The latest advance in relationship marketing creates a continuous dialogue with customers, allowing them to hear just what they need to know, just when they need to know it.

The Perfect Message at the Perfect Moment

PROMOTIONAL MESSAGES DON'T WORK if customers aren't receptive to them. To boost the odds of being greeted by eager eyes and hungry ears, marketers ask questions that target their audiences. Who should receive the message? What should the content of the message be? How should we deliver the message?

The one question they rarely ask is, *when* should we deliver the message? Yet in marketing, timing is arguably the most important variable of all. Promotions are like weather reports and news bulletins – people need them when they need them. Too early and they are forgotten. Too late and they are ignored.

Most people don't want to hear from most companies most of the time, and in an era of marketing overload – characterized by irrelevance as well as volume – unsolicited communication can provoke apathy or worse, resentment. The business press has lately described a "chaos scenario" in which traditional media (television, print) and established formats (the 30-second spot) are in decline but new, more effective media and formats are still evolving. In the messy interim, advertisers find their

by Kirthi Kalyanam and Monte Zweben

MATT HERRING

messages are not being absorbed or even noticed, let alone acted on.

However, there are moments in a customer's relationship with a business when she truly wants–even needs–to communicate with that business. Her life has changed. Her desires have changed. Her perception of the business has changed. If companies contact her with the right message in the right format at just that moment, their chances of a warm reception rise. But few companies sync communications to milestones or transitions in their customer relationships. Even fewer respond to events in their customers' lives.

Consider the airlines. No slouches when it comes to peddling seats, they send an expensive package of promotions to their most valuable customers with each and every loyalty-program statement. But what happens when a customer suddenly stops using an airline he once flew frequently? That customer's apparent defection is a fundamental change in behavior that requires intervention by the airline if it wants to keep his business. Unfortunately, airlines and other organizations cannot afford to manually track and respond to a customer's every act, or failure to act. Such vigilance simply does not scale.

In marketing, timing is arguably the most important variable of all.

The question "when?" – like most marketing questions – can be answered by technology: specifically, by a new computer-based model called "dialogue marketing." Dialogue marketing is, to date, the highest rung on the evolutionary ladder that ascends from database marketing to relationship marketing to one-to-one marketing. Its principle advantages over those older approaches are that it is completely interactive, exploits many communication channels, and is "relationship aware" : that is, it continuously tracks every nuance of the customer's interaction with the business. Consequently, dialogue marketing responds to each transition in that relationship as it occurs – at the moment the customer requires a particular type of attention.

Dialogue marketing is getting good results in several industries, including retail, hospitality, travel, financial services, media, packaged goods, and telecommunications. As it proliferates, it may provide the firm new footing that Madison Avenue seeks. The following article lays out dialogue marketing's fundamentals and briefly describes the technologies required to make it work. (Editor's Note: A number of vendors, including the coauthor's company, offer systems that perform the functions of dialogue marketing. Corporate IT departments can also develop their own.)

__Kirthi Kalyanam__ (kkalyanam@scu.edu) is the J.C. Penney Research Professor and the director of Internet retailing at the Retail Management Institute at Santa Clara University in California. __Monte Zweben__ (zweben@bluemartini.com) is the founder, chairman, and CEO of Blue Martini Software in San Mateo, California.

