CRM

in a Down Economy

A Peppers and Rogers Group White Paper

FEBRUARY 8, 2001

PEPPERS + ROGERS GROUP
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First the meteoric expansion of the Internet fuels a frenzy of technological investment, and now an economic downturn hammers the tech sector to within an inch of its financial life. Obviously business challenges come fast and furious in this new era, but whether or not the current economic downturn is ever formally classified as a "recession" (two successive quarterly declines in GNP), many of our clients are asking what role CRM should play in this kind of an environment. Does CRM "work" in a down economy?

We all see the unending stream of disappointing earnings reports. Holiday retail sales were lackluster. The financial markets have made it all but impossible to raise new capital. Dot.com companies and other newly funded, technology-heavy businesses are racing to reach profitability before their cash runs out. Many of them are losing the race, laying off people, and auctioning their meager physical assets to pay creditors.

No longer is anyone asking whether the Internet "bubble" will burst. Some predict the current economic downturn, and especially the weakness in financial markets, may last for a year or more. In this kind of a downturn, companies often fail to consider any initiative or program that isn't certain to offer instant success. Immediate gratification.

And yet, for the majority of companies, Customer Relationship Management (CRM) expenditures still have first priority in their IT budgets. Even as companies scale back their overall capital spending, our informal surveys show that most firms still intend to allocate their first spending to the CRM space. This is despite the fact that for most businesses, managing customer relationships is a difficult task to implement, requiring not just an investment in IT infrastructure but a willingness to reorganize significant business processes as well. Clearly, implementing a CRM program requires an investment of both money and time.

So what is going on? Why aren't CRM efforts being cut along with other investments and non-core business activities, as businesses everywhere hunker down to weather this economic storm?

There are three principle reasons why CRM efforts are just as important to a business – perhaps even more important – in a down economy than they are in a booming economy:

1. Managing customer relationships represents a "cheap growth" option for any firm. It can improve its business results in a more direct way, with more efficiency and less waste, even to the point of reducing its short-term marketing and operating costs.

2. Investments in CRM process changes can be made incrementally, in small pieces. This is in stark contrast to supply chain integration and many other IT-led business efficiency improvements. Moreover, each incremental CRM investment can generate immediate, measurable cash flow benefits.

3. Locking in valuable customer relationships is a strategic capability. The strength of customer relationships will determine the competitive performance of a company in both good times and bad. Reducing resources directed at building customer relationships leaves a firm at a significant competitive disadvantage.

Let's consider the implications of each of these ideas, one at a time, in order to better understand the compelling nature of the customer-relationship-management idea.

CRM Makes Cheap Growth Possible

One of the central premises of CRM, as a business discipline, is that customers are all different. They are meeting different needs when they buy products or services from the firm, and they represent different levels of profit for the firm. Some customers are highly profitable, while others are not so profitable.

Rather than trying to grow by hammering away at a *population* (i.e., a "market"), a firm that manages customer relationships grows by making its individual customers more profitable. Cheap growth comes from selling products to those customers most likely to buy, while wasting less time and resources trying unsuccessfully to sell to those customers not likely to buy.

In a phrase, "cheap growth" comes from making individual customers more profitable, individually. But as a task, this is not even conceivable unless a firm is engaged in managing its individual customer relationships, one customer at a time. It requires a firm to have a reasonably good idea of the value and growth potential of different individual customers, whether it uses a sophisticated statistical model of lifetime value or a rougher, down-and-dirty ranking mechanism.

Keep in mind, also, that we are not all marching lockstep through the same economic situation. Everyone is different. Even if unemployment soars to 10%, some people will still be making money and spending it freely. But for a traditional, non-CRM company, hammering away at a market population will yield even less in an economic downturn, when the prosperous customers are fewer and farther between. Knowing how your customers vary in value allows you to concentrate on the types of customers and prospective customers who are more likely to generate meaningful profits for your business. And the worse the downturn becomes, the more important it is to have this kind of insight.

Conversely, even in the best of economic times, not every customer is going to be profitable. In any customer base, there will almost certainly exist some customers who tend to cost more to serve than they are ever likely to return in profit. A traditional, non-CRM company can do nothing about this unpleasant fact, but if you are managing customer relationships, then another sure strategy for growing cheaply is simply to serve fewer unprofitable customers.

