and a radical change in culture and as such, was met with a great deal of resistance at a business operational level. This was primarily on account of:

- The extent of intervention into the credit granting decision making was reduced at an operational level;
- The thinking of office managers as in their view they had years of experience in credit granting decision making, and now felt threatened;
- The fear of job loss and retrenchment;
- The impact that scorecards would have on credit application approval rates.

In response to the above resistance, a decision was made by Relyant Credit Services to introduce an appeal process whereby, if the scorecard rejected an application, the application could be elevated to a higher management level for review. At this stage the assessment process would entail manual intervention based on judgmental evaluation. If the person

reviewing the application disagreed with the decision of the scorecard, the person reviewing the application had the authority to override the decision. As a result of this a high percentage of rejected applications were being referred for review and in fact overridden, detracting from the benefits of automated decision systems.

By the end of 2000, automated application scorecards had been implemented in all Relyant brands. The business structure remained unchanged whereby application processing was initiated at the stores. The credit granting processes being automated by the host IT system and the results being returned at store level.

3.6.4.1 Application Scorecard Theory

The development of application scorecards comprises the following component parts. The relevance of covering this is to highlight the rigorous process involved to ensure strong predictive capabability.

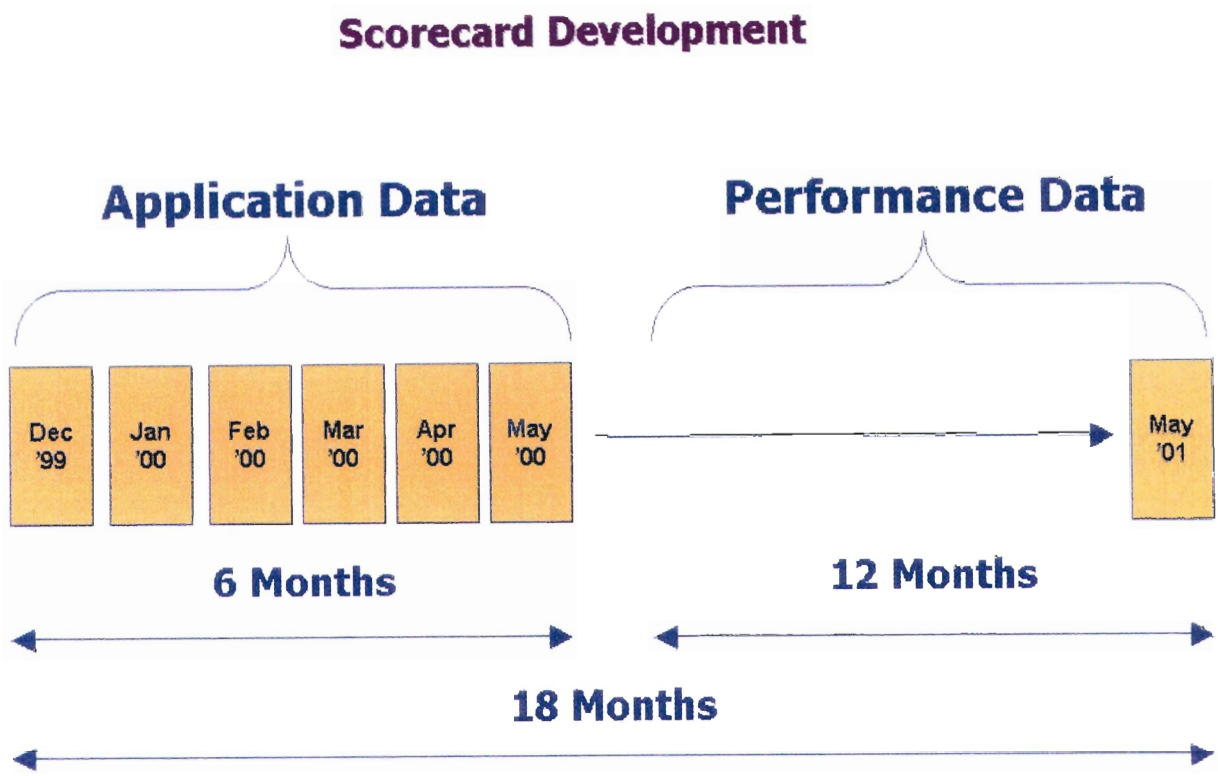
- **Data Set**

  The scorecard is built by analysing data specific to a particular brand and consists of application data and account payment performance data.

- **Time Window**

  The time window typically consists of a period of 18 months. The first 6 months usually consists of account application data, with the performance of each account being monitored from the month immediately after being approved to the end of the time window. The minimum performance period is usually 12 months.

Fig.3.6 Scorecard Data Set and Time Window



- **Empirical Analysis**

This is the observation and analysis of account performance of each of the 6 months application data and involves a process of statistical analysis and optimisation involving

- Good/Bad definitions of account performance
- The identification of characteristics that are predictive
- The weighting of attributes (within characteristics) based on logarithmic formulae.

- **Good/Bad Definition**

  These definitions pertain to the status of an account in terms of its performance so as to extract strong predictive characteristics.

  A good account is defined in terms of the nature of the business. For example, within furniture retail, a good account may be an

account whose highest arrear status has been 2 months over the entire performance period.

A bad account may be defined as an account whose highest arrear status has been 3 or more months over the performance period.

Any definition outside of good and bad is classified as indeterminate. In observing the performance of accounts within the data set over the performance period, the performance relative to good and bad definitions is empirically analysed for the purpose of identifying the strongest risk predictive characteristics and calculating the attribute weightings.

- **Identification of Predictive Characteristics**

  These are generally a combination of demographic information, stability and contactability information and information relative to the application. The following characteristics are typically predictive in terms of risk assessment.

Table 3.6 Scorecard Predictive Characteristics

Scorecard Development

Occupation	Type of Dwelling
Residential Post Code	Years at Current Residence
Gender	Years Employed
Language	Income
Age	Deposit Percentage
Marital Status	Account Age in Months
Dependents	Account Type
Telephone	**Period of Contract**

Table 3.7 Risk Weighting and Score Allocation

Scorecard Development

Period of Contract	Weight
05 – 07 Months	0.52
10 – 16 Months	0.04
17 – 19 Months	-0.13
20 – 22 Months	0.24
23 – 36 Months	-0.11

Period of Contract	Score
05 – 07 Months	90
10 – 16 Months	45
17 – 19 Months	0
20 – 22 Months	15
23 – 36 Months	10

- **Risk Weighting and Score Allocation**

  In the above, the characteristic "period of contract" is a risk predictive characteristic. The terms of an instalment loan can vary from 6 months to 36 months and therefore certain bands have been identified and each band forms an attribute. For each attribute a weighting is calculated and this is used to determine the score that the attribute will be allocated. In the above example, an applicant requiring finance for 6 months will be allocated 90 points as opposed to an applicant requiring finance for 24 months who will be allocated 10 points for the characteristic "period of contract".

- **Risk Model**

  The risk model determines a score distribution table which groups accounts into 5 percentile risk bands, with band 1 being lowest risk and band 20 being the highest. Therefore, the higher the application score, the lower the risk.

- **Cut-Off Score**

  The cut-off score is determined by analysing the risk bands within the score distribution table and optimising the degree to which the bad rate should be reduced. The score distribution table is used to associate exposure to risk by looking at the bad rate percentages with an appropriate cut-off score. In fig 3.1 the minimum acceptable score for a bad rate of 29.13% is 173.

Table 3.8 Score Distribution Table

Scorecard Development

Development Sample (December 1999 - May 2001)

Approx. score %-ile	Approved Good (G)	Approved Bad (B)	Approved Indet. (I)	Rejected (R)	% of obs.	Approv. Rate (AR)	Bad Rate (BR)	% of all goods	% of all bads	% of all indet.	% of all rej.	Total	Min. Score	Max. Score
~5%	1050	48	38	118	4.93	90.59	4.37	7.36	1.30	2.61	1.96	1254	352	591
~10%	987	86	70	145	5.06	88.74	8.01	6.92	2.33	4.81	2.40	1288	319	351
~15%	916	89	64	199	4.98	84.31	8.86	6.42	2.41	4.40	3.30	1268	298	318
~20%	852	118	64	188	4.80	84.62	12.16	5.97	3.20	4.40	3.12	1222	283	297
~25%	855	165	78	211	5.15	83.88	16.18	6.00	4.47	5.36	3.50	1309	270	282
~30%	765	149	64	206	4.65	82.60	16.30	5.36	4.04	4.40	3.41	1184	260	269
~35%	819	160	77	222	5.02	82.63	16.34	5.74	4.34	5.29	3.68	1278	250	259
~40%	738	187	83	248	4.94	80.25	20.22	5.17	5.07	5.70	4.11	1256	241	249
~45%	783	205	87	266	5.27	80.16	20.75	5.49	5.56	5.98	4.41	1341	232	240
~50%	690	193	62	251	4.70	79.01	21.86	4.84	5.23	4.26	4.16	1196	224	231
~55%	708	185	85	295	5.00	76.83	20.72	4.96	5.01	5.84	4.89	1273	216	223
~60%	664	206	66	307	4.89	75.30	23.68	4.66	5.58	4.53	5.09	1243	208	215
~65%	653	228	93	337	5.15	74.29	25.88	4.58	6.18	6.39	5.58	1311	200	207
~70%	657	235	76	389	5.33	71.33	26.35	4.61	6.37	5.22	6.45	1357	191	199
~75%	697	251	99	375	5.59	73.63	26.48	4.89	6.80	6.80	6.21	1422	181	190
~80%	489	201	73	325	4.28	70.13	29.13	3.43	5.45	5.01	5.39	1088	173	180
~85%	552	218	78	397	4.89	68.11	28.31	3.87	5.91	5.36	6.58	1245	163	172
~90%	518	244	70	449	5.04	64.95	32.02	3.63	6.61	4.81	7.44	1281	150	162
~95%	505	289	71	525	5.46	62.23	36.40	3.54	7.83	4.88	8.70	1390	131	149
~100%	363	232	58	582	4.85	52.87	38.99	2.55	6.29	3.98	9.64	1235	0	130
Totals	14261	3689	1456	6035	100.00	76.28	20.55	100.00	100.00	100.00	100.00	25441		

- **Relyant Scorecards**

  The basis of each brand's application scorecard is in accordance with the above processes and has been developed by specialist risk software developers. The performance of the application scorecards were evaluated by comparing the performance of accounts that were accepted prior to scorecards being implemented with accounts that were accepted after the implementation of application scorecards.

  Fig. 3.6 contains graphs showing the performance of accounts accepted prior to the use of scorecards for a particular brand. Graphs 01 to 06 represents accounts accepted in the successive months January 1999 (graph 01) to June 1999 (graph 02), and how these accounts performed over a period of 9 months. In graph 01, 76,39% of all accounts accepted were 1 cycle delinquent (1 month in arrear) after a period of 9 months while 8,12% were 2 cycles

delinquent and 15,49% were 3 or more cycles delinquent. On average, for the 6 periods January to June 1999, the percentage of accounts that were in cycle 1 nine months later is 74,6%.

Fig. 3.7 contains graphs showing the performance of accounts accepted after the implementation of scorecards for the same brand as used in Fig. 3.7. Credit applications for 7 successive months were analysed over the period October 2000 to April 2001. In graph 01, for example 87,8% of all accounts accepted were in cycle 1, nine months after acceptance while 4,16% were in cycle 2 and 8,04% were in cycle 3 and greater. On average, for the 7 periods October 2000 to April 2001, the percentage of accounts that were in cycle delinquent 1 nine months later is 87,7%.

