A Measure of Success

You know a lot about your customers. You know who they are, where they live, what their buying habits are.

And if you're like most companies, you've done absolutely nothing with that pile of market intelligence. It just sits there, earning you no money and creating zero shareholder value.

Here's what your company needs to do to put all that hard-won information to work.

By Larry Selden and Geoffrey Colvin

PHOTOGRAPH BY PIER NICOLA D'AMICO

SYLVIA REYNOLDS, WELLS FARGO
"I was amazed at what you could learn in a mortgage application. You could ask for someone's divorce papers!"

HEY, AMERICAN EXPRESS—do you know us?

Do you ever. You know where we travel and when, on which airlines, in which class of service. You know the restaurants where we eat and the stores where we buy wine and books and clothes. You know this and much else for millions of us. And no one else has that very same data! (While AmEx's headquarters was damaged in the World Trade Center attack, no data was lost.) The company should enjoy an awesome competitive advantage.

Yet it doesn't—at least none that the stock market has noticed. American Express trades at just 22 times earnings, when the market average is 26. In fact, AmEx's price/earnings ratio has averaged around 20 percent below market averages during the past three years.

AmEx is hardly the only data-rich, value-poor corporation that comes to mind. Think of other financial services firms, phone companies, airlines, retailers, hotel chains, rental car companies, service providers—the infotech revolution was supposed to make their customer knowledge the killer competitive advantage of our time. Consultants like Don Peppers and Martha Rogers (*The One to One Future, Enterprise One to One*) have been writing about the possibilities for years. Yet far from commanding premium P/Es, these companies almost in-

ERIC MILLETTE

variably trade at crummy multiples (see chart below). The missed opportunity is stunning: If the 10 firms represented by our chart could nudge their multiples up to the market average, they would create more than $500 billion of new shareholder wealth. Why they've failed to make use of the massive troves of customer data they possess is one of the great business puzzles of the Info Age.

It's important to note that this is not mainly a technology problem. While integrating data scattered among a hodgepodge of business units and computer platforms is no layup, it is no longer an insurmountable hurdle. The proof is that a few companies, such as Dell Computer, are using the technology well and delivering premium P/E multiples in this down market.

If technology isn't to blame, what is? Not privacy concerns, regulatory restrictions, or other apparent obstacles that managers like to cite (see "Don't Buy These Excuses," page 62). Talk with managers at companies that use customer data effectively, as well as those at companies that are struggling, and it's clear that the most important problems lie within. Converting customer data into real shareholder value—a process we call customer knowledge management (CKM)—starts with the right corporate mind-set, organization, accountability, and leadership. Until an organization squares these away, even the fanciest new tools will do little but run up the IT budget.

Our analysis of successes and failures in the use of customer data shows that every company needs a strong foundation made of seven elements. As we describe them, ask yourself which ones your company has, needs to build, or needs to strengthen. Give your company a score of 0 to 10 on each trait. At the end we'll explain what your total means.

1 Leadership committed to delivering and maintaining a premium P/E multiple.

GREAT COMPANIES RECOGNIZE THAT they must excel in the eyes of their capital suppliers—the shareowners. A weak stock means you'll have a tough time attracting the best employees. It's harder to please customers when you're struggling to fund research and customer service. When you need to buy companies to get technology, talent, or access to key markets, a strong stock may be your best currency. That's why many leading companies focus explicitly on maintaining a P/E multiple that's superior to some broad market benchmark such as the S&P 500.