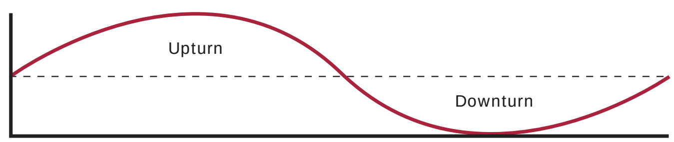
Any firm with an understanding of its individual customer values can almost always apply that understanding to improve its immediate sales efficiency, and rationalize or even reduce its overall marketing costs in the process. Not only will this save the company money, it almost always results in greater customer satisfaction as well, as customers find they are less "pestered" with irrelevant or nonsensical marketing solicitations. Stories from three of our own clients illustrate this premise:

• Bentley Systems, one of the world's leading providers of software for the engineering, construc-

The role of "customer equity" during different economic cycles

Your relationship with a customer is an *evergreen* process. Each individual customer relationship goes on through time, transcending the comings and goings of the economic cycle. For a business, this means that the actual importance of a customer relationship won't erode with these cycles, although the use the company makes of the relationship may change, based on external economic conditions.

Think of the value of customer relationships as a company asset. A firm can use this "customer equity" to improve its growth and profitability prospects during both economic downturns and upturns. The particular CRM strategies it must emphasize and invest in will vary, however, based on the economic situation. Just as a squirrel buries nuts in anticipation of winter, a smart business will build customer equity during good times in order to live more comfortably in bad. Squirrels know that winter is inevitable, but so is spring.



	In an upturn...GROW	In a downturn...HARVEST
Business growth	In an upturn the market is expanding, and companies have the resources both to acquire new customers and grow existing ones.	In a downturn companies should "get the most" from every existing relationship, selling more to customers they already have ("cheap growth").
Marketing	Companies should invest in building brand awareness and attributes—with the objective of attracting new and different customers.	Companies should focus on activation: current customers are a known quantity, so motivate them to do more business with you.
Channels	Focus on *reach*. Invest in your sales force and pay for new accounts, new categories, new markets; develop existing channels and pursue new ones.	Focus on economics. Try to squeeze the most value from each account or customer. Pay for profitability, not volume or conquest.
CRM Infrastructure (investments)	Cash flows are plentiful, so add CRM capabilities. Invest in IT and improve workflows.	Cash is short, so optimize current IT capabilities. Most existing CRM systems are extraordinarily underutilized, and now's the time to increase the usage of them.
Product/Service Portfolio	Divest non-core businesses. Now is the time to sell less productive assets - because divestiture during upturns will attract higher prices.	Focus on adding to core capabilities in a downturn, while prices are low. Use acquisitions and partnerships to create alliances around core offerings.
Unprofitable customers	Emphasize customer development. Convert marginal and loss-producing customers into money makers.	Be more aggressive about converting unprofitable customers, and cut them away if profitability seems impossible.

tion and operation (E/C/O) market, implemented a fairly simple system for ranking clients by long-term value and then aligning the sales effort accordingly. By doing this, Bentley was able to achieve the same level of revenue and profit even after reducing its overall marketing expense by more than 30%.

• For a Japanese auto manufacturer selling in the United States, we drew a "touchmap" of individual customer interactions, paving the way for potential cost reductions of at least $1.5 million per year. This represents a 4.3% savings in what the company spends on interactions with new customers (excluding advertising).

• Scottish Power was surprised to learn through customer data analysis that pre-paying customers were in fact some of its most profitable customers. This was just one of the findings that allowed it to tailor its sales and marketing efforts so as to operate much more efficiently in a deregulated and rapidly changing economic environment.

But cost reductions and marketing efficiencies are just one aspect of the "cheap growth" argument. Another central rationale for concentrating on individual customer relationships is that by doing so a firm can better insulate itself from price competition. If your customer tells you something about how he wants to be served, and you adjust your firm's behavior to meet that need, then the customer himself now has a vested interest in his relationship with you. To recreate his relationship with your competitor, your customer would first have to re-teach the competitor what he has already taught you. Thus, the more any particular customer teaches you, the more loyal that customer will be, which makes him more and more resistant to price offers from competitors. And this customer-relationship benefit is particularly important in a downturn.

