Leveraging Customer Value

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At the invitation of Arthur D. Little, Inc., executives from a number of leading companies met earlier this year to discuss state-of-the-art advances in one key area of growth: leveraging customer value (LCV). LCV is the set of activities by which companies select, attract, and retain profitable customers, and thereby maximize value over time.

The impact of customer retention on profits can be substantial. For example, a 5-percent increase in customer loyalty can generate a 25- to 85-percent improvement in corporate profitability.' These results can dwarf the impact of cost reductions. Furthermore, the investment required to achieve this impact is relatively small. Industry leaders in general agree that it costs 5 to 10 times more to get a new customer than it does to retain an existing one.

But successful retention programs are increasingly difficult to plan and implement. In most businesses, customers are more demanding and less loyal than ever before. In addition, customers are changing their expectations of suppliers in the face of an ever-widening range of options. At the same time, management's short-term focus and the constraints of traditional financial reporting formats restrain the company's ability to identify and focus on customers with attractive long-term remaining value. Where opportunity does exist, strong relationships are already being formed, creating additional barriers for new entrants.

Despite these challenges, leading companies such as those at the Arthur D. Little colloquium have found ways to effectively distinguish their products and services, restructure industries, forge innovative partnerships, and create meaningful stakeholder value through LCV They have taken customer management out of the back room and into the boardroom as a key strategy to generate stable growth in profits. In effect, these companies are leading us to LCV

Balancing Stakeholders' Needs

Leveraging customer value builds on Arthur D. Little's High Performance Business concept and emphasizes key interrelationships (Exhibit 1). At the top of the high performance customer-value triangle are the company's stakeholders. Companies that leverage customer value strive to balance and satisfy the needs of all their key stakeholders, including their customers, owners, employees, and distributors. They pay particular attention to selected customer segments and frontline employees – key leverage points to success. As L.L. Bean's Scott A. Bryant, Vice President, Customer Satisfaction, put it at the colloquium, „You're only as good as the ability of your frontline people to make the company's reputation a reality in every single contact with every single customer."

Exhibit 1

Leveraging Customer Value

High performers achieve stakeholder satisfaction through effective management and execution of all customer-interaction processes, as indicated in the middle of the triangle. Shoring up the high performance triangle are resources and an organization properly aligned to support the customer-interaction processes. In addition to frontline staff, key resources include database information, marketing, and technology that enables the frontlines to deliver customer satisfaction.

This high performance approach emphasizes a cross-functional orientation organized around customers and interaction processes, not functional departments. As the Hewlett-Packard Company's Bruno Pillet said at the colloquium, „Customer management must be an imperative across all functional boundaries.“ Pillet is Hewlett-Packard's Business Process Reengineering Manager for Worldwide Customer Support Operations.

The leading executives who met at the colloquium demonstrated „best practices“ in each component of LCV In the following pages we describe these as they relate to the elements of the LCV triangle.

Profitable Stakeholder Satisfaction

Older business models often pitted stakeholder groups against each other. For example, paying employees more meant raising prices – which hurt customers. But ADL's experience with companies who leverage customer value suggests that satisfying one group of stakeholders often leads to higher satisfaction in other stakeholder groups – a phenomenon we call the „virtuous circle“ This synergistic reinforcing circle enhances the attraction and retention of high-quality employees, who in turn deliver higher customer satisfaction and retention, which generates better-than- average returns to owners over time.

LCV drives stakeholder satisfaction in several dimensions:

• Shaping (and exceeding) stakeholders' expectations

• Redefining stakeholders beyond current paradigms

• Devising strategies that are win-win for all stakeholders

Shaping Expectations. Many of our colloquium participants excel at shaping and exceeding stakeholder expectations. For example, L.L. Bean has always had a policy of 100-percent customer satisfaction. Furthermore, it lets the customer determine what satisfaction means. This strategy dates back to the company's inception, when Mr. Bean almost went out of business. Originally he designed a hunting boot with a waterproof bottom and leather upper. Unfortunately, the bottom and upper began to separate. Bean redesigned the boot and replaced all of the original orders free of charge. While it almost put him out of his fledgling business, unswerving commitment to customer satisfaction became the essence of the company's tremendous success.

The Vanguard Group, Inc., represented at the colloquium by Vice President John E. Barth (Institutional Client Services), seeks to shape and exceed its customers' expectations by sending them a quarterly „report card“ on the company's performance in a number of areas. The card reports not only on performance attributes considered important by Vanguard's customers today, but also on ones the firm believes will be important in the future. By establishing performance standards, Vanguard raises the threshold that other companies must meet, distinguishes itself, and increases the retention of existing customers.

Armor KONE Elevator, Inc., is yet another company that actively shapes its customers' expectations, according to Robert G. Duncan, Vice President, Service Operation and Marketing. Field service operations typically focus on the speed of responding to and fixing problems. KONE is reshaping field performance expectations by reporting on preventative-maintenance service visits as well as on fast response to problems. This should focus customer attention on the value KONE provides in reducing the number of costly emergency calls.