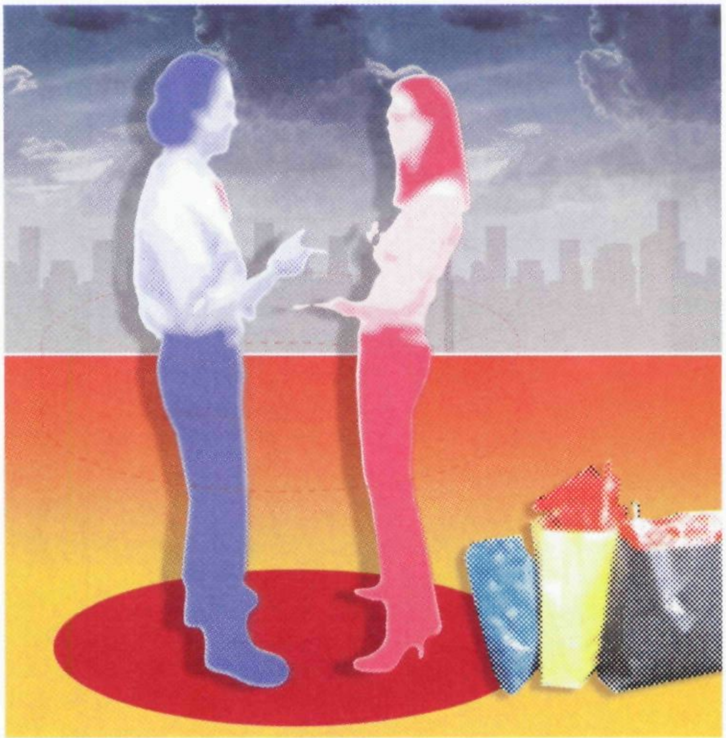
It's Time to Talk

Modern marketing doctrine is founded on the primacy of databases, which allow companies to segment customers into demographic and psychographic clusters. In basic database marketing – still alive and kicking – analysts query databases at marketers' behest and produce lists of customers in various subgroups. The marketers then use batch communications to send members of those subgroups nearly identical messages at infrequent intervals, according to the company's schedule. Most of those messages are designed to sell products.

In the 1980s, database marketing spawned relationship marketing, which shifted the emphasis to retaining and nurturing clients. Data segmentation grew more sophisticated as marketers studied differences in customers' profitability and calculated their lifetime value. A decade later, one-to-one marketing sought to exploit the Web's powerful assertion, "I know who you are," by creating personalized messages for individual customers. But one-to-one marketing rarely strays beyond the borders of the Internet. And while it addresses the question, "What should the content of this message be?" that is a necessary – not a sufficient – improvement.

The dialogue model is also a product of database technology and personalization philosophy marching forward in tandem. Yet while dialogue marketing has the body of a software system, it possesses the soul of a salesperson. Great salespeople understand that customer relationships are built, maintained, and expanded through dialogues, which take place one after another over time. A dialogue is, very simply, a series of outreaches and responses between a company and a customer ideally leading to some action on the part of the customer. The person or software conducting a dialogue "listens" to the customer's needs and chooses the content and channel of communication based on what the customer says and does.

So, for example, a dialogue might begin when a company's system sends an e-mail inviting the customer to visit a Web site for information. When a week passes without the customer clicking on the embedded links, his silence triggers the next step in the dialogue–an alert to a salesperson to make a call. The system waits another week after that human contact and then shoots the customer a reminder e-mail. This time, the customer clicks through to the site, and his choices there automatically queue new interactions.



That step-by-step, wait-and-respond approach distinguishes dialogue marketing from its forebears. But the model's most distinctive characteristic may be its attention to the temporal dimension of customer relationships. Time, literally, is its essence. Dialogue-marketing systems are very sensitive to the interval between purchases, movement along loyalty curves, and increasing and decreasing frequency of physical and online visits. Such data registers in these systems as transitions or events, and each time one occurs, the software automatically commences an appropriate dialogue with the customer. Transitions may be positive (indicating an increase in business or loyalty) or negative (indicating a decrease in business or loyalty). All transitions present opportunities to engage the customer anew.

Transitions are a more meaningful lens than transactions for viewing the customer relationship because they focus on the relationship's evolution. In effect, transactions show you a series of frames; transitions play you a movie. Consider the common practice among retailers of collecting raw transactional data and transforming that information into recency, frequency, and monetary (RFM) value scores. These scores, which have been in use since the early days of database marketing, record when customers last made certain transactions, how often they made those transactions, and the monetary value of those transactions. Companies often break down RFM scores by segment, brand, or product category. So a retailer might track:
- the recency of transactions in the shoe department;
- the frequency of transactions in the shoe department;
- the average monetary value of transactions in the shoe department;
- the recency of transactions involving a particular brand of shoes;
- the frequency of transactions involving a particular brand of shoes;
- the average monetary value of transactions involving a particular brand of shoes.

Traditionally, the retailer would collect such data over time. Then, at intervals, it would send out a batch communication to customers who have spent, say, more than $1,000 on a particular brand during the course of a year.