Scorecard Development

Pre-Scorecard

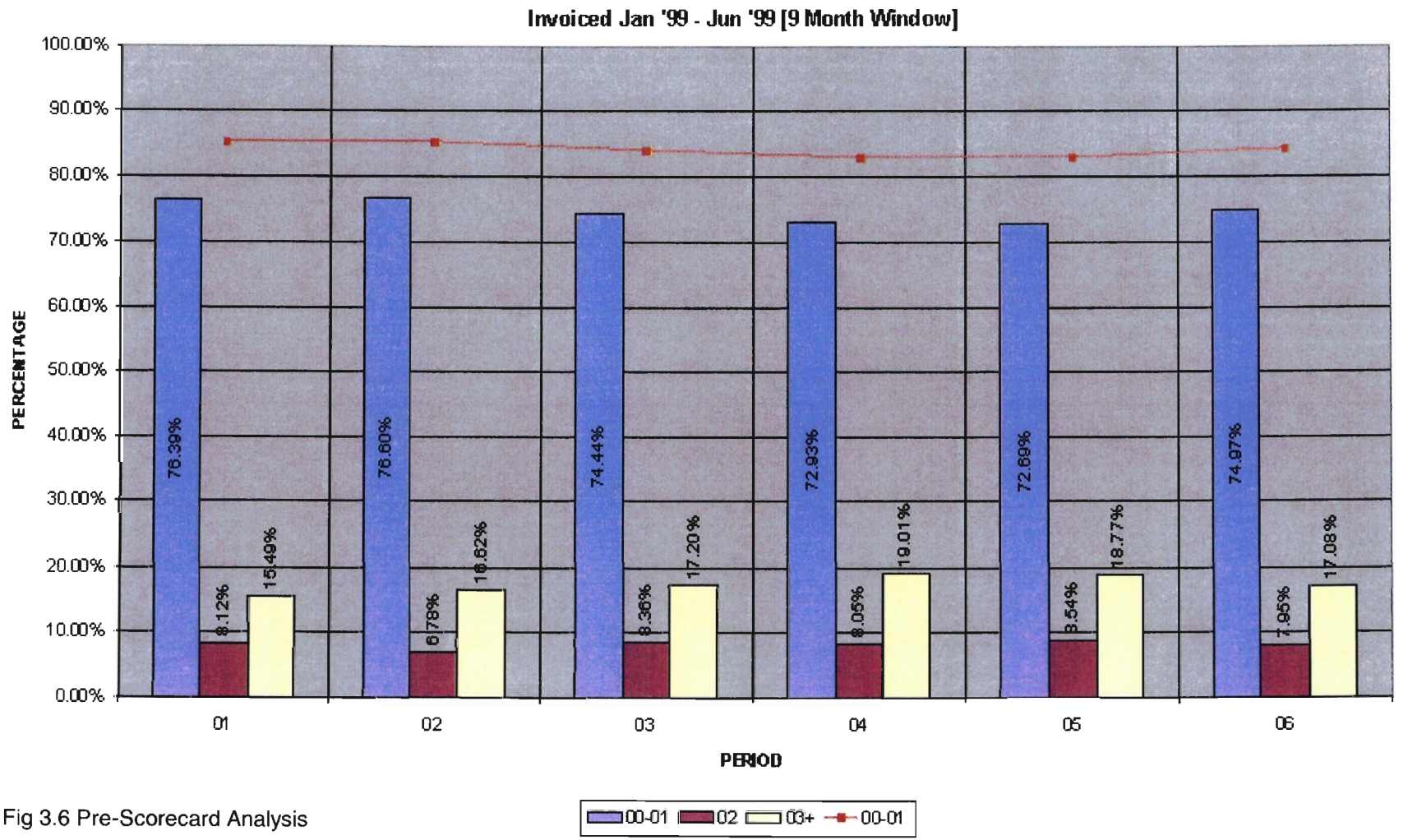


Fig 3.6 Pre-Scorecard Analysis

Scorecard Development

Post Scorecard

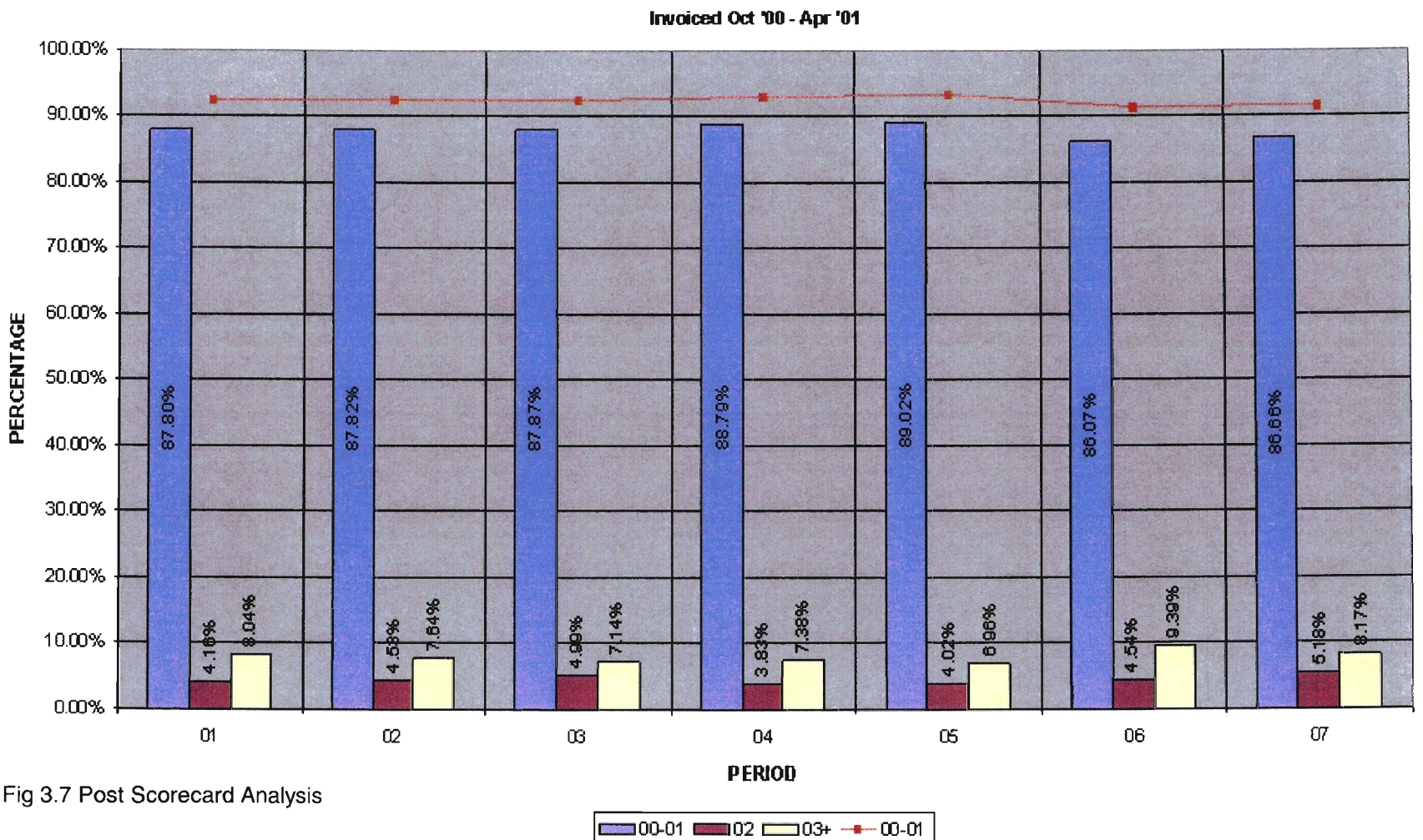


Fig 3.7 Post Scorecard Analysis

3.6.4.2 Application Scorecard Monitoring

A benefit arising from the introduction of application scorecards is that monitoring mechanisms can be put in place to report on the consistency of credit granting decisions with regard to"

- Accept/Decline decisions; and
- Performance of applications approved

Since the introduction of application scorecards, Relyant have implemented monitoring reports to report on the above two measures.

Table 3.6 is an example of a report monitoring the accept/decline decisions made by the application scorecards. This report also reflects the number of rejected applications that were overridden, as a result of manual intervention due to the appeal process.

Table 3.7 is an example of a performance report used by Relyant, which reports on the performance of accounts over a "window" period of 9 months and shows the percentage of accounts that 1 cycle delinquent, 2 cycles delinquent and 3 or more cycles delinquent after the 9 month period. Each brand is reflected separately and the consolidated group results are also determined.

Fig. 3.9 shows the results of table 3.7 in a graphical format. This type of reporting commenced with all applications approved in October 2001 and every successive month thereafter up to August 2002. Each period, for example, period 01 consists of accounts approved in October 2001 and their status 9 months later, July 2001(first line in table 3.7). In fig.3.9 the percentage of accounts in cycle 1 nine months after approval is generally around 84%. A benefit of this type of reporting is that if performance in a particular month is below the norm, a reason can be associated with a particular occurrence in the credit granting nine months earlier.

Table 3.9 Scorecard Accept / Decline Analysis

Month	Accept					Reject					
	Auto Pass	Cancelled	NBG'd	Sub-Total	%	Cancelled	NBG'd	Overrides	Rule Based	Sub-Total	%
07/06/2003	20,481	1,214	12	**21,707**	**65.28%**	28	6,700	4,196	623	**11,547**	**34.72%**
07/05/2003	17,675	999	20	**18,694**	**65.61%**	76	5,765	3,325	634	**9,800**	**34.39%**
07/04/2003	18,157	1,104	28	**19,289**	**64.45%**	31	6,152	3,763	692	**10,638**	**35.55%**
07/03/2003	14,947	933	12	**15,892**	**64.36%**	33	5,087	3,096	586	**8,802**	**35.64%**
07/02/2003	15,961	1,082	12	**17,055**	**66.34%**	32	5,051	2,995	577	**8,655**	**33.66%**
07/01/2003	32,711	1,486	23	**34,220**	**67.39%**	54	8,640	5,529	2,334	**16,557**	**32.61%**
07/12/2002	25,192	1,140	19	**26,351**	**63.44%**	27	6,776	4,231	4,151	**15,185**	**36.56%**
07/11/2002	19,942	982	11	**20,935**	**63.80%**	42	6,610	2,967	2,258	**11,877**	**36.20%**
07/10/2002	15,315	842	14	**16,171**	**60.26%**	46	5,808	2,834	1,976	**10,664**	**39.74%**
07/09/2002	17,222	1,009	14	**18,245**	**60.37%**	73	6,144	3,431	2,331	**11,979**	**39.63%**
07/08/2002	15,835	1,040	10	**16,885**	**56.04%**	50	6,775	3,552	2,866	**13,243**	**43.96%**
07/07/2002	15,147	980	8	**16,135**	**53.14%**	58	7,322	3,893	2,958	**14,231**	**46.86%**
07/06/2002	18,006	1,174	8	**19,188**	**55.48%**	79	7,076	4,089	4,151	**15,395**	**44.52%**
07/05/2002	16,415	1,263	7	**17,685**	**54.76%**	12	7,076	3,553	3,970	**14,611**	**45.24%**
07/04/2002	15,462	1,139	11	**16,612**	**56.59%**	58	6,377	2,558	3,749	**12,742**	**43.41%**
07/03/2002	15,361	1,087	12	**16,460**	**54.53%**	70	5,931	1,617	6,105	**13,723**	**45.47%**