Redefining Stakeholders. It is no longer adequate to define the customer as the entity that pays you. Colloquium participants took a significantly broader view of their customers – including everyone from distributors to end users.

For example, Whirlpool Corporation shifted away from thinking about its customers only as the distribution channel, according to Gary L. Lockwood, Director, Customer Assistance. They now call channel participants „trading partners“ and product end-users „consumers.“ This paradigm shift led to the creation of a national customer service center to improve quality. Today Whirlpool completes an amazing 92 percent of consumer inquiries on the first call. Initially skeptical, the trading partners now realize that the service center strengthens Whirlpool product sales and service beyond levels they could have afforded to achieve themselves. Customers are retained, trading partners prosper, and Whirlpool uses direct-market feedback to improve product development and sales.

Companies that leverage customer value also redefine their employee stakeholders. Each employee represents not just one area or function, but the entire company. The goal is to present a unified company image and use direct-market feedback to guide improvement initiatives throughout the organization.

At Beth Israel Hospital in Boston, every employee from housekeepers to doctors is involved in satisfying patients and visitors. If a patient approaches an employee with a question or problem, that employee provides two things: an informed referral to the hospital contact who can effectively address the inquiry, and his/her own name and phone number so that, if the query is not satisfactorily resolved, the patient can recontact the initial employee.

According to Kimberly P. Wilson, Director of Customer Service at Knight-Ridder Financial, Inc., sales support and service employees are responsible for preparing a report tided „The Customer Said...“ and distributing it to all departments that might be affected by the customer's comments. The distribution list includes product development, sales, field service, and sales support.

Setting Strategies. A balanced stakeholder strategy requires identifying target prospect segments. Leading companies segment their customers by needs and target groups that have attractive long-term value and requirements that match their own strengths and core competencies. This approach ensures a win-win combination.

Developing win-win customer-management strategies typically requires a shift in the company's focus, from divisions, units, or products to customers. Many companies' internal operating statements measure division, unit, or product revenue and profits, not customer revenue and profits. Since you get what you measure, driving profits in these traditional areas may undercut potential customer profits today and for the long-term.

According to Scott Sachs, Director of Customer Service at American Express, his firm changed its card-member services business from a product-based structure – green, gold, and platinum cards – to one based on customer segments: college seniors, corporate, etc. The company now focuses on appealing to each customer segment with services that fit its needs.

ADL has observed that leading companies that leverage customer value drive their business to leverage their largest non-balance-sheet asset: the customers.

Customer acquisition involves an investment, from which a company expects an attractive return. Leading companies estimate the lifetime values of various customer segments to determine how much they can afford to invest in acquiring them without diluting shareholder value. These companies also estimate the remaining value of their current customer base and invest in programs to improve returns from higher retention, more frequent and larger purchases, customer cross-marketing, and prospect referrals.

For example, when Vanguard is acquiring customers, it analyzes a prospect's requests for proposals and asks whether this is a company that it wants as a lifelong partner. With regard to customer retention, Vanguard varies the means of delivering and discussing its quarterly report card according to the size of the customer (e.g., in person, by mail or phone).

Effective Business Processes

Shifting gears to the processes that deliver stakeholder satisfaction, colloquium participants reported that they design and execute their critical customer-value-creating processes in a way that distances them from the „rest of the pack“:

• Processes encompass all customer interactions, thereby integrating marketing and sales with operations on a real-time basis.

• Process boundaries commence and conclude in the customer organization, projecting a one-company image.

L.L. Bean successfully tackled customer management as a broadly defined process this way. Its order management process now achieves a one-company image of product and service delivery and conveys an impression of „unique service“ to each customer.

A walk through the steps of customer interaction illustrates the opportunities for achieving high performance:

Order Generation or Generation of Needs. ADL has observed that in leading customer management companies, marketing and sales work closely with product development and operations. Their mutual objectives are to target customer groups, to ensure that customer needs are reflected in new products, and to ensure that operations are positioned to deliver the necessary services to satisfy and exceed target customer expectations – at a profit.

Order Processing. The company (supplier), knowing the special requirements of customers in advance, processes the order to fit those needs and prices it accordingly. The supplier immediately communicates to the customer its ability to fill the order, confirms price bids, and verifies delivery. A dynamic customer profile is a key enabler here.

Order Fulfillment and Distribution. The supplier optimizes production and shipping while communicating with customers about any change in order status or delivery. For out-of-stock items, L.L. Bean provides automated postcard updates to customers as delivery dates become more defined. Suppliers work seamlessly with customers and carriers to assure that deliveries are scheduled in line with logistical constraints at the customer location (e.g., schedules for multi-order trucks, unloading appointments, inventory procedures).

Field Service. The technical service reps are on the frontline, carrying out field service to achieve increased customer loyalty. They must be supported by the information and technology necessary to prepare for, diagnose, and close out calls quickly and effectively, as illustrated by KONE Elevator's field service team.

Post-Sales Service, Claims, and Financial Issues.