With dialogue marketing, by contrast, the retailer monitors changes in individual customers' RFM scores as they happen and sets the system to launch a dialogue when it detects a meaningful transition. The system responds immediately to individual rather than aggregate data, so the retailer can reach out to the customer while she is fresh in the throes of new-sandal fever or has gone an unprecedented six months without buying a pair of pumps. And dialogues don't just follow up transitions; they follow *through*–to another transaction, a deeper engagement, or simply a larger wedge of customer attention.

The Nature of Changes

No two companies collect identical data, and so each will define the specific transitions that trigger customer dialogues. In general, transitions reflect a change either in the customer's life or in his relationship with the business. They are particularly valuable in the creation and operation of complex loyalty programs. A company might set dialogues to launch when a customer
- makes a purchase in a new category (first suit, first time in our new shoe department);
- buys a brand so frequently that he qualifies as a zealot;
- exceeds a certain monetary value in a year and thus qualifies as a VIP;
- crosses a threshold in a loyalty program;
- requests a change of address, indicating a household move;

- purchases an item that indicates a major life change such as an infant car seat, or a large project such as a sink or cabinets. (Dialogue systems can also incorporate data from third-party vendors that track the issuance of new mortgages, openings of college savings accounts, and other commercially available data.)

Once a transition triggers a dialogue, that dialogue often moves the customer to another transition, at which point a new dialogue with a different goal kicks in. For example, a major regional grocery chain identified a tipping point: People who ordered from its Web site more than four times were very likely to become regular customers. The company's technology staff programmed its dialogue-marketing system to respond to new customers via e-mail, using steep store-financed discounts to push them aggressively through those first four purchases. After purchase number four, the system automatically begins generating less expensive treatments, for example, offering only trade promotions financed by consumer goods manufacturers.

Other transitions represent not an opportunity but rather a threat–usually, that a customer will defect. Recall for a moment the airline with its high-value customer gone AWOL. Now imagine the company practices dialogue marketing. The system detects the customer's failure to book a flight for several months and sends a message to a service representative asking him to call and try to rectify the problem. If the customer complains of poor service, the representative logs the details into the system, triggering the creation of a written apology signed by an executive and including an incentive to return – automatic upgrades or frequent-flier miles, for example. If her account remains inactive, then the next month the system sends her another note with a reminder about the incentive. If yet another month passes, she gets a call from a senior customer-service manager. When she finally buys a ticket, the system launches a dialogue for special treatment of "saved" customers.

As this example illustrates, dialogue marketing considers not just when to communicate but also *how* to communicate: Dialogues play out across multiple channels depending on the content of the message and the urgency of the situation. Some customer actions will trigger the system to respond immediately, with a personalized e-mail, a personalized piece of direct mail, or an alert to a salesperson to make a call. Other responses will lay the groundwork for future interactions. The system might store a personalized message at the point of sale to be delivered when the customer next visits, or send the message to a call center representative to be used when the customer phones. Or it might place customer-specific content on a Web site in preparation for a virtual visit.

Customer value is another major consideration in channel choice. Before launching its resource-intensive retention dialogue, the airline's system would establish that the customer in question is top tier, based on her previous and predicted purchasing. If the customer qualified as only medium value, the system might mail her a message, either electronically or by placing her contact information on a direct mail list together with personalized content for the message. A low-value customer might receive an e-mail, or nothing at all if he is not profitable or not online. This portfolio of approaches is another way in which dialogue marketing improves on most one-to-one initiatives.

Technology: What Lies Beneath

Four fairly new technologies make dialogue marketing possible:

Intelligent Process Engines. Standard database applications store multiple tables of data and provide screens that allow users to insert, edit, and delete entries from those tables. Intelligent process engines do more: They track individual "states"–where a customer stands in relation to the company at any given moment. (For example, a person who accepts a promotion is in a different state than a person who rejects it.) These engines initiate actions based on changes to those states and provide feedback to managers on the results.

Event-Driven Computing. Intelligent process engines respond to changes in states; event-driven computing responds to actions as they are noted by a company's enterprise systems. An automated engine runs continuously in the background of all customer-focused applications, "listening" for events (a customer playing a slot machine; someone registering on the Web site) and deciding how to react, thus minimizing the need for human intervention.