Period	BRAND 1			BRAND 2			BRAND 3			BRAND 4			BRAND 5			GROUP		
	00-01	02	03+	00-01	02	03+	00-01	02	03+	00-01	02	03+	00-01	02	03+	00-01	02	03+
Oct 2000 to Jul 2001	90.31%	4.73%	4.96%	90.76%	3.54%	5.70%	89.72%	4.09%	6.19%	87.86%	4.20%	7.94%	79.72%	5.93%	14.35%	85.91%	4.79%	9.30%
Nov 2000 to Aug 2001	92.06%	2.93%	5.01%	91.71%	3.72%	4.56%	89.23%	4.67%	6.09%	88.07%	4.54%	7.40%	81.08%	5.84%	13.08%	86.07%	4.92%	9.01%
Dec 2000 to Sep 2001	93.12%	2.42%	4.47%	91.35%	4.27%	4.38%	89.75%	4.40%	5.85%	87.85%	5.06%	7.08%	80.94%	6.76%	12.30%	86.38%	5.27%	8.35%
Jan 2001 to Oct 2001	93.96%	2.61%	3.42%	92.03%	3.86%	4.11%	88.64%	4.42%	6.94%	88.74%	3.86%	7.40%	78.43%	6.52%	15.04%	85.77%	4.84%	9.39%
Feb 2001 to Nov 2001	93.31%	3.14%	3.55%	90.28%	3.56%	6.15%	87.97%	4.66%	7.38%	88.94%	4.02%	7.03%	77.88%	6.55%	15.58%	84.64%	5.11%	10.25%
Mar 2001 to Dec 2001	92.05%	3.49%	4.46%	89.48%	4.33%	6.19%	86.35%	6.21%	7.44%	85.94%	4.58%	9.48%	75.87%	8.40%	15.73%	82.56%	6.49%	10.95%
Apr 2001 to Jan 2002	91.54%	3.38%	5.08%	89.76%	5.28%	4.95%	86.33%	5.27%	8.40%	86.70%	5.20%	8.09%	75.98%	7.60%	16.42%	83.21%	5.95%	10.84%
May 2001 to Feb 2002	88.87%	4.87%	6.26%	89.11%	4.50%	6.39%	84.90%	6.04%	9.06%	85.06%	5.18%	9.76%	73.64%	8.34%	18.02%	81.07%	6.59%	12.34%
Jun 2001 to Mar 2002	88.78%	4.76%	6.46%	90.46%	4.71%	4.83%	84.96%	5.78%	9.27%	84.58%	5.79%	9.63%	73.61%	8.35%	18.05%	81.19%	6.62%	12.19%
Jul 2001 to Apr 2002	89.95%	3.81%	6.24%	88.69%	4.40%	6.91%	84.82%	5.35%	9.82%	84.04%	6.25%	9.71%	71.42%	8.51%	20.06%	80.27%	6.52%	13.21%
Aug 2001 to May 2002	89.04%	3.54%	7.42%	88.30%	4.96%	6.74%	84.44%	4.96%	10.60%	85.86%	4.83%	9.31%	71.64%	7.43%	20.92%	80.69%	5.71%	13.60%
Sep 2001 to Jun 2002	92.16%	2.79%	5.05%	90.36%	3.98%	5.67%	86.79%	5.12%	8.08%	88.56%	4.52%	6.93%	77.41%	7.94%	14.65%	84.56%	5.71%	9.73%
Oct 2001 to Jul 2002	90.94%	3.42%	5.63%	90.32%	4.09%	5.59%	87.40%	4.76%	7.85%	89.18%	4.14%	6.68%	78.46%	6.36%	15.18%	84.92%	5.08%	10.01%
Nov 2001 to Aug 2002	90.83%	3.09%	6.07%	91.18%	4.35%	4.47%	86.66%	4.73%	8.61%	88.62%	4.16%	7.22%	78.01%	6.85%	15.14%	84.44%	5.24%	10.32%
Dec 2001 to Sep 2002	91.89%	3.55%	4.56%	90.91%	3.79%	5.31%	88.10%	4.00%	7.90%	89.67%	3.76%	6.58%	80.61%	6.73%	12.66%	86.07%	4.93%	9.00%
Jan 2002 to Oct 2002	92.04%	2.94%	5.02%	90.01%	4.75%	5.24%	87.09%	4.45%	8.45%	87.63%	4.01%	8.35%	78.26%	5.90%	15.84%	84.94%	4.71%	10.35%
Feb 2002 to Nov 2002	91.39%	4.15%	4.46%	88.54%	6.30%	5.16%	85.61%	5.58%	8.80%	87.41%	4.77%	7.83%	79.33%	6.47%	14.20%	84.16%	5.71%	10.13%
Mar 2002 to Dec 2002	90.97%	2.80%	6.23%	89.12%	5.49%	5.38%	86.09%	5.47%	8.44%	85.87%	5.03%	9.10%	78.90%	6.55%	14.55%	84.22%	5.50%	10.27%
Apr 2002 to Jan 2003	90.93%	4.03%	5.04%	87.21%	5.39%	7.39%	84.47%	5.59%	9.93%	83.66%	5.51%	10.83%	78.94%	6.40%	14.65%	82.81%	5.76%	11.43%
May 2002 to Feb 2003	89.64%	3.72%	6.64%	86.70%	4.98%	8.33%	83.64%	5.83%	10.52%	83.56%	6.07%	10.37%	77.13%	6.91%	15.96%	81.90%	6.04%	12.06%
Jun 2002 to Mar 2003	91.11%	3.16%	5.73%	85.83%	5.73%	8.45%	84.16%	5.58%	10.27%	82.87%	5.96%	11.17%	77.11%	6.36%	16.52%	81.92%	5.74%	12.35%
Jul 2002 to Apr 2003	91.92%	3.23%	4.85%	85.42%	5.26%	9.33%	82.14%	6.59%	11.28%	82.50%	6.27%	11.23%	75.05%	6.98%	17.97%	80.56%	6.31%	13.13%
Aug 2002 to May 2003	91.18%	3.83%	4.99%	86.56%	5.27%	8.17%	83.44%	5.63%	10.92%	82.09%	5.85%	12.05%	77.70%	6.86%	15.44%	81.80%	5.98%	12.23%
Average	**91.22%**	**3.50%**	**5.29%**	**89.31%**	**4.63%**	**6.06%**	**86.20%**	**5.18%**	**8.61%**	**86.32%**	**4.94%**	**8.75%**	**77.27%**	**6.98%**	**15.75%**	**83.48%**	**5.63%**	**10.89%**

Table 3.10 9 Month Window Performance Analysis

ANALYSIS OF CREDIT GRANTING

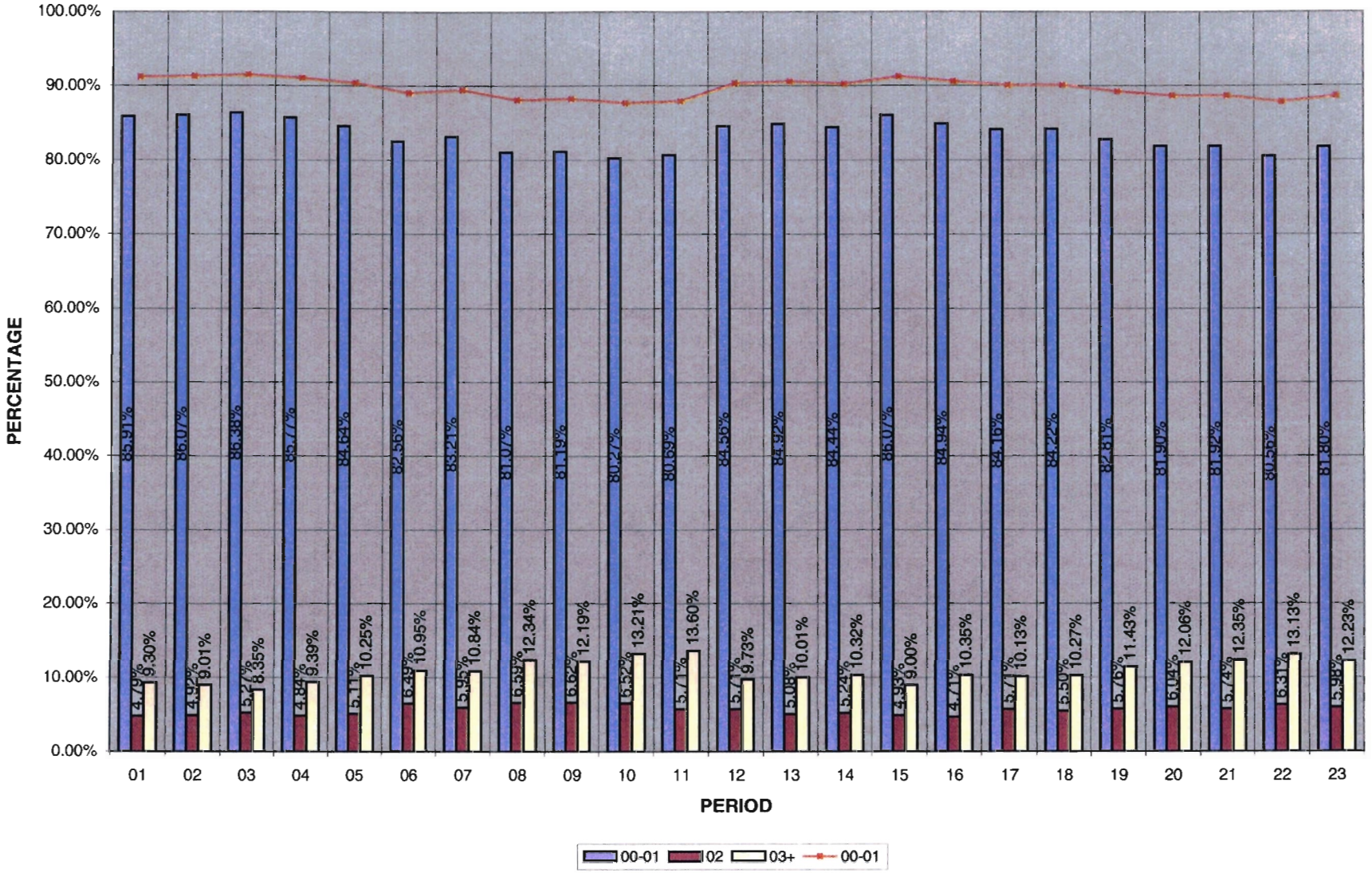


Fig 3.8 9 Month Performance Graphed Analysis

3.6.4.3 A Credit Bureau Scorecard

In March 2001, Relyant introduced the usage of a bureau score as part of the credit granting process.

The methodology is essentially the same as an application scorecard in terms of development, however the interpretation is that it is more a behaviour score, as the score calculation is dynamic in that it is constantly recalculated based on the performance of an individual, based on their performance in respect of the status supplied and housed on the credit bureau's database. The score is typically based on

- Demographic information
- The number of credit enquiries of a person
- The payment profile of existing accounts with subscribers to the bureau
- Whether there is any adverse information on the bureau

The score is predictive in terms assessing risk and the greater the score the lower the risk.

The approach taken by Relyant, in terms of introducing the use of a bureau score, was to overlay the decision outcome based on the policy rules and the brand application scorecard with a bureau score, hence strengthening the decision making process and introducing consistency in the process of overriding scorecard reject outcomes. An example of this application is that if an application did not meet the application score cut-off, it could be accepted if the bureau score exceeded a particular bureau cut-off score.

This resulted in a revised credit granting process flow with the pillars of credit granting comprising:

- Policy Rules
- Application Scorecard s
- Credit Bureau scorecard

The impact of the introduction of the above automated credit assessment decision making is reflected in the following Relyant debtors' book statistics published in the Relyant Retail Annual Report of 2002.

Table 3.11 Relyant Debtors Book Statistics

	2002 %	2001 %	2000 %	1999 %
Total debtors provision (% of gross)	30.9	19.2	21.4	26.0
Total Arrears	13.9	16.4	19.5	26.9
Ageing of Debtors Book				
Less than two installments in arrears	79.7	75.0	73.4	56.7
Two to six installments in arrears	12.3	11.3	11.9	20.6
More than seven installments in arrears	8.0	13.7	14.7	22.7

3.6.5 Account Management

As mentioned under 3.10.3 that after the merger in 1998, the collection of delinquent debtors were predominantly under store control with only the seriously delinquent debtors (cycle 13 months and greater) being collected from the two Central Credit Offices (CCO's), one in Benoni and one in Durban. During the course of 1999, a third CCO was opened in Cape Town as result of the efficiency and success beginning to be displayed by the two CCO's.

At the end of 1999, it was decided to increase the volume of accounts being collected centrally and it was agreed that the CCO's would now collect accounts that were in cycle's delinquent 7 and greater. Whilst this was an improvement, it still was not ideal, as accounts should be collected from earlier stages of delinquency from a central environment. This

decision was not well received by senior operations management within the brands, as they were reluctant to relinquish control, however due to cost pressures they agreed to this decision

By the middle of 2000, there was a further decision to allow accounts at much earlier stages of delinquency (cycles delinquent 3 and greater) to pass to the CCO's for collection and in addition to this there was a monthly transfer of delinquent accounts from the stores to the CCO's, based on a prescribed business rule. Whilst the bulk of the debtors' book was still controlled by the stores from a collections point of view, the move towards centralisation had commenced.

3.6.5.1 The Introduction of TRIAD

In June 2001, a decision was made by Relyant to acquire the TRIAD Adaptive Control software. The implementation of TRIAD is typically a large project taking between 12 and 18 months to install. The implementation of TRIAD commenced in November 2001 and went live in October 2001 with the collections module, 11 months after the implementation process commenced.

The introduction of TRIAD proved to be a significant milestone in the history of Relyant.

- **TRIAD, a Breakthrough to Innovation**

  TRIAD can best be described as sophisticated, business intelligence software, used as a vehicle to drive customer account management. TRIAD was first introduced in South Africa by fashion retailers. About nine years ago, the Foschini Group was the first company to introduce the TRIAD adaptive control software into their business. They were followed shortly thereafter by Truworths. Other retailers to also implement the TRIAD software at a later stage were Woolworths and Edcon. The only major bank to introduce TRIAD within their business is ABSA.

By Relyant implementing TRIAD into their business, meant that they were the first furniture retailers to introduce such innovative software, giving them access to a sophisticated account management system.

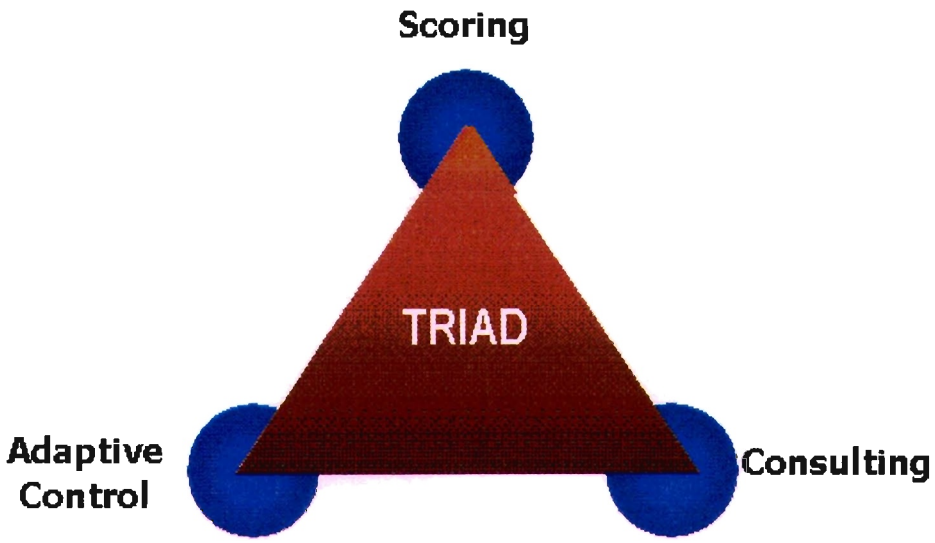
- **TRIAD Functionality**

  The TRIAD account management system, developed by Fair, Isaac which is a leading American risk software development organisation, specialising in risk related software, products, services and consulting, encapsulates most of the sophistication covered in chapter 2 with regard to predictive analytics, data mining and segmentation.