When supply outstrips demand, as is characteristic of a down economy, price competition is more prevalent. In the 2000 season, the downturn became painfully visible as retailers competed for a dwindling supply of shoppers using unprecedented, across-the-board price reductions at least two weeks *before* Christmas. But look closely at the business news accounts of this season and you'll find that those firms maintaining the strongest relationships with their past customers were able to make their numbers without significant discounting.

Big retail chains like Sears, Montgomery Ward, Federated, Bradlee's, and even Wal-Mart and Nordstrom, posted extremely disappointing holiday sales results (with both Montgomery Ward and Bradlee's declaring bankruptcy a few days after Christmas). But the relationship marketer Lands' End had a wonderful quarter, with a 12% increase for the season, including a 50% bump in Web site sales. And Toys-R-Us, which re-launched its own relationship-based Web site in partnership with Amazon.com last fall, reported that sales on the site tripled from the previous year, while store sales were up a respectable 3.5% for the quarter.

CRM Can be Implemented Incrementally

For the most part, companies don't want to implement comprehensive, all-or-nothing technological changes, even in a much brighter economy. Wholesale technology replacement and process change is not only expensive, it is so time-consuming as to be nearly self-defeating. The competitive environment is moving too fast. It's not likely to sit still for you while you spend two years or more on a comprehensive, top-down changeover in your company's information systems and business processes.

In a downturn, it's more important than ever to allocate investments and capital spending to the kinds of activities that can not only be measured in the short-term but will also, as is the case with customer relationships, have a long-term competitive payoff.

Today's capital markets are forcing more companies to pay attention to this kind of short-term benefit, especially in the Internet sector. It used to be that Internet investing was thought of as something like a land grab, and investors were funding even wild ideas if they could demonstrate a chance of profit in three to five years. Today, very few companies are able to tap the capital markets without a clear, six-month or maybe twelve-month program to achieve profitability.

Fortunately, in most cases a firm can launch even a comprehensive CRM initiative with a series of incremental, bite-sized projects. Moreover, these projects can often be made to fund themselves with immediate, measurable cost reductions or efficiency improvements. One of our long-time clients, Hewlett-Packard, at one point had over a hundred individual CRM initiatives underway at various places around its worldwide organization. Each project was identified and described, and the results of each were independently tracked on the company's intranet. HP spun off its test-and-measurement division to become Agilent Technologies, and both companies – Agilent and HP – are implementing their CRM projects on an incremental, one-project-at-a-time basis.

Before committing to a major expenditure for any CRM initiative, it is usually possible to ascertain the results of the initiative in advance. Managing customer relationships involves treating different customers differently. As a process, CRM is closely related to the direct-marketing discipline. Therefore, it is a process that is inherently easy to test and validate. No self-respecting direct marketer would even dream of committing millions of dollars to a mailing campaign without already having validated the campaign on a test population so that the precise results can be known in advance, and the economics of the expenditure are justified.

Most of our current client engagements include some sort of customer-specific pilot project, in which a relatively small population of customers becomes the subject of an "experiment" to validate the best way to improve their overall profitability. Many of our clients have several pilot projects proceeding at once, with different types of customers.

Therefore, rather than an "all-or-nothing" proposition, CRM is something that any business can do incrementally, and it can implement it in ways that generate provable, measurable financial benefits.

Locking in Customer Relationships is a Strategic Capability

In the final analysis, what CRM allows a company to do is to stay extremely close to its customers. This means the company can both detect and react to changes in customer plans more quickly and efficiently than its competitors, giving it an important strategic advantage. Does the customer absolutely require lower pricing? Does the service mix need to be altered? An organization that really knows its customers is better equipped to find creative or even customized solutions optimal for buyer and seller alike.

For example, what if pricing becomes the absolutely most critical issue? In the B2B or even B2C space, a company that maintains individual customer relationships can work with these customers to retool the value chain when necessary, including the possibility of emphasizing different aspects of its value chain for different customers, and giving up less in the aggregate. Certainly, price will become more critical. But maybe the issue isn't so much the price of the product itself as it is total cost of ownership. Maybe closer collaboration in terms of supply-chain management can help both organizations – buyer and seller together – better manage the buyer's production and inventory, reducing or even eliminating pricing pressure. Usually, the more processes the seller can handle for the buyer, the more the buyer's total cost of ownership can be reduced.