Scalable Web Application Architectures. Dialogue marketing requires companies to manage dialogues for millions of customers who are in different states of relationship with the business and to do so across multiple channels. Scalable Web application architectures are distributed systems that balance the load of user requests across many computers. As computational demand increases, these architectures allow companies to add more servers so they can incrementally scale applications to serve those millions of customers in a variety of ways.

Web Services. In dialogue marketing, multiple databases and other systems must constantly talk to one another, a task that once required significant programming. Web services allow one computer to send a request for information over the Internet using a simple URL address and another computer to automatically respond in a standard language called XML. This advance greatly reduces the amount of computer skills required to operate such systems.

The Data Rich and the Data Poor

Not surprisingly, companies that collect masses of data and cut that information every which way have emerged as dialogue marketing's virtuoso early adopters. Harrah's Casinos, for example, which is known for its sophisticated use of database-marketing technology, runs an elaborate set of dialogues that consider every permutation of the casino-vacationer relationship (see Gary Loveman's article "Diamonds in the Data Mine," HBR May 2003). Harrah's system defines customers in these ways:

- Decliners: number and recency of visits are dropping
- Incliners: number and recency of visits are rising
- Inactive: no visits for a long period of time
- New Business: only one recent visit
- Past Due: no visits for a designated period of time, but not yet considered decliners
- Due Now: not yet considered decliners but need a tickler to bring them in now
- Ad Hoc: everyone else

The company uses dialogues to take customers from negative states (such as decliners) to positive states (such as incliners), chiefly by alerting live "player hosts" to intervene at the first sign of a transition. Since Harrah's began using dialogue marketing in 2003, it has raised revenue by 30% to 69%, depending on the customer segment; increased by 20% to 25% the contacts that produce return visits; and boosted the number of VIP customers overall.

Not all companies, however, are equally awash in data. Some businesses are built on infrequent transactions with individual customers (you buy a cup of coffee once a day, a house once a decade). And while luxury brands may excite occasional purchasers to stay connected to the business, many companies find it difficult to hold customers' attention beyond the sale.

One company with a relative paucity of data is Logitech, a designer and manufacturer of personal peripherals for computers, mobile phones, and MP3 players. Despite its customers' low purchasing frequency, Logitech has managed to create a new loyalty program based on dialogue marketing. The system is nourished by a database of registered customers who trade demographic information for timely notification of software upgrades and new products. Logitech has collected this information over several years from customers buying online or seeking help from support staff.

Because Logitech doesn't gather enough data from customers to effectively detect individual transitions, it sets its clock according to aggregate historical information in the registration database. For example, a principal goal of the loyalty program is to induce first-time or single-item buyers to purchase another product; so the system decides when to start a follow-up dialogue based on the lapse of time between similar customers' first and second purchases. Having determined that repeat customers bought their second products almost immediately after the first, the system launches follow-up dialogues while that initial transaction is still warm. By reaching out again so soon, however, the company risks alienating customers who dislike the hard sell. So Logitech designs those dialogues with a service orientation–for example, explaining how its portable products can assist customers in their travels.

The dialogue to stimulate a second purchase unfolds through a series of such informative e-mails, each of which invites the customer to take one of several actions. If those missives receive no response, the system queues up a replacement product dialogue to commence at a time determined by historical data on the pace of replacement purchases for the customer's product type. As the dialogue-marketing program bears fruit, Logitech's rates of repeat and replacement purchases should rise, spawning more and more data. The company is incorporating that new data into its model, and that, in turn, should cause dialogues to launch at more precise intervals.

Dialogue marketing is, to date, the highest rung on the evolutionary ladder that ascends from database marketing to relationship marketing to one-to-one marketing.

A Dialogue for Every Season

Customer relationships are rich in transitions and events. At different times, companies will need to talk people into a commitment or out of a defection, over a conceptual hurdle or through a complex process. Working with their technology departments, marketers can design repositories or "houses" of dialogues that manage every category of customer interaction. Once the software engine is rolled out, marketers can gradually phase in those dialogues, monitoring their effectiveness and optimizing them until they achieve their desired ROI.

Every company's house should eventually contain four types of dialogues that scale upward in sophistication and ambition.