  The software comprises the following three fundamental pillars and hence the name TRIAD:

  - Scoring
  - Adaptive Control
  - Consulting

Fig 3.9 TRIAD Functionality



SCORING

- 3 Behaviour Scorecards
- Predictive capabilities of risk and delinquency levels

ADAPTIVE CONTROL

- Taking the appropriate action at the appropriate time
- Strategy setting based on segmentation as well as a number of timed actions
- Flexible "front-end" PC Table Maintenance System that allows user control of strategy design Software design

CONSULTING

- Access to best practice consulting
- Strategy development
- Analysis of results
- Champion / Challenger testing

Scoring:

This feature embraces the power of predictive analytics in that it comprises three behaviour scorecards. The scores that are delivered are behaviour scores in that their computation is based on predictive characteristics relative to account payment behaviour. A separate scorecard calculates a score for cycles delinquent one, two and three separately, strengthening the power of the scorecards. Each customer is scored every month at the billing run and the score delivered is indicative of future payment performance. The underlying philosophy of scorecards is that past behaviour is indicative of future performance.

Adaptive Control:

This feature is driven by the segmentation capabilities of TRIAD. Through a process of decision tree filtering, common groups of accounts can be separated out, thus in a sense applying a principle of data mining so that suitable appropriate actions can be taken in respect of the different account groupings. This essentially ensures that the right action is taken at the right time, be in a collections environment or alternatively within the context of marketing.

An innovative feature is that a strategy or a campaign can be captured into Personal Computer Table Maintenance System (PCTMS) and uploaded into the TRIAD software for execution. This is a significant innovation in that it gives users a great deal of flexibility in making changes and reduces reliance on the IT department and hence more control in the hands of the risk department.

Consulting:

The benefit of TRIAD is that a part of the investment includes access to best practice consulting from specialist strategy consultants. They play an important role in strategy design and the testing of strategies before implementation. They also assist with evaluating the success of strategies and designing champion/challenger strategies to ensure incremental and continuous improvement.

3.6.5.2 The Application of TRIAD

It is important to cover the application of TRIAD on a high level in order to be able to put its relevance into context in relation to the theory of customer lifecycle account management as covered in chapter 2.

- **Fundamentals of Strategy Design**

  Fig.3.11 consists of a schematic representation of the fundamental features of a TRIAD strategy.

  The strategy is based on a decision tree approach to identifying separate groups of accounts, on the basis of segmentation, in order that specific actions can be applied to each of the separate groups.

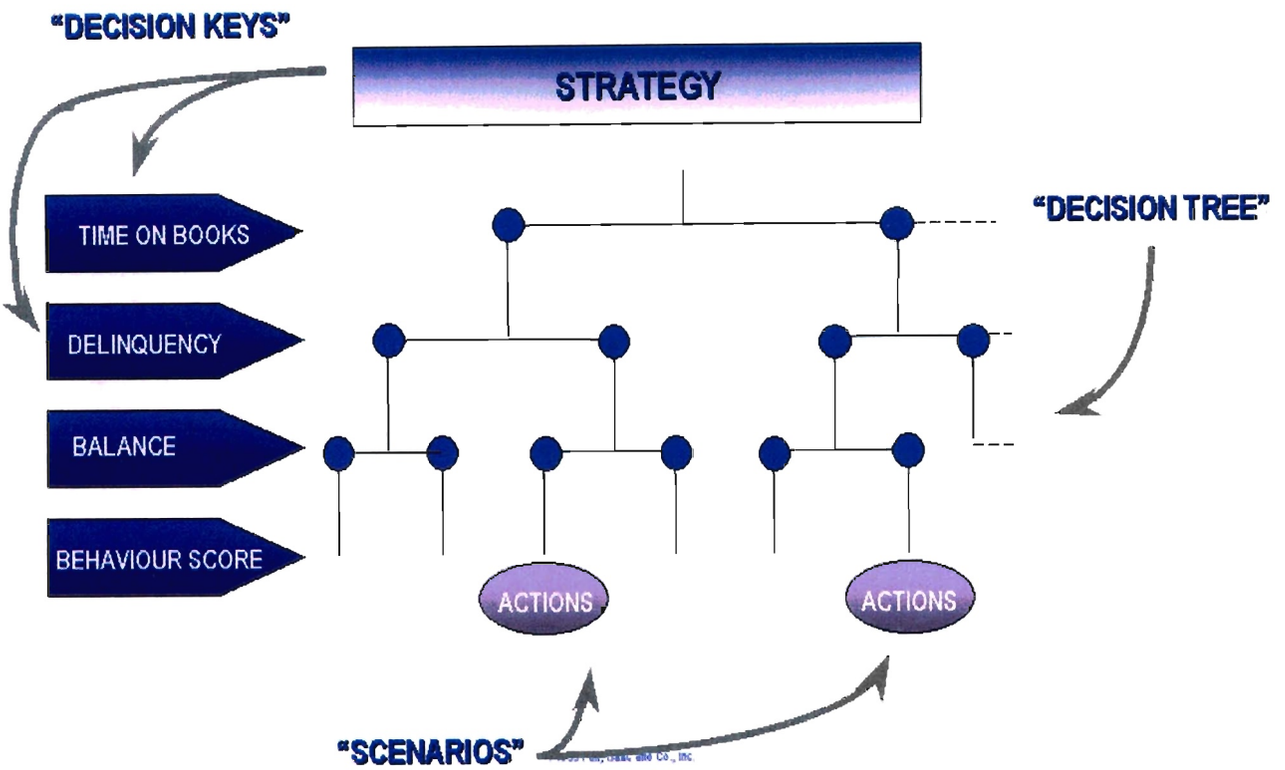
  The decision keys determine the basis upon which the segmentation must be done as well as the order in which it must occur.

  The segmentation can be based on predetermined breaks. For example, for the decision key "balances", rand value breaks can be used such as R 100 to R 2 999 and then R 3 000 to R 4 999 and so on.

  At the end of each grouping, pre determined actions can be specified and these are referred to as scenarios.

  A strategy can thus be summarised as a process of segmentation applying a filtering process based on specified criteria in a particular sequence.

Fig 3.10 TRIAD Strategy Features



- **A Sample Strategy**

  Fig 3.12 consists of a schematic representation of a sample collections strategy.

  The structure of the strategy has already been discussed up to the different groups of accounts right at the end where appropriate action can be predetermined (blocks in red)

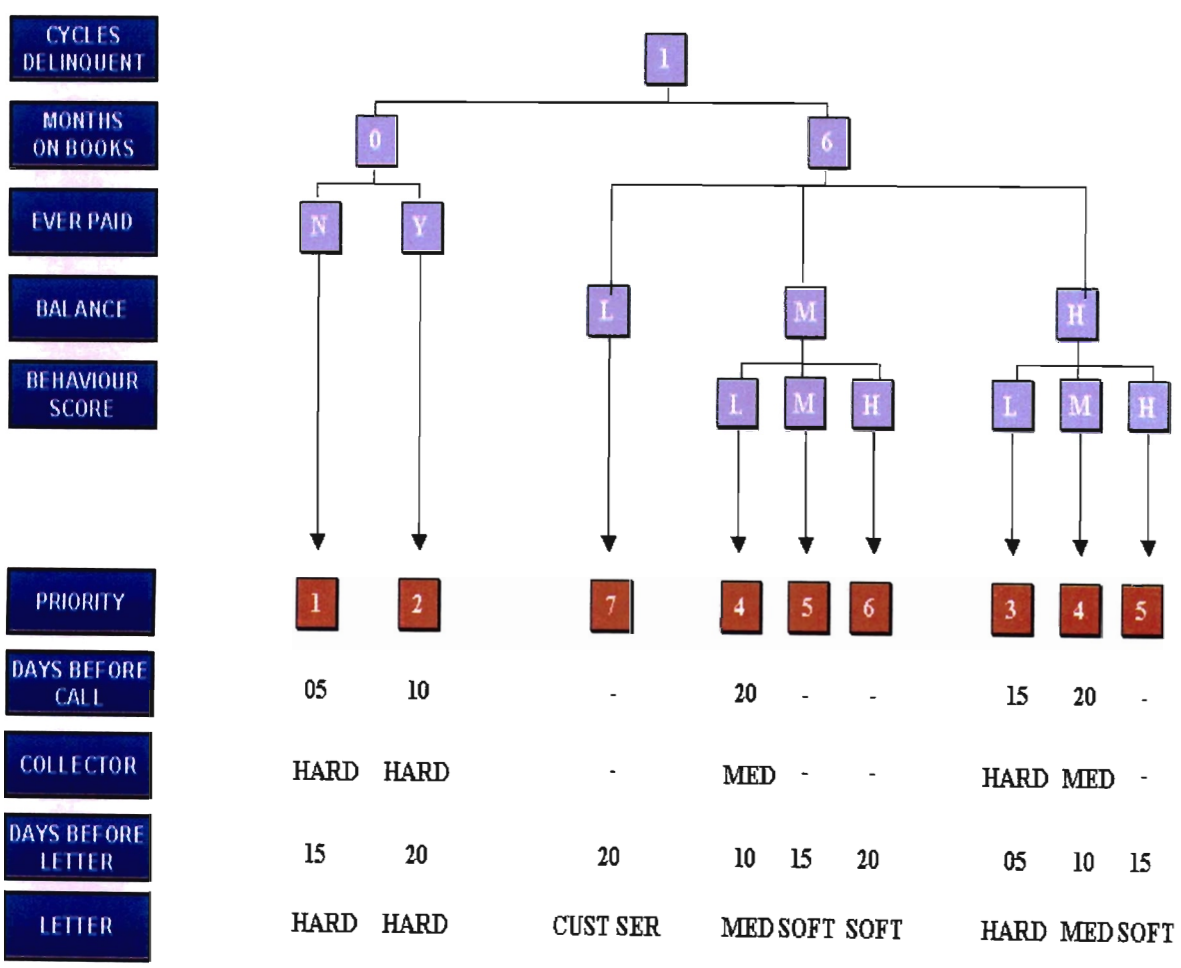
  The numbers in the blocks in red relate to priority of actions and the order in which the groups must be actioned. This introduces the functionality of tilted actions.

  The numbers alongside "days before call" specify when the prescribed actions must be taken, hence introducing the functionality of timed actions.

The description "hard or medium" alongside collector indicates the nature of the action required, meaning whether the tone of follow up must be mild, medium or harsh. This introduces the functionality of the tone of the follow up process.

Apart from the properties of predictive analytics, data mining and segmentation, TRIAD also has the functionality of timed actions with the added capabilities of tilting the actions and regulating the tone of the actions. This is precisely in accordance with the theory of taking the right action, for the right person, at the right time through the right channel.

Fig 3.11 TRIAD Sample Strategy



3.6.5.3 Risk-Based Marketing

Since its inception, Relyant has not adopted a risk-based approach to marketing strategies or marketing campaigns.

The predominant approach to marketing has been by means of:

- Direct Marketing; and
- General Marketing

General marketing has typically taken the form of T.V. advertising, radio advertising and press and magazines.

Direct marketing has generally been in the form of the procurement of mailing lists in terms of sourcing new business. The following mediums have been used with regard to mailing.

- Catalogue campaigns; and
- Leaflets

In terms of sourcing repeat business from existing or paid up customers, the above two approaches are also used. In addition to this the following methods are applied.

- Statement messages; and
- Statement inserts or stuffers
- It is interesting to note that of Relyant's business generated, approximately 50% is repeat business.

- **Risk-Based Marketing and TRIAD**

  Given the capabilities of TRIAD in terms predictive analytics, data mining and segmentation, it has the power to make a significant contribution towards revenue generation, with acceptable risk levels, particularly in light of the fact that 50% of revenue is from repeat business. The investment in TRIAD included the Marketing Communications module and will make a significant contribution towards risk-based marketing.

3.7 Recent Events at Relyant

According to the Relyant Annual Report 2002, the most important development in Relyant's history was the capital restructuring just completed prior to its 2002 financial year-end, which significantly reduced gearing. This event saw the introduction of POCO, a German investor who acquired a significant shareholding. This was realised through a R790 million recapitalisation programme effected by way of a rights issue and a cash injection of more than R300 million by the German investor.

3.8 Conclusion

Against the background of the way in which Relyant was formed, it was always going to be a challenging task to propel the company to financial and operational success.

The on going restructure programmes involving store closures and brand rationalisation as well as the drive to constantly reduce costs did not allow for value creating initiatives to be explored. The trading problems experienced, coupled with the overtraded nature of the furniture industry also did not provide an appropriate environment conducive for growth.

The exorbitant restructure costs, the acquisition of the Renaissance Group, as a means to strategically reposition the group with portfolios having a balance between cash and credit and the foray into micro loans placed enormous pressure on cash flow and in 2002, the level of borrowings rose to the point where it could not be sustained without a substantial injection of funding.