Traditionally backwaters for underperforming personnel, these activities are in the mainstream of customer-value-creating processes. Colloquium participants indicated they manage defections and complaints in a structured rather than in an *ad hoc* manner. Beth Israel Hospital, for example, systematically processes complaints not only to resolve them but also to assess their implications.

Processes that focus on problem prevention rather than on problem fixing are another hallmark of companies that leverage customer value. L.L. Bean focuses its efforts on a key element of its order management process: matching customer expectations about products (and service) with customer purchase decisions. Its principle: knowledgeable sales reps (familiar with product attributes and limitations) should take the time during customer interactions to go beyond simply selling a product and ensure that the *right* product is sold. Sales reps are trained to pace their interactions according to customers' circumstances (regional culture, age, temperament, and so forth), so that each customer feels as though the service is tailored, and no one is rushed into the wrong buying decision. Selling a customer the right high quality product dramatically reduces returns and claims while enhancing satisfaction and loyalty.

American Express Travel Services customer service agents avoid „jumping through hoops" when something breaks by emphasizing problem anticipation and prevention and providing incentives to encourage this behavior. In essence, these companies strive to transform their frontline teams from reactive responders into initiative sellers. This distinguishes them from the rest of the pack.

In fact, colloquium participants confirmed that the boundaries between their companies and their customers are blurring, and interactions are managed well into the customer's organization. Hewlett-Packard is, according to Bruno Pillet, pursuing ways to „build customers into its business processes – to more effectively define customer expectations and to make sensible trade-offs." In its robust customer information systems, Hewlett-Packard has its customers share the burden of maintaining and updating their own information. It is successful because it demonstrates the benefits of doing so, not simply the burdens.

L.L. Bean believes that the process boundaries between its organization and its customers' organizations will continue to merge to the point where customers may place orders and request service directly – e.g., using technology imbedded in their PC, TV, or other media. To this end, Bean's improvements to its customer ordering and servicing systems are designed to make them consumer-friendly rather than customer-service-friendly. New customer-order entry procedures and systems will be used by a wide range of „system-literate" customers, each with his or her own system interface and experience base.

Information Resources

In leading fourth-generation customer management companies, the interaction process is enabled by robust information systems characterized by:

• Accessibility to all „players" active in customer management

• Current, accurate, and complete information

• Dynamic customer information systems subject to real-time updates

The fundamental objectives of information systems are to facilitate the frontline's ability to build relationships and satisfy customers, and to provide all management levels with access to accurate and timely information to support their business decisions. Information accessibility is essential to achieving this objective.

At L.L. Bean, product knowledge is a prime requirement for sales reps. Each rep has all catalogs at his or her station, on-line, supported by a product information database that can answer questions about product fit, shrinkage, the right weight line for an eight-foot fly rod, etc. Vanguard goes the next step and provides customers with access to selected automated information in response to inquiries. Customers „unlock" the system with a special code. The automated response unit can answer most queries and complete most transactions.

Whirlpool's on-line product information system enables customer reps to walk customers through a diagnosis of performance characteristics and identify problems down to the component. A service call is then scheduled with a franchised service company. Information gathered is maintained in a corporate information system, which is actively used by other departments, including product management, engineering, and quality assurance. This way the company understands the current issues on the customers' minds and the implications for Whirlpool's products and services. Hewlett-Packard's customer information system recognizes that a portion of that information can be updated automatically during customer transactions, and that another portion can be more effectively updated by customers (with demonstrated benefit to customers and Hewlett-Packard).

Driving the Customer-Value-Creation Process

The fourth element of the LCV triangle, the organization, must support the customer-value-creation process to achieve success. Leading companies have found that multifunctional teams organized around customers are more effective than traditional functional divisions, improving internal communication and creating a common sense of purpose.

Knight-Ridder Financial Services created and aligned teams across sales, sales support, and field support. All members of the team serve the same customer group. When they recognized two groups as important stakeholders within a customer's organization, Vanguard created account teams to align servicing and processing for each company and participant member.

Teamwork is necessary but not sufficient to leverage customer value. Incentives must be designed to encourage and motivate employees in their new roles. For example, Knight-Ridder Financial Services has aligned team compensation and incentives with total revenues from the customer. Now, each member of the team drives toward the same goal. L.L. Bean has shifted away from the traditional measuring of the number of sales call per frontline rep in a given time period; the company now encourages its frontliners to spend extra time with customers to proactively sell more and make sure the right product is sold.

Leading companies are discovering customer-value-based pathways to profitable growth. In the process, they are reinforcing top management's commitment to the journey. They have discovered customers are not a renewable resource. They are establishing best practices in each component of the LCV triangle. They have found that being first in customer satisfaction and retention provides them with a window of opportunity for distinguishing themselves while it enhances their image as leaders. The benefits of this approach are evident in lower employee turnover rates, higher customer retention, and enhanced shareholder value.

[1] *„Putting the Service-Profit Chain to Work,"* Harvard Business Review, *March-April, 1994, p. 165.*

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