Foundation Dialogues. As their name suggests, foundation dialogues manage the fundamentals of the customer life cycle: the marketing version of Shakespeare's seven ages of man. These dialogues require only basic data, such as a customer's name and contact information. They do not demand significant process changes or cross-functional coordination. Examples include:

Acquisitions. Acquisition dialogues aim to bring in new customers. They start out in batch fashion with a targeted audience and grow more specialized as prospects respond.

Service Follow-Ups. Follow-ups might begin with a thanks-for-your-recent-purchase message, a notification that an item is ready for pickup, or a simple satisfaction check. They then unfurl into additional offers of help.

Win-Backs. Win-back dialogues launch in response to defections: when a customer asks to terminate her cell-phone-service plan or cancels a magazine subscription, for example.

Level I Dialogues. Each of these product- or event-centric dialogues is named for the type of message that starts the exchange. (See the sidebar "Turning Invitations into Dialogues.") More sophisticated than foundation dialogues, they leverage customer purchase data that may include such information as price or deal sensitivity. Integration with inventory and other systems requires greater IT participation. Examples include:

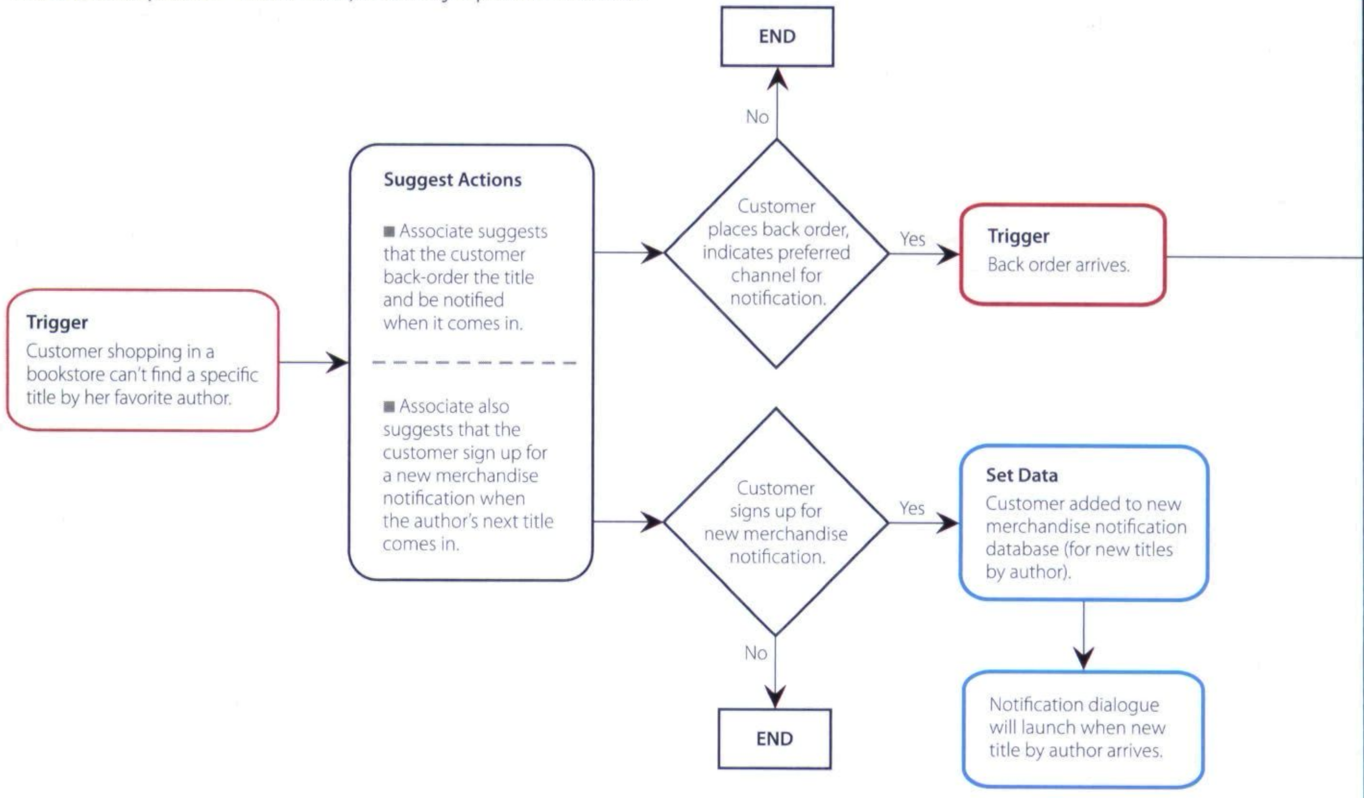
Event Notifications. Notification dialogues draw on geographic data and purchase histories to invite select customers to marketing events.