Given the above, an important strategy that was pursued was innovation in the arena of credit management and the introduction of automated decision systems in the form of application scorecards and the TRIAD adaptive control account management software. This, in addition to a move towards cetralisation affords Relyant an opportunity to differentiate itself from its competitors

Chapter 4 Evaluation

4.1 Introduction

In evaluating the strategic path followed by Relyant, it is important to view this against the backdrop of how Relyant was formed in 1998 as well as the prevailing external environmental conditions and the trading conditions experienced by the furniture retail industry during this period.

Given the fact that Relyant resulted from a merger between two separate furniture companies, Amrel and Beares as covered in chapter 3, there were numerous issues to address and on account of this; the company faced many restrictions in terms of making strategic choices. A significant constraint faced by Relyant since inception was the high level of borrowings and on account of this experienced extremely low levels of financial flexibility and indeed significant financial risk. In addition to this the industry has been affected by slow economic growth and a static sales trend in durable and semi-durable goods. The CEO's report in the 1999 Annual Report commented on declines in private consumption expenditure of 6,5% and 8,3% for the final two quarters of 1998 and also declines of 14,5% and 13,7% for the first two quarters of 1999. "Stats SA for December 2002 show household furniture had the largest seasonally-adjusted decline in retail sales in the fourth quarter of 2002 at 7,1%, while audio appliances dropped 3,5%." (Business Day, April 2003).

The approach in chapter 4 is to evaluate the fundamental corporate-level strategies adopted by Relyant in terms of suitability and to focus on the credit excellence strategy and explore how this can be progressed to an overall customer relationship life cycle comprehensive strategy, linking this to the related theory in chapter 2.

4.2 Relyant Corporate-Level Strategy

The predominant strategies driven by the Relyant senior management since inception were:

- A restructure programme
- Being a low-cost retailer
- The strategic repositioning of the brands
- A focused credit management strategy

4.2.1 The Restructure Programme

The fundamentals of this strategy entailed the closure of numerous stores, and warehouses. It also included wide-scale retrenchments. The initial restructure programme, over the first two years of Relyant's existence in 1998 and 1999 included the closure of 140 stores and 60 warehouses. It also included the retrenchment of 2 500 people.

This strategy of restructuring the business did not end in 1999, and over the next two years there were more store closures and further retrenchments, although not on the same scale as the first two years.

4.2.2 A low-cost Retailer Strategy

This strategy entailed a constant drive to reduce the overall cost-base of Relyant. In certain respects it was an extension of the restructure-programme strategy. A fundamental component of the strategy was the implementation of a group-wide productivity programme as well as the implementation of an Activity Based Costing project.

Another aspect of this strategy was the rationalisation of certain furniture brands. A number of former Beare Group brands such as Furniture Mart, Bargain Shop and Target were done away with and a former Amrel brand, Melody's, was also done away with. Another cost related decision was to consolidate two of the brands under one management team, whilst retaining the two separate brand identities.

4.2.3 Strategic Brand Repositioning

This strategy adopted a two-pronged approach. The first approach was to reduce the number of furniture retail brands from 13 to 7. Following on a research project conducted by a consulting group, the rationalisation of

brands was completed with the view to focusing the respective brands on their target market segments in order to improve their competitive position in the marketplace.

The second approach was to reposition Furniture City in the Value Retail Division (as covered in chapter 3) and to rebrand it as "The Cities" incorporating Appliance City (acquired) and Sleep City. Part of this strategy was the acquisition of the Renaissance Group thus giving Relyant access to cash based brands such as Glicks Furnishers, Dial-a-Bed, Mattress Factory and Bruce the Bed King, hence making up the balance of the Value Retail division. A further aspect of the brand repositioning strategy was the consolidation of two brands, Savells and Fairdeal to form a single brand Savells/Fairdeal with one management team, hence benefiting from synergies and critical mass.

4.2.4 A Focused Credit Management Strategy

This strategy was covered in great detail in chapter 3. The salient aspects of this strategy are;

- The introduction of brand specific, empirically derived application scorecards;
- The introduction of the empirica, credit bureau risk score in the credit granting process;
- The fully automated credit granting decision making process.
- The introduction of a centralised credit granting facility to deal with the referral of applications declined by the automated process,
- The introduction of the TRIAD adaptive control software with all the automation and innovation that it introduces to the account management process, specifically delinquent collections in the case of Relyant.
- As a result of the introduction of TRIAD, a concerted move towards centralisation of collections has taken place within Relyant, representing a significant departure from the status quo immediately after the merger.

A crucial observation with regard to the credit management strategy is the move towards innovation and technology representing a significant paradigm shift within furniture retail culture and presenting an avenue towards achieving competitive advantage.

4.3 Evaluation of Relyant Corporate-Level Strategy

An appropriate way to analyse Relyant's corporate-level strategies is to apply the principles of suitability with regard to life cycle analysis and portfolio analysis.

"Suitability concerns whether a strategy addresses the circumstances in which an organisation is operating" (Johnson and Scholes 1999:355). Assessing the suitability of strategic options can be a useful basis on which to screen options before more detailed analyses are undertaken concerning the acceptability and feasibility of those options.

According to Johnson and Scholes (1999), a fundamental step is establishing the rationale for each strategic option. This is directly related to issues around strategic choice as it entails:

- Whether the option exploits opportunities in the environment and avoids threats;
- Whether it capitalises on the firm's strengths and core competences and avoids weaknesses;
- Whether it addresses the cultural and political context.

"Life cycle analysis assesses whether a strategy is likely to be appropriate given the stage of the product life cycle" (Johnson and Scholes 1999: 356). The life cycle/portfolio matrix consists of two dimensions and compares the evolutionary stage of the market situation and the competitive position relative to other players within the industry. This is illustrated in fig. 4.1

Fig. 4.1 The Life Cycle / Portfolio Matrix

COMPETITIVE POSITION	STAGES OF INDUSTRY MATURITY: Embryonic	Growth	Mature	Ageing
Dominant	Fast grow Start up	Fast grow Attain cost leadership Renew Defend position	Defend position Attain cost leadership Renew Fast grow	Defend position Focus Renew Grow with industry
Strong	Start up Differentiate Fast grow	Fast grow Catch up Attain cost leadership Differentiate	Attain cost leadership Renew, focus Differentiate Grow with industry	Find niche Hold niche Hang in Grow with industry Harvest
Favourable	Start up Differentiate Focus Fast grow	Differentiate, focus Catch up Grow with industry	Harvest, hang in Find niche, hold niche Renew, turnaround Differentiate, focus Grow with industry	Retrench Turnaround
Tenable	Start up Grow with industry Focus	Harvest, catch up Hold niche, hang in Find niche Turnaround Focus Grow with industry	Harvest Turnaround Find niche Retrench	Divest Retrench
Weak	Find niche Catch up Grow with industry	Turnaround Retrench	Withdraw Divest	Withdraw

Source: Johnson and Scholes 1999: 357

4.3.1 Relyant Relative to the Life Cycle/Portfolio Matrix

In terms of competitive position, whilst Relyant is not at the same financial and operational levels of performance as the industry major players, however, in terms of size and critical mass, it certainly is one of the larger furniture retail groups. The major players are Ellerines and the JD Group, who have proved to be steady performers, with none of them really standing out as being streets ahead of the rest of the furniture companies. In light of this, Relyant's competitive position can be classified as favourable.

In terms of the industry stage of maturity, the furniture retail industry is undoubtedly overtraded and there is a great deal of consolidation taking

place. Recently the JD Group acquired Profurn, also considered as one of the major players in furniture retail. In light of this the furniture retail industry can be classified as being in a mature stage.

Given the above, Relyant falls within the shaded grid of the life cycle/portfolio matrix. The strategic options in this grid are harvest, hang in, find niche, hold niche, renew, turnaround, differentiate, focus and grow with the industry.

In terms of Relyant's corporate-level strategy, it would appear that the strategic choices have been predominantly to pursue a turnaround strategy and also possibly a "hang in" strategy.

Given the ongoing restructure programme involving store closures and retrenchments as well as the low-cost retailer strategy, it would suggest a defensive strategy to ensure survival and to "hang in." In terms of suitability, the strategic choices have been appropriate, given the circumstances that Relyant was in given the background to the merger as described in chapter 3. In terms of rationale, the strategic choices were also relevant as Relyant clearly had to avoid threats of external market conditions predominantly on account of a drop in consumer demand, rising interest rates and the impact of the lottery and the gaming industry. The choices are also justified in terms of a concerning internal weakness, prevalent from the start of Relyant in the form of its high gearing position, making financial flexibility extremely restrictive and ruling out the possibility of an expansive strategy of growth.

The focused credit management strategy, with its move towards centralisation also supports a turnaround strategy in that this has resulted in significant cost saving, economies of scale, productivity and operational efficiencies.

However, criticism can be leveled at the brand repositioning strategy in terms of the acquisition of the Renaissance Group and the subsequent

creation of the Value Retail division. In terms of strategic choice theory, this decision can be classified as horizontal integration, a decision arising from a position of substantial internal strengths and numerous environmental opportunities, a position Relyant were certainly not in during 2001. In terms of strategic intent the approach was correct, however in term of timing it was incorrect.

The rationale for the creation of Value Retail was to "balance" the Relyant portfolios, reducing the dependence on credit sales and applying the underlying logic of the BCG model. From a portfolio analysis point of view, perhaps the thinking was for the Value Retail chains to move from question marks to stars and later being elevated to cash cows. In this way Value Retail could complement the chains in terms of cash flow and contribute towards addressing the gearing problem.

Whilst the restructure, low-cost and credit management strategies were appropriate in terms of suitability, Relyant can be criticized in terms of strategy implementation. An aspect that was lacking was a process of alignment of strategic objectives at lower levels of management and staff so that staff understood the organisational objectives as well as the rationale. What was also lacking was a process of change management, which was non-existent.

4.4 Challenges Facing Relyant

In an analyst report by Rod Salmon, writing in a Merrill Lynch investor paper, Relyant Retail's half year results to December 2001 was covered. The salient points were as follows:

- Headline Earnings Per Share (HEPS) decreased by 32% to R0.44 and no dividend was declared.
- The group will not achieve HEPS for the full year in line with the previous year and the forecast has been reduced by 20% to R0.66 for financial year 2002.

- The company has substantially increased the cash proportion of sales within business revenue from 18% last year to 33% in the above period, in line with stated strategy. (a result of the Renaissance acquisition)
- However, gearing has continued to increase and stands at 105% with debt rising to R1.04bn. An unsustainable level in the view of the writer.
- The likelihood of the business trading out of debt should the securitisation fail (a financing option Relyant were pursuing), will, in the view of the writer, be slim, particularly as interest rates are rising, unless Relyant goes through a massive rationalization programme, similar to that which Profurn needs.

In a subsequent report written by Darren Cohn dated 11 September 2002, for UBS Warburg, he writes about looming consolidation in the furniture industry, listing the following points:

- The SA retail furniture industry is in disarray: Relyant (rights issue) and Profurn (being acquired) are being recapitalised; JD Group (-3,7%) and Ellerines (+2%) produced disappointing HEPS growth and have seen their share prices depreciate 40% (JD Group) and 20% (Ellerines) this year.
- Industry profitability and balance sheets have been under pressure. With 85% to 95% of sales on hire purchase (HP), balance sheets are stretched growth is too rapid. The excessively competitive environment resulting from Profurn's aggressive expansion strategy has also eroded gross margins.
- Both JD Group and Ellerines are in the process of improving their debtors' systems. It is the belief of the writer that this is responsible for the stability of Ellerines' disclosed arrears to gross debtors at 24%. Similarly, the JD Group's arrears have improved from 17% in 2000 to 13% in 2001. The expectation is that there will be continued improvement in these systems which will positively affect arrears.

The UBS Warburg article also comments that Relyant grew its attributable profits from R4.8 million in its financial year to June 1998 to R31 million for 2001, 59% compounded annually. In 2002 the company increased its provisions by an abnormally large R241 million, which was partly responsible for it reporting a loss of R619 million in that year. This was also as a result of Relyant changing to an "arrears" debt recognition basis from "since paid".

As can be seen from the above analyst reports, the debtors' book and credit management is an integral part of organisational performance and financial success with regard to the furniture retail industry.

4.5 Transforming the Customer Relationship Life Cycle Model into Value Creating Strategy

Chapter 2 covered in great depth the component parts of a customer relationship life cycle model. The elements of this model included:

- Customer Data Management
- Customer Valuation
- Customer Marketing Management
- Customer Risk Management
- Customer Interaction Management

By integrating the elements of the above model into a strategic tool for creating value, a furniture retail company can differentiate from its competitors, not in terms of product development, but in terms of adopting a customer-centric focus. In this way the company can achieve competitive advantage in a competitive environment by leveraging its primary asset, its customer database.

An evaluation of the major players within the retail furniture industry indicates that there is very little difference in terms of:

- The markets they serve
- The geographic spread of their store locations
- The merchandise that they sell within the similar target market sectors
- The basis of their advertising
- The nature of their business structure (predominantly decentralised)
- Their financial offerings (predominantly instalment lending)

In addition to the above, the industry is overtraded in that most major players have a number of stores trading in the same towns resulting in competition within the enlarged companies as well as across companies. On account of intense rivalry and competition, operating margins are adversely affected and credit granting criteria often compromised.