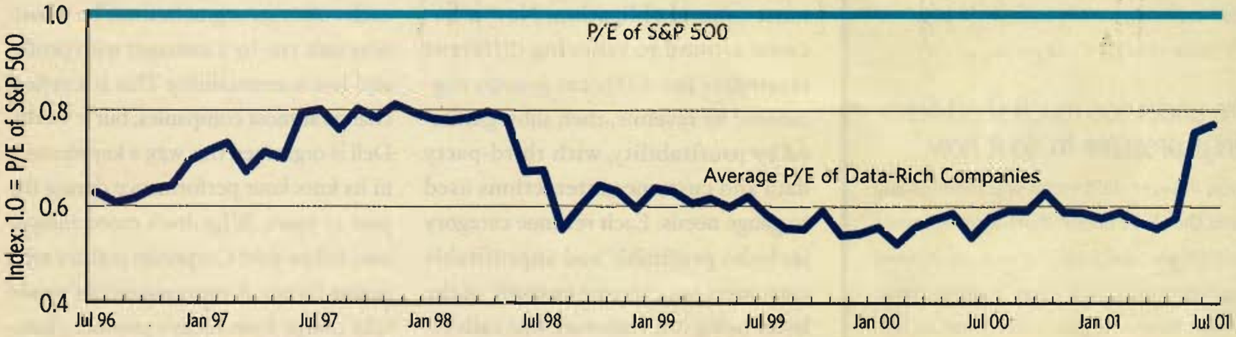
Yet in our experience, most companies are unwilling to set—even internally—such an aggressive goal. This is a major problem, since using customer data more effectively often requires wrenching institutional change. Many of the companies sitting on untapped gold mines of customer data typically benchmark against peers, not the broad market. If the whole industry is in the dumps, a poor performer can look good by comparison and the urgency to improve vanishes. Set the capital market goals low, and the customer service goals will almost certainly be low as well.

2 Strategic planning built around customer segments—and a cultural belief that not all customers should be treated identically.

WITH THE CKM TOOLS NOW AVAILABLE, it's far easier than ever for a company to learn a piece of crucial information:

If They're So Smart, Why's Their P/E So Low?

You might expect companies with tons of customer data to deliver great value to shareholders, but most do just the opposite. This chart reflects the average P/E multiples of 10 firms* drawn from a variety of industries with rich opportunities to build customer knowledge. Nevertheless, all 10 almost always traded at P/E multiples below that of the S&P 500 during the past five years, and the average of the companies' P/Es was always well below the S&P. If these firms could simply raise their P/Es to that of the market, they'd create an additional $500 billion of shareholder wealth, a stunningly large missed opportunity.



*American Express, Bank of America, Chubb, Citigroup, General Motors, Merrill Lynch, Morgan Stanley Dean Witter, SBC Communications, Sears Roebuck, Verizon Communications

Don't Buy These Excuses

Executives can give you plenty of reasons for not making better use of their extensive customer data—but many of their excuses aren't valid. Among those we've heard most:

"The privacy issues are too tough."

As long as a company is using its own data or legitimately purchased third-party data, privacy issues are rarely significant. More important is how much the customer expects the company to know: A consumer may be jolted to receive an offer suggesting that his credit card company knows the size of his mortgage, though that information may be easily and legitimately available. An advantage for big financial services firms is that customers expect them to know a lot.

"We're in a regulated industry."

Government regulations may prevent certain moves; phone companies, for example, can't differentiate some services by customer profitability. But even then, opportunities to use customer data for creating shareholder value—through cross-selling, up-selling, and offering new products and services—remain plentiful.

"We've already got a lot of initiatives."

An insidious excuse, because it suggests that all is well. But all is not well unless those initiatives are expected to achieve a target return on investment and someone is being held accountable for those results. It's rarely so.

"We're under too much short-term earnings pressure to do it now."

Then you'll never do it—can you think of any company that isn't under short-term earnings pressure? If you don't get the process started now, competitors could seize an advantage. When that happens, you'll really get to feel some earnings pressure.

how much money it's making (or losing) on each customer. You'd think every company would want to segment customers by expected profitability and treat the most profitable customers best. After all, extensive research—most notably by consultant Frederick F. Reichheld—proves that retaining current customers is enormously more profitable than bringing in new ones, a finding that goes double or triple for the most profitable customers.

Yet many companies resist. Often a key reason is that the corporate culture regards it as unfair to treat some customers better than others. It's an odd attitude; after all, as consumers we almost always feel we deserve special treatment if we're loyal customers, and getting it makes us more inclined to do additional business. It's important to keep that in mind. Because customer loyalty is so valuable, the most profitable customers *should* get better treatment.