Repurchase Reminders. Repurchase reminders are gentle nudges to purchasers of consumable products – such as laser printer cartridges, paper, sneakers, drill bits, oil, and lightbulbs – that it is time to buy again. Dialogue-marketing systems can be programmed to correlate an individual customer's purchase of such a product with the known life span of that product.

Inventory and Price Alerts. Inventory alerts announce new arrivals and promotional items of presumed interest. For example, a shipment of Celtic folk CDs to a music retailer would automatically trigger messages to customers

Striking Up the Conversation

A merchandise notification dialogue often begins with a customer in search of a product – in this case, a book by a particular author.



whose purchasing histories are rife with Clannad and the Chieftains. Loyal customers can receive advance notice of price changes, having first crack at a markdown or sale.

Overstock Outreaches. These dialogues launch when overstocked items are about to be marked down. Before prices are slashed, the system seeks customers who have bought such items before and might do so again, perhaps because they are approaching the next level of a loyalty program or because the last such item they purchased is due to expire.

Level II Dialogues. These dialogues draw on individual customers' purchasing patterns or on predictive modeling to influence the progression of the relationship with that customer. They require a sophisticated understanding of a customer's history with the company and considerable cross-functional coordination as everyone from corporate buyers to executives gets involved. Examples include:

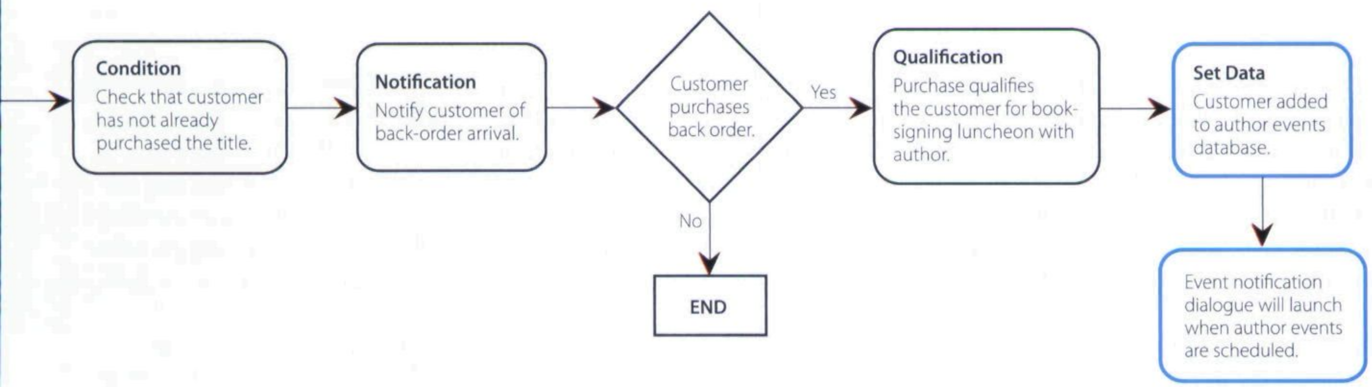
Defection Interventions. Defection dialogues are triggered when the system detects early warning signs, such as a decline in purchasing frequency. They rely on predictive modeling and so are distinct from win-back dialogues, which launch after a customer has already been lost.

Life Cycle Progressions. These dialogues move customers through states of increasing loyalty. For example, when Harrah's customers approach the highest tier of the company's loyalty program, life cycle dialogues automatically contact them with a message such as, "You are only one visit away from our Total Diamond reward level."

Category RFM Transitions. These dialogues allow category managers, merchandise managers, buyers, and product managers to respond to changes in customers' individual RFM scores within their categories.