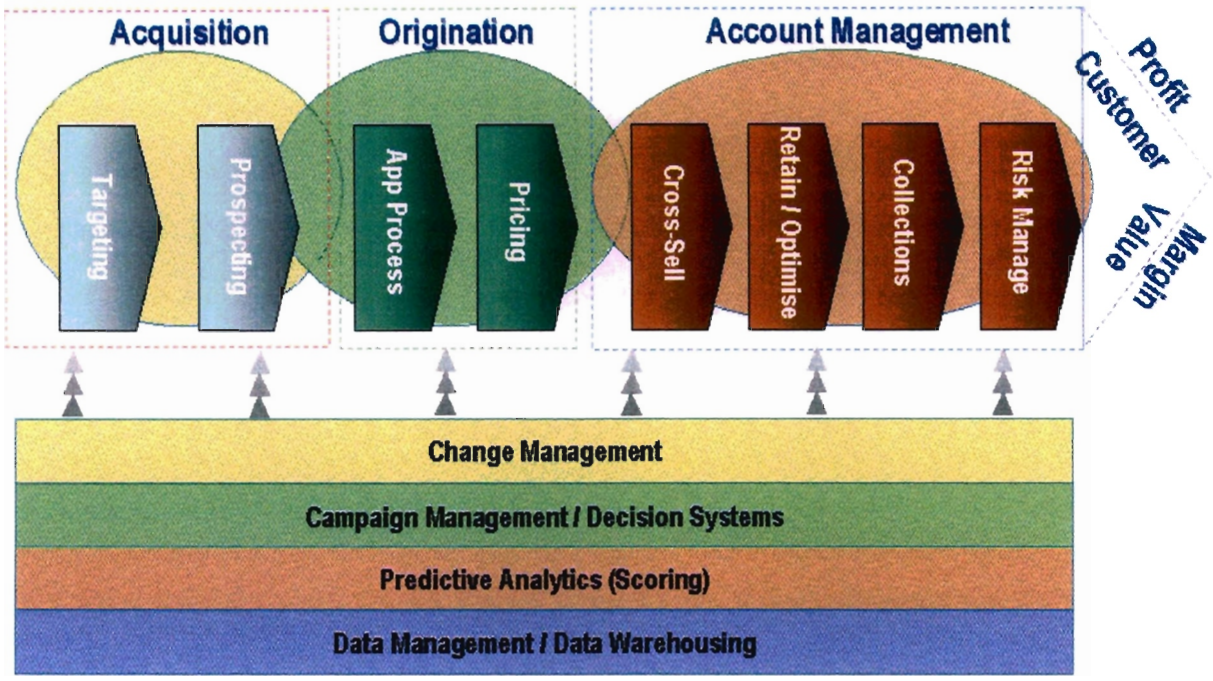
In light of the above, an organisation such as Relyant must seek to gain competitive advantage through differentiation, taking cognizance of the above industry similarities.

Given the sensitive nature of the debtors' book, both from an operational performance and investor perception point of view, the grand strategy of Relyant should embrace the principles of the customer differential which is " strategically attracting and developing a customer base" (Nykamp 2001).

4.5.1 The Customer Life Cycle Model within a Value Chain Methodology

By incorporating the component parts of the customer relationship life cycle model into a value chain strategy, the theory researched in chapter 2 can be implemented in a focused and practical manner.

Fig. 4.2 The Customer Life Cycle Value Chain



The value chain comprises two predominant sections namely:

- Primary or core activities; and
- Secondary or support activities

In terms of the primary or core activities, the following three divisions should constitute the core activities of the value chain:

- Account acquisition
- Account Origination
- Account Management

In keeping with value chain theory, the following aspects of the customer life cycle model should constitute the secondary or support activities.

- Data Management
- Predictive Analytics and Data Mining
- Decision Systems
- Change Management

4.5.2 The Primary Activities of the Value Chain Strategy

The structure of the links within each of the three divisions of the core activities of the customer relationship life cycle model should be as follows:

4.5.2.1 Account Acquisition

This division should comprise the following links which entail an automated approach to the customer marketing function:

Prospecting

The objective of this link should be to attract new business by way of data swaps and the procurement of marketing lists with other non-competitive organisations.

The offer should be made after a screening approach on the basis of a risk filtering process, which can entail the utilisation of a credit bureau score.

Targeting

The objective of this link is to target good performing repeat customers by utilising appropriate analytical tools. The TRIAD adaptive control marketing strategies embracing behaviour scores are extremely successful in this regard.

4.5.2.2 Account Origination

The links within this division, which deal with the automated process of credit applications and risk assessment should be as follows:

Application Processing

The requirement here is to have an efficient IT system to handle this, with the facility of all relevant data fields with appropriate validation checks and for the process flow to be comprehensive embracing policy rules, application scorecards and a dual matrix decisioning structure. It is imperative for the entire process to be fully automated.

Pricing

The requirement here is to have a facility to offer risk based pricing to low risk customers, driven by behaviour scores and data mining and segmentation capabilities, with the risk-based offers being flexible in terms of merchandise discounts or financing discounts. Once again, the process must be automated.

4.5.2.3 Account Management

This is an important division within the core business section as it spans across a number of links. This section of the value chain deals with the following critical areas.

Risk Management

This is a critical link within the overall model in that it drives the vision of the entire customer relationship life cycle model and also coordinates the activities of this portfolio. This entails ensuring that the appropriate building blocks of the overall value chain strategy are implemented in the correct sequence.

Follow-Up and Collections

This is a critical part of account management as it impacts on financial implications such as cash flow and bad debt provisioning. It can create positive investor sentiment if successfully handled and plays a major role in providing a solid foundation for future repeat business.

In this regard the TRIAD account management systems plays an integral part with its delinquent collections strategy design functionality. It also is instrumental in ensuring good customer relations are maintained in the follow-up and collections environment.

Retain/Optimise

This is a crucial link within the overall drive to ensure customer value. An important concept covered under customer value was that 20% of the customer base would generate 80% of the profits. The objective of this link

is to identify good performing customers who have a history of being profitable in terms of the extent of their purchases and their degree of risk, for repeat business.

Cross-Sell

This is an extremely important link to derive maximum benefit from leveraging the customer base. This also works extremely well in organisations that have a number of portfolios. On account of the aspirational nature of consumers, cross- selling affords organisations the opportunity to cross-sell and up-sell within their overall customer base, thereby retraining good customers and maintaining market share.

4.5.3 The Secondary Activities of the Value Chain Strategy

The support activities of the value chain strategy should be as follows:

Customer Data Management

As covered in chapter 2, the entire customer relationship life cycle model is dependent upon customer databases and data warehouses, ensuring that techniques of predictive analyses, data mining and segmentation can be executed. These techniques form the basis of decision-making and if the data is not available, accessible or accurate, then the wrong decisions will be made.

Predictive Analytics and Scoring

The philosophy of application scoring, behaviour scoring, response modeling and attrition modeling all revolve around predictive analytics capabilities. This is an essential building block in creating customer value.

Campaign Management and Decision Systems

This requires having access to business intelligence software such as TRIAD and application decision systems. The functionality of this type of software is that it empowers organisations to implement pre-determined strategies with adaptive control capabilities and as a result automate the data mining process and implement and execute strategies in conjunction

with third party fulfillment agencies. An added benefit is the degree of flexibility as the Risk Portfolio is not dependent on IT for software development and can implement changes with a large degree of autonomy.

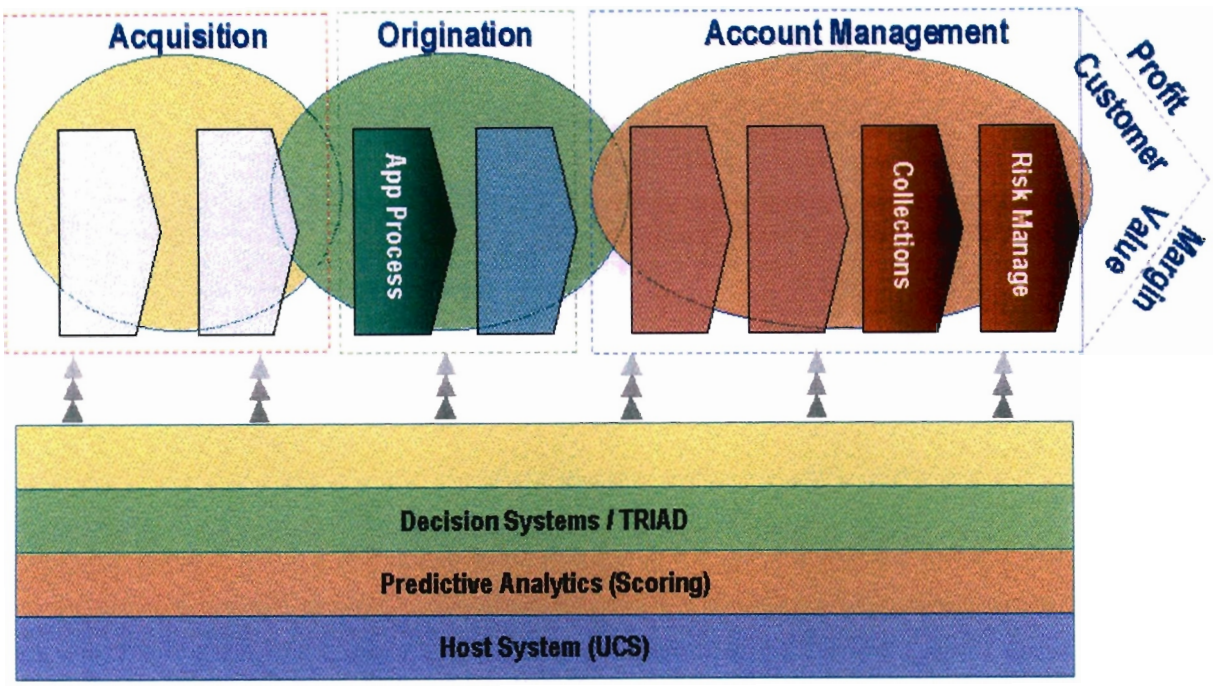
Change Management

The risk management portfolio forms an integral part of the overall business structure and as such has to interface with other departments such as IT, marketing and operations. This portfolio also has to influence the introduction of technology and innovation. This invariably represents a paradigm shift and a change in culture. On account of this, new technology and innovation can only be embraced if there is a process of communication, education and change management.

4.6 Relyant's Position relative to the Value Chain Strategy

Whilst Relyant has embarked on a process of implementing aspects of the value chain strategy, it still has a long way to go in order to reach a stage whereby the entire value chain strategy would be fully implemented. The position that Relyant is in is represented in Fig. 4.2.

Fig. 4.3 Position of Relyant



4.6.1 The Current Position of Relyant

In evaluating Relyant's existing position with regard to the value chain strategy, there are aspects of the primary activities as well as the support activities already in place and these are as follows"

4.6.2 Primary Activities

The status within Relyant is in this regard is:

4.6.2.1 Account Acquisition

There are no linkages in place within this component of the core activities. Relyant does not have a strategic approach in place in adopting a risk-based strategy to prospect new business and target existing business. However, with the acquisition of TRIAD, they will be in a position to implement this.

4.6.2.2 Account Origination

With regard to account origination, Relyant has the application processing linkage in place but not the Pricing link.

Application Processing

Relyant's application processing is fully automated and the decisioning process entails policy rule checks, and application scoring as described in chapter 3. These two processes are overlaid with the utilization of a credit bureau score to strengthen the decision-making process. An area of weakness, however, is on account of the decentralsed business structure, there are data capture problems causing data integrity problems.

4.6.2.3 Account Management

Relyant has made considerable progress, in relation to the rest of the retail furniture industry, with regard to this component of the core activities within the value chain. The linkages currently in place are Risk Management and Collections

Risk Management

Relyant has embarked on the creation if a risk management portfolio at a corporate level. This portfolio has commenced setting a strategic vision embracing the introduction of technology, innovation and best practice. However, this function still needs to be formalized and progressed to the stage whereby there is an interface with other functions such as IT, marketing and operations.

Follow-Up and Collections

In terms of this linkage, Relyant has made tremendous strides and are clearly the industry leader. The three regional credit centres with their sophistication, together with the TRIAD account management software has given Relyant a competitive advantage. There is however opportunities for improvement by way of predictive dialer technology and automated staff performance and measurement systems.

4.6.3 Secondary Activities

In terms of secondary activities, Relyant has made considerable progress, relative to the proposed value chain strategy.

Customer Data Management

Relyant's debtors host system is driven by the software of the IT outsource partner, Universal Computer Software (UCS). Whilst it is suitable in terms of existing business requirements, in terms of databases and data warehousing as covered in the research of chapter 2 and the proposed model, it falls far short of what is required. This is undoubtedly an area that needs to be addressed in order to reap the benefits of the value chain strategy.

Predictive Analytics and Scoring

Whilst Relyant is relatively sophisticated in this regard, having access to application scoring and behaviour scoring, it still has a tremendous amount of progress to make in terms of acquiring "in-house" analytical software such as SAS or SPSS.