One of the bedrock principles for cultivating better relationships with customers is to focus the company on increasing its "share of customer" with each individual customer. On the surface this means that a firm will concentrate more effort on cross-selling and up-selling of other products and services – an inherently more efficient allocation of sales effort in almost all situations.

But beyond that, and especially in the B2B space, taking a "share-of-customer" approach implies seeking out more opportunities to collaborate with individual customers. Collaborative efforts might help a customer manage or use the product or service it bought from the firm; it might help the customer repair it, service it, or maintain it; and it might even help the customer improve its overall business by using the product more effectively.

In other words, taking a "share-of-customer" approach means focusing on the individual customer's "total cost of ownership" of the product. When Dell launched Premier Pages, a Web-based service designed to allow enterprise customers to order pre-configured Dell products and services within company-specific purchasing guidelines, what Dell was doing was helping its customers manage their total cost of ownership of Dell products. Dell is, in fact, inserting itself right in the middle of its enterprise customers' own cost equations, making its services highly valuable to any business customer focused on costs.

And never are B2B customers more focused on costs, or more eager to negotiate such arrangements, than when the economy turns down. In a down economy, business customers want to reduce costs like everyone else. They want immediate efficiencies, benefits, and cost savings. Usually these desires are expressed in the form of price negotiations. But a CRM-enabled organization – a one-to-one enterprise – can give the customer exactly what it wants by *adding* services, rather than reducing prices. It should be noted that, while all the PC manufacturers have suffered setbacks in the most recent couple of quarters, Dell's business prospects, relative to its competitors, have become noticeably brighter.

In the B2C space, the same logic applies, only it results in a somewhat different dynamic. A one-to-one enterprise helps its consumer customers to get more life from the product they've bought, to squeeze more use out of it, or to benefit from owning the product in ways that the consumer had not originally even imagined.

This is especially evident in any product category in which purchase cycles might be stretched out during a downturn (consider home appliances or autos, for instance, when worried consumers might put off the next purchase until the economy turns up). If your customers are visiting less often, you can still keep them loyal by maintaining relationships with them that "fill in the gaps" between increasingly lengthy purchase cycles. You can maintain the car, or warranty it. You can interactively recommend a variety of appliance options to consider. You can insure the product, or finance it.

Recession 2001: Time to Optimize Your CRM Investment

As corporate purse strings tighten, the temptation is to reduce strategic investments and instead focus firmly on the near term. As we have discussed above, the most focused one-to-one programs actually are beneficial, even in the short term. The reason most companies aren't whacking at their CRM budgets today is that a well-executed relationship project can increase cash flow immediately.

Today's one-to-one enterprise is more capable when it comes to responding rapidly to changing demand patterns, as well as identifying greater process efficiencies and collaborative opportunities. The fact is that investments in one-to-one CRM represent a competitive edge in any economy. This is the time for greater, not less, focus on CRM. □

About Peppers and Rogers Group

Peppers and Rogers Group was founded in 1993 by Don Peppers and Martha Rogers, Ph.D., co-authors of a series of books and articles on managing customer relationships, including *The One to One Future* (1993), which first popularized the term "one-to-one marketing." Steve Skinner, a former partner at McKinsey & Company, is president and CEO. As the preeminent management consulting firm specializing in customer-focused business issues, Peppers and Rogers Group helps clients devise strategies and plans for strengthening their customer relationships; assists clients in the operational implementation of their customer relationship initiatives; offers training and e-learning programs, research studies, workshops and keynote presentations; and helps clients locate and evaluate CRM professionals through its 1to1® Executive Search subsidiary. Peppers and Rogers Group's advertising-supported newsletters and magazines reach more than 250,000 CRM professionals around the world.

In addition to its headquarters in Norwalk, Conn., Peppers and Rogers Group maintains 16 other offices throughout North America and on five other continents. Recent and current clients include Agilent Technologies, Bayer Corporation, Bentley Systems, Ford Motor Company, Jaguar Cars, Lowe's, Verizon and Volvo. Internationally, new clients include Banco Itau, Sul America Investimentos, EDS, Lloyds Bank, and Unimed (Brazil); Bell South (Chile), Ford Chile; Novartis Pharma (Argentina); Village Group (Australia); Dogus, one2one, P&O Stena Line, Syngenta, Thomson Holidays, and Winterthur (Europe) ; and Discovery Health and SAS Institute (South Africa).

For more information, visit the company's Web site at **www.1to1.com**

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