Brand RFM Transitions. These dialogues allow brand managers to respond to changes in customers' individual RFM scores within their brands.

Level III Dialogues. Level III adds a physical element to dialogues. These on-site interactions – although just feasible now – will likely be common in the future, when customers carry RFID cards into stores or key their identities into smart shopping carts. As they shop, customers will receive personalized messages on their cell phones or PDAs, or on screens scattered around the store. Those messages will draw on the same data other dialogue-marketing applications use. So a book buyer passing the cooking



Turning Invitations into Dialogues

Every day, tens of millions of consumers receive e-mails or postcards announcing a do-it-yourself workshop at the hardware store they frequent or an online retailer's markdown on gourmet cookware. Such notifications are based on customers' demographic data and purchase histories, but they invite minimal or no interaction. Consequently, they are not dialogues.

A simple notification can become the core of a dialogue, however, if it advances the relationship by soliciting additional information, by giving the customer several ways and reasons to respond, and by following up with new communications. Consider an e-mail announcement for a designer trunk show. Such an event notification is generated based on customers' purchasing histories or other indications of interest in that particular designer. It includes the specifics of the event, and possibly photos of designs to be modeled.

To transform the event notification into an event notification dialogue, the retailer would have to include a call to action with multiple options. Those options might include:

a. I will attend.

b. I will attend, and please have available some designs in my size for me to try on. (Because the dialogue system is relationship aware, it knows the customer's size.)

c. I will not attend, but I am interested in scheduling an appointment to try on the following merchandise. (This option might be followed by a link to the retailer's Web site displaying a full array of garments from which the customer could select.)

d. I am unable to attend because of another commitment.

e. Thank you, I am not interested in this designer.

The customer's choice of option would, in turn, trigger the system's response. Customers who chose (a) or (b) would receive a reservation confirmation and directions, as well as a reminder a few days before the event. Customers who chose (c) would receive a follow-up inquiring about convenient times during the week. Customers who chose (d) would receive a follow-up asking if they would like to update their preferences (in say, sizes or styles) and be invited to future events. Customers who chose (e) may become the target of a win-back dialogue. Or the retailer may simply assume that those customers have been qualified incorrectly and update the database accordingly.

Notification dialogues also feature an expiration date: If the customer fails to respond by that date, they launch a follow-up. In this example, a high-value customer who has attended many of the designer's shows in the past might merit a call from a sales associate. The dialogue-marketing engine would alert that associate and provide her with a script.

No matter how customers respond to notification dialogues, the retailer learns something. Customers who select (b) indicate a higher degree of interest than do those who choose (a). If many customers select (c), the retailer should probably consider scheduling a second event. And all that data, of course, is fed back into the system to enrich future dialogues as the long conversation continues.

section might receive an alert that only $20 separates him from the store's Chef's Club and its 25% discount.

That final, futuristic category of dialogue is especially appealing because it reaches even beyond "when" to answer the question of "where"–drilling down to the very aisle a customer is passing. For now, though, marketers must focus on timing as they seek to bind customers more closely.

• • •

The technology to conduct dialogue marketing exists today, and it will only get better. Marketing organizations will need to collaborate with their IT departments to develop or install these systems, but once they are in place the demands on IT will decline significantly as dialogues fire off automatically, without any need for additional database queries. Ultimately, such systems will prove far less expensive than trying to field a service staff large enough to handle the many complex circumstances and evolving states that customer relationships present.

Turning a traditional marketing strategy into a dialogue-marketing program is a straightforward matter. Begin by identifying the communications you make with customers in a batch fashion, then ask yourself what events could trigger those communications to make them more timely. Add a question or call to action to each message, and prepare a different treatment or response for each possible answer. Finally, create a series of increasingly urgent calls to action that kick in if the question or call to action goes unanswered.

Companies that blast frequent, irrelevant messages dilute their brand equity. What customers want is great service and a consistently excellent experience across all channels. For those reasons, we believe that many elements of dialogue marketing will be ubiquitous in five years. Companies that adopt the dialogue model early can rise above today's unwelcome din and become not just the voice that customers hear but also the one they listen for.

Reprint R0511G; HBR OnPoint 219X
To order, see page 170.