Campaign Management and Decision Systems

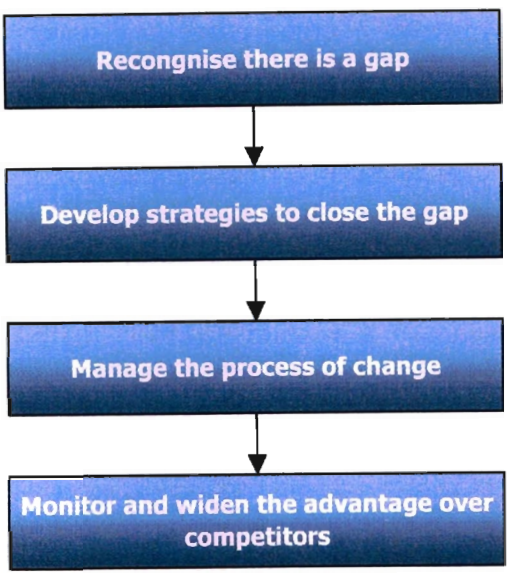
In October 2002, Relyant introduced the TRIAD account management system. This is an innovation in the retail furniture industry. Since implementation, TRIAD has been used predominantly in a collections environment. Whilst, it has the functionality for marketing campaigns in addition to collection campaigns, this has not been utilized as yet. TRIAD has the capacity to provide for seven different modules, though not all are relevant to furniture retail. This provides Relyant with a significant competitive advantage.

Change Management

As depicted in Fig.4.2 this support activity is non-existent in Relyant and as described under the value chain model, this is an integral part of the strategy as the acceptance of cultural change is a critical component of business success.

4.7 How to Bridge the Gap

Fig. 4.4 Gap Analysis Model



Source: Ambrosini (1998) : 221

By transforming the customer relationship life cycle model into a value chain strategy, it sharpens the focus of what Relyant must do to pursue a strategy of differentiation for competitive advantage, given the similarities of the retail furniture industry.

Within the context of the value chain strategy, the following areas within the core activities need to be addressed.

- **Account Acquisition**

  Relyant needs to address putting in place a risk-based approach to customer marketing, embracing the principles of automation. This must address soliciting new business by way of data swaps with other retailers and marketing data base companies. Relyant also needs to implement strategies to adopt a data mining and segmentation approach to identifying good repeat business. This is especially on account of the fact that its level of repeat business is around 50%.

- **Account Origination**

  Primary approach here is to address its application processing system in terms of data validation as well as the system architecture. The distributed system does not lend itself to a 360-degree view of a customer's performance profile. A strategy to consider at a later stage is the ability to pursue risk-based pricing marketing offerings.

- **Account Management**

  The challenges facing Relyant in this area are twofold. Firstly, a strategy that must be prioritised is the generation of low-risk repeat business. Relyant has a wonderful opportunity to leverage this benefit. A second strategy that has to be pursued is the introduction of cross-selling across portfolios. A great deal of benefit can be derived from this, however a culture of resistance to this initiate must first be addressed.

- **Support Activities**

  With regard to the support activities in the value chain, the predominant areas of focus are data base management/data warehousing and change management.

  The existing IT system in Relyant is cumbersome in terms of it structure and architecture and as a consequence, effective data base management and data warehousing in terms of the theory covered in chapter 2 far from ideal. This presents numerous constraints with regard to the application of predictive analytics and business intelligence software.

  An extremely crucial aspect of managing the process of closing the gap is change management. This requires a carefully orchestrated programme embracing the principles of change management driven by human resources with the input of the risk department.

4.8 Conclusion

The evolution of strategic choices made by Relyant appears to have been based predominantly on a "hang in" philosophy as well as a simultaneous approach of turnaround strategy. In terms of the background to the formation of Relyant, the company's beginning was off a high cost structure as well as high levels of borrowings. The strategic choices, in terms of suitability, were appropriate given the fact that Relyant was competing with large, stable and well-established opposition companies in the form of Ellerines and the JD Group. In addition to this, the life cycle of the retail furniture industry was at a mature stage and market conditions were far from ideal, given unemployment, volatile interest rates, declining consumer demand and inflation.

The initial strategy of a focused restructure programme and the pursuit of being a low-cost retailer achieved the desired objectives. The rationalisation of its brands and the exercise in refocusing the reduced number of brands on specific target market segments was successful and contributed towards significant cost reductions. Whilst this resulted in a positive effect on profitability, it did not lead to sustainable value creation, nor did it arrest the rising gearing levels. This problem was exacerbated by the acquisition of the Renaissance Group, as this did not achieve earnings growth, but instead placed additional strain on cash flow and as a result caused borrowings to rise to unsustainable levels with Relyant facing liquidity concerns. In 2002, Relyant had to initiate a recapitalisation programme, by way of a rights offer, whereby a German investor POCO took up a significant shareholding and financial institutions converted their debt to equity.

On a more positive side, one of the strategies implemented by Relyant was to pursue credit excellence. The underlying theme of this strategy was continuous improvement, driven by implementing quality systems and innovation. The success of this is evident in the performance of Relyant's debtors' book, which has drawn favourable reports from various investor

analysts. The milestones of the credit excellence strategy have also been covered in this chapter.

Having gone through the recapitalsation programme, the questions that the Relyant directorate now face must have to do with grand strategy selection going forward. In terms of Relyant's current position, it is still unable to pursue an aggressive expansive strategy, as it has to consolidate its position and chart a path of turnaround towards incremental sustainable value creation.

Chapter 5 Recommendations

5.1 Introduction

A report by Darren Cohn in a UBS Warburg report in September 2002 makes reference to a cash flow collapse after 1999 among furniture retail companies. According to the report, furniture retailers sell 90 – 95% of their goods on HP, with repayment periods of around 22 months. They finance the debtors themselves, and therefore they will typically absorb cash so long as their sales are growing. The writer goes on to attribute cash-flow strains to the following factors:

- Declines in profits caused by, for example, a fall in gross margin.
- Growth rates or credit terms that stretch balance sheet capacity.
- Deterioration of debtor quality.

The result of cash-flow strains, in turn leads to over-gearing. It is the opinion of the writer that because furniture retailers fund their HP sales using their own balance sheets they tend to consume cash within their working capital. This becomes more pronounced the faster they grow their sales.

A fundamental limitation within furniture retail is the lack of clarity of purpose in terms of retailing and financing. This is predominantly because of a need to grow sales and sales are financed by the business' own balance sheets. Whilst retailing is the core purpose, the extension of credit is an integral part of growing sales. Unless there is an underlying philosophy of optimization, an overemphasis of one aspect is going to result in undue pressure on the other.

5.2 Strategic Options

In assessing potential strategic options, an obvious point of departure is the consideration of Relyant's strengths and weaknesses. A brief overview of this is as follows.

5.2.1 Relyant Weaknesses

The following areas of weakness exist:

Gearing and Cash Flow

This has been a problem since the inception of Relyant and has been restrictive in terms of financial flexibility and pursuing growth opportunities.

Market Share

In light of the problems experienced by Relyant on account restructuring and store closures, market share must have been lost to the more stable opposition companies.

High Risk Market Segments

One of Relyant's bigger brands is positioned to focus on LSM 3 and 4. These are relatively high-risk markets in terms of the customer base being low-income earners or employed in the informal sector. This can pose threats of operational risk.

Staff Morale

Given the on going restructure programme and numerous store closures, this must have had an impact on staff morale, especially in a retailing environment where people performance and motivation is critical.

Culture

Whilst the merger happened five years ago there are still underlying cultural issues that need to be resolved. Also, the divide between operations and credit management is a constraint in achieving the desired levels of organisational performance.

5.2.2 Relyant Strengths

The following areas of strength exist:

Low-cost Retailer

Relyant has achieved considerable success in this strategy to bring its cost base in line. This strategy was pursued constantly since inception in 1998.

Brand Repositioning

By reducing the number of brands, Relyant has ensured a more focused approach in terms of the different brands targeting specific target segments. Whilst the value retail division has not delivered the desired results, it has positioned Relyant with access to diverse portfolios and if successful can contribute towards balancing its risk.

Credit Excellence

This is an area where Relyant has performed relatively well and statistics of the debtors' book since inception confirms this. There are a number of reasons for success in this area, some of which include:

- The efficient regional credit centres, which form a key competitive advantage.
- The introduction of automated application scorecards used in the assessment of credit.
- The introduction of the TRIAD adaptive control account management system.
- The overall approach to the introduction of technology and innovation.

5.3 Strategic Choices

In making recommendations in respect of strategy selection, the approach is to cover the following broad areas:

- Recommendations at a strategic level

- Recommendations at a operational level
- Recommendations at a support level

In terms of Relyant's existing position, in so far as evaluating progress since inception, the organisation has addressed many of the internal weaknesses that were present at the beginning and the restructure programme and the low-cost focus has brought about a certain amount of stability. Also, the recapitalisation of the company has addressed the high gearing problem and the injection of capital introduced by the German investor should lead to more financial flexibility in terms of growth.

5.3.1 Strategic Positioning

In reviewing the strengths and weaknesses of Relyant, in terms of the SWOT analysis diagram as formulated by Pearce and Robinson (1991), Relyant could be considered to be in cell 3, which supports a turnaround strategy. It is not practical for Relyant to pursue either a diversification strategy or an aggressive strategy, given its existing resources. The strategic path should consist of a turnaround strategy initially and through a process of achieving competitive advantage through a customer-centric approach towards differentiation; Relyant could then pursue a growth strategy in keeping with its mission.

5.3.2 Strategy Selection

With reference to Pearce and Robinson's grand strategy selection matrix, the approach for Relyant, in terms of its existing position, should be to capitalize on internal strengths in order to overcome its weaknesses. In terms the grand strategy selection matrix, this would fall in quadrant 2, confirming the approach to be a turnaround strategy.

According to Pearce and Robinson (1991), a turnaround strategy can entail redirecting resources from one internal business activity to another and at the same time the firm maintains its commitment to its basics mission and enables further development of proven competitive advantage.

This would be extremely apt in the case of Relyant given the lack of clarity of focus in so far as retailing and credit/risk management is concerned. Instead of operations management intervening in decision-making requiring credit/risk expertise, operations resources should focus on their core purpose of retailing.

Whilst the underlying theme of strategic choice for Relyant is one of turnaround, there also has to be a simultaneous approach with regard to innovation in terms reviewing its business model.

"Deciding when and how to change your business model demands careful thought and judgement. Leaders must be bold. They must also be pragmatic. They must be radical. But they must also be rational" (Manning 2003: 47). According to Manning (2003), companies that cling to life are not attractive to anyone. As they linger for a long time they may be admired for their longevity, but they are unable to fulfil their economic or social obligations. Manning goes on to say that as their competitiveness is blunted, the cost of keeping them on life support becomes unjustifiable. Attracting and keeping customers gets costlier and more difficult. The best people no longer want to work there and suppliers don't seek their business.

Manning (2003) is of the opinion that few firms run out of growth opportunities. In his view, most firms are held back not by what happens outside their walls, but what happens inside. The essence of strategy is to make a difference that really matters and companies should strive to create a sustainable competitive advantage. The objective should be to create a better strategy and to execute it better than others can do will lead to a long and profitable future.

5.4 Recommendations

Whilst there has been much literature written about the theory of management and performance measurement, when the question of "delivering value" is raised, there does not appear to be many answers. In

determining recommendations with regard to strategic choices that should be made by Relyant, one has to put into the right context, the nature of the industry and the competitive position of the company so that these recommendations are practical, relevant and focused.

5.4.1 Recommendations at a Strategic Level

According to Manning (2003), it was Peter Drucker who said, "Enterprises are paid to create wealth, not control costs." Manning is of the opinion that growth doesn't come from cost cutting and that growth requires investment.

Value Creation

In light of the above, given Relyant's strong focus on cost reduction, it is necessary for the company to move towards a strategy of value creation as enhancing profitability through cost-reduction cannot lead to a position of sustainable profitability. In order to elevate performance to competitive advantage and wealth-creation, it is essential to focus on a strategy of value creation.

A technique devised by Manning (2003), applies what he calls a 3x discipline. The intention is to ensure the approach is focused and manageable. This technique consists of a triangle with the "purpose" of the strategy at the centre of the triangle. At each of the 3 vertices of the triangle, a "value driver" is listed. For each value driver, is listed 3 goals and 3 actions. Fig 5.1 illustrates this discipline.

This approach is extremely relevant for Relyant to adopt as a means of implementing a value creating strategy to drive differentiation and innovation. The value chain strategy to integrate customer relationship life cycle management can be implemented in terms of the Value Plan format (Fig.5.2)

Fig.5.1 The Value Plan

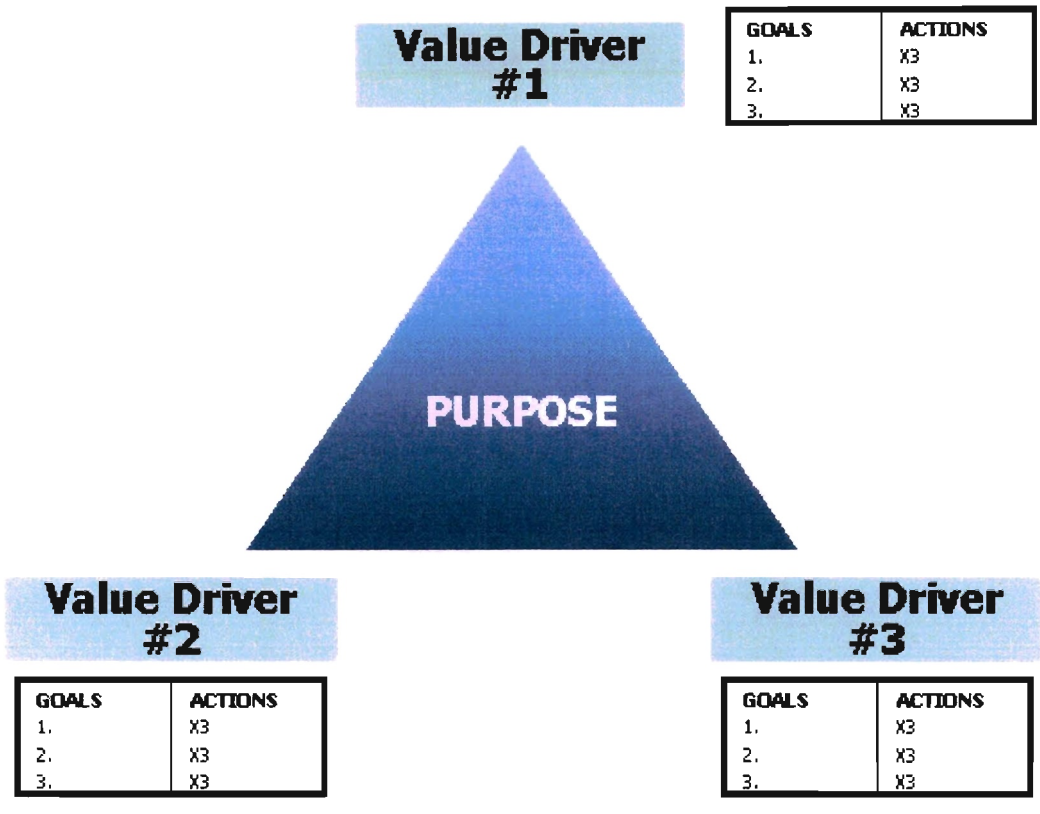
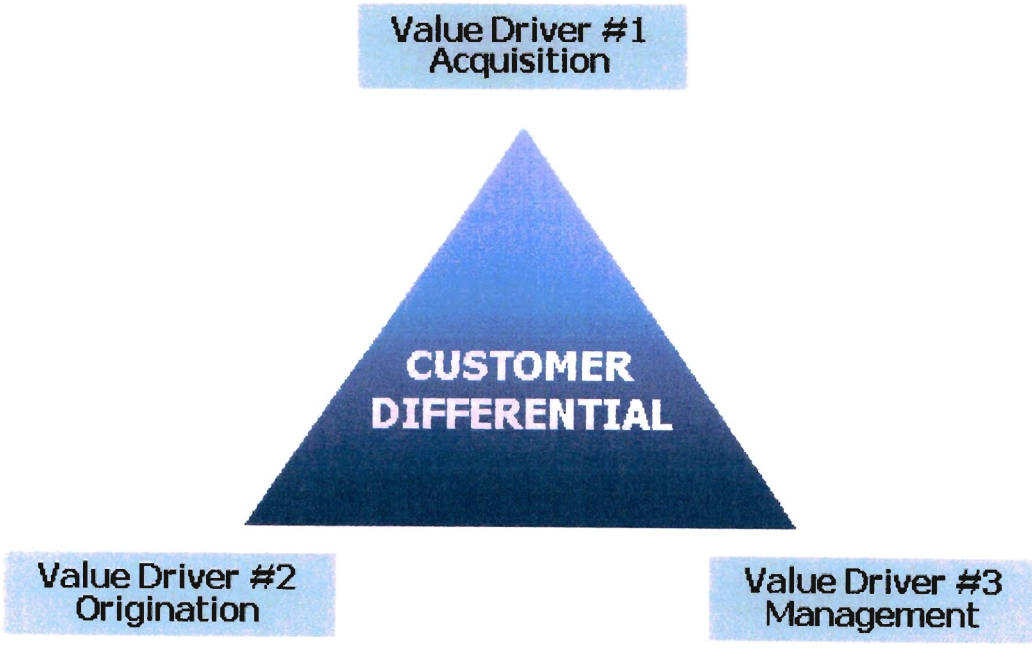


Fig.5.2 The Relyant Value Plan



The purpose of the value creating strategy should be to achieve the "customer differential" which entails strategically attracting and developing a customer base.

The three value drivers should be as follows:

Value Driver 1: Account Acquisition

The three goals under account acquisition should be:

- Predictive analytics as a means of identifying the right customer.
- Prospecting, involving a risk-based approach to attracting new business.
- Targeting, involving marketing strategies to generate low-risk, profitable repeat customers.

Value Driver 2: Account Origination

The three goals under account origination should be:

- Front-end decision systems to drive risk assessment strategies.
- Application Processing Systems to ensure a smooth, automated process flow.
- Pricing software that will allow risk-based pricing on merchandise and financing offerings.

Value Driver 3: Account Management

The three goals under account management should be:

- Risk Management, the driving force of strategy implementation and execution. The overall management of TRIAD being crucial.
- Delinquent Collections involving the execution of collection strategies driving cash flow, synergies across portfolios and cost efficiencies.
- Retain and Cross Sell. The objective here is to prevent customer attrition and to leverage the customer base by exploring cross selling opportunities.

The objective of a value creating strategy is to position the company to gain competitive advantage within the industry. The approach is to redirect the resources of the credit/risk portfolio to leverage the customer base and the vehicle should be a customer-centric focus to achieve differentiation by identifying and supplying what the customer wants.

Business Structure

Another strategy that must be considered, at a strategic level, is a means of clarifying the focus in terms of core purpose. Currently there is a lack of clarity in terms of operations (retailing) and credit management. There is too much intervention from the trading side of the business with regard to credit assessment and collections. In my opinion, this is proving to be a significant constraint in terms of growth and value creation.

There needs to an approach to separating these two core aspects of furniture retailing and it has to be at a responsibility and accountability level. At the moment there is resistance to remove the credit control costs from the brands' area of responsibility. On account of this, credit/risk management continues to play a support role whereas it should be providing a value-creating role. This used to be an issue some ago with the fashion retailers, but they realized the restrictive affect this had and have since changed.

5.4.2 Recommendations at an Operational Level

The following key areas need to be addressed in order to provide a solid foundation for future success.

Information Systems Infrastructure

Whilst the implementation of the existing in-store distributed network system in 1998, managed by outsource partner UCS, was a significant improvement on a previously manual type system involving extensive data capture, its adequacy and effectiveness at this stage is questionable. Given, the diverse portfolios within Relyant as well as two separate

divisions in value retail and chains, the ability to consolidate data and to view information across brands is far from ideal.
In addition to this, evolution has taken place within the business with the introduction of the three regional credit centres, the introduction of TRIAD and more recently a central credit granting facility. As a consequence, the system has been "enhanced" to cater for these changes and the integration has not been seamless.

The architecture of the system is becoming cumbersome and in most instances, changes and enhancements requested by the business require software development. In terms of database management and data warehousing, the system does not allow for the 360 degrees view of a customer and data analytics cannot be undertaken at a level of requirements to pursue strategies in keeping with the customer relationship life cycle model.

There needs to be a complete review of the efficiency and effectiveness of the current system and the feasibility of making provision for the data warehousing requirements to enable the required predictive analytics and data mining techniques to be undertaken.

Credit/ Risk Management

There is currently a great deal of public debate around whether this portfolio is a backroom or boardroom function. The current thinking at Relyant is that credit is a support function and that the ultimate control lies with brand management.

The first recommendation is that the portfolio is not restricted to credit and that it be extended to cover credit and risk because this portfolio transcends just credit and provides strategic input into credit, marketing, IT as well as operations.

The second recommendation is that this portfolio, on account of its strategic nature, be elevated to participation at management board level

and that it effectively drives the vision and strategy of customer relationship life cycle management.

Centralisation

In keeping with best practice, it is crucial that Relyant embrace the principles of centralisation with regard to credit/risk management. Currently there is strong resistance to this philosophy from the brand management teams. There are numerous reasons why this should be accepted and implemented.

Firstly, with regard to credit assessment, the only way in which decision optimisation can be achieved is through centralisation. The decentralised nature of the business structure does not lend itself to efficient execution of the principles of credit assessment and application processing. Whilst there are certain functions that need to be conducted at the stores, vital functions such as data capture validation, credentials validation need to be completed centrally. Also with regard to the consistent application of criteria and the application of policy are best managed and controlled centrally.

Secondly, with regard to delinquent account follow-up, operating in a centralised environment ensures consistent application of collection strategies. Managing efficiency and productivity of staff is best managed from a central environment. Centralisation also facilitates management, control and training of staff. As a result of the critical mass due to centralising all credit management processes, maximum benefit can be derived from synergies, efficiencies and economies of scale.

5.4.3 Recommendations at a Support Level

Given the nature of the material researched and the recommendations emanating from this, it is clear that in terms of Relyant's existing position, this represents a significant paradigm shift. In order for these strategies to be accepted, a fundamental requirement for successful implementation and execution is that certain people issues need to be addressed.

Leadership

In order to ensure that there is a focused approach to pursuing a turnaround strategy and gradual progress towards achieving competitive advantage through differentiation, there has to be strong leadership from the top.

According to Miller and Dess (1996), the research on leadership concluded by John Huey revealed that in the organisations emerging today, "corporate leaders will face two tasks: first, to develop and articulate exactly what the company is trying to accomplish, and second, to create an environment which employees can figure out what needs to be done and then do it well." Miller and Dess (1996) argue that Huey's statement emphasises the importance of a leader successfully facilitating and setting the direction for the discovery and action that organisational learning requires.

Nadler and Tushman (1990: 77-97) state that "Charisma is not enough to effect large-scale system change. Charismatic leadership must be bolstered by instrumental leadership through details on roles, responsibilities, structures and rewards. Furthermore, as many organisations are too large and complex for any one executive...leadership must be pushed throughout the organisation, to maximize the probability that managers at all levels own and are involved in executing the change efforts."

In order to influence the integration of the credit/risk portfolio as a critical component of operations and to address the business structure is going to require influential leadership.

Change Management

The current business structure of Relyant and the lack of clarity of purpose is a deeply entrenched culture within Relyant and indeed within the retail furniture industry. Whilst there has been progress made by the credit function in terms of introducing technology and the move towards

innovative quality systems, this has still not been well received by brand senior management and there is still a lack of belief and commitment to the process on their part. In addition to this there is still strong resistance to the moves towards centralisation.

Possible reasons are as follows:

- The vision was not communicated to brand management.
- Insecurity on the part of certain staff members in terms of the impact that it will have on their future in the company.
- A cultural issue on account of entrenched views and beliefs.
- A lack of getting brand management involved in the decision making process.
- A strong resistance to change on the part of brand management.

There has to be a structured process of change management that has to be implemented to address this critical issue to ensure the successful implementation of suggested strategies.

5.5 Conclusion

It is clear from the analysis that a significant contribution to Relyant's sales is through the extension of credit. Relyant's debtors' book is currently in the region of R 2 billion, representing a sizeable asset and customer base.

The analysis also revels that in terms of Relyant's strategic positioning, it cannot pursue an aggressive or growth strategy. In terms of the evolution of strategies embarked upon since inception, Relyant has managed to stabilize its position, given its historical background. In light of this, a sensible strategic option would be to pursue a turnaround strategy, with the initial milestone being low and sustainable growth with the view to improving shareholder perceptions through the delivery of shareholder wealth creation. Once this initial milestone has been successfully concluded, Relyant can pursue a strategy of concentrated growth.

In order to achieve the above, Relyant will have to carefully review its business model and look to incorporate the recommendations emanating from this research. A fundamental requirement is to view the credit/risk component of the business as an integral part of the business model to achieve successful organizational performance and not to simply view it as a support service to occupy the "backroom" of the business.

The major thrust of its strategy must be to pursue a strategy of differentiation to achieve competitive advantage within the retail furniture industry. The underlying theme of achieving this must be to adopt a customer-centric approach to all aspects of its business. A key driver to delivering shareholder value is to place value creation at the heart of its business model through the vehicle of extracting customer value from its customer database.

The research clearly shows that the way to translate this into reality from a practical point of view is to embrace the principles of integrating automated predictive decision systems into customer relationship life cycle management. The recommended approach is to adopt the value chain strategy to create value, enhance profitability through cost saving and achieve competitive advantage in an industry currently experiencing consolidation.

Relyant has positioned itself well through its brand repositioning and credit excellence strategies and must now build upon this platform to realize its mission of being a first choice furniture and appliance retailer in Africa.

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