Applying that principle isn't always easy. To satisfy your best customers, you must be able to segment not just by profitability but also by needs. For example, a bank might find that its most profitable customers include young professionals with big mortgages as well as elderly widows who keep large balances in savings accounts. But only one of those groups would be a logical prospect for sophisticated investment products.

Fidelity Investments has made significant progress in the past three years in creating (and acting on) multiple segments. The company long held that treating all customers equally was almost a moral obligation. Now it has come around to tailoring different strategies for different groups segmented by revenue, then subsegmented by profitability, with third-party data and customer interactions used to gauge needs. Each revenue category includes profitable and unprofitable customers (an extreme example of the latter being one customer who calls Fidelity some 3,900 times a year). Fidelity then applies all this data in several ways: to develop products and services for each group, to create marketing programs, and to differentiate service. The results are higher customer loyalty, better returns on marketing investments, and a bigger share of customers' total spending on financial services.

Nevertheless, many companies remain wary of similar opportunities in their businesses. Failure to differentiate becomes an even bigger problem when the economy tanks. Companies cut head count in branches, call centers, and installation centers, reducing customer service "equitably." Just when it's most essential to keep the most valuable customers and get more of their business, these undifferentiated cost cutters do exactly the opposite.

3 A truly customer-centric mind-set and a corporate organization built around customer segments.

AT MOST COMPANIES THE WORLD REvolves around products or functions or geography. Customers endure the all-too-familiar experience of contacting different parts of the organization and finding that each part knows nothing about that customer's experience with the others. Have you ever called your local phone company and tried to order a new service like, say, a DSL connection? Depending on where you live, you may be treated like a total stranger, even if you've been a customer for decades.

For that to change, someone must "own" the customer—and that means each customer segment must be a business unit run by a manager with profit-and-loss accountability. This is a radical change at most companies, but it works. Dell is organized this way, a key element in its knockout performance during the past 15 years. Why don't more companies follow suit? Corporate politics are a major factor. A reorganization would take power from today's product-, function-, and territory-based barons, all of whom command formidable resources with which to kill the new system.

More fundamentally, the problem is one of mind-set—what the company perceives itself to be all about. No company uses customer data better than Amazon. Ask former CFO Joy Covey why, and she replies immediately, "It's the mind-set." From day one, founder Jeff Bezos made clear that Amazon would use its information about customers to build relationships with them and make them happy. There simply was no other way of operating.

Not many companies inherit a customer-centric mind-set from their founders. But those that weren't born with one will need to get one—and organize on that basis—before hoping to turn customer data into shareholder value. "We're building toward that customer-centric model," says Stephen Butler, a Verizon executive who's among those trying to shake things up at a company with roots going back more than a century to life as a regulated utility. It's a long slog, but Butler is starting with the right insight. "It's more than just technology," he says. "It's a change in culture and organization."

STEPHEN BUTLER, VERIZON "It's more than just technology. It's a change in culture and organization."

CRAIG CAMERON OLSEN

4 Caring enough about customer data to invest in developing it—and then holding managers accountable for returns on those investments.

IT'S REMARKABLE HOW MANY COMPANIES just don't care about customer data. Banks in the United States are exhibit A. "As an industry we always had the data, but we threw it away," says Sylvia Reynolds, who recently joined Wells Fargo as head of marketing for the National Home Equity Group. Wells Fargo is emphatic about not throwing data away today, as it cranks up a major effort to create more value from what it knows. Reynolds adds: "When I first got into the industry, I was amazed at what you could learn in a mortgage application. You could ask for someone's divorce papers! I started thinking of all the things we could do with this information."

Even companies that spend a lot on infotech often spend remarkably little on developing customer knowledge. At most of the companies we've investigated, infotech investment is conceived as building infrastructure—with the payoff defined vaguely at best—rather than as pursuing profitable projects.

It needn't be that way. General Electric has coined the phrase "drive it to the ledger," meaning that if something is worth doing, its bottom-line benefits must be planned and tracked. Excellent companies routinely apply that practice to such activities as cost cutting and working capital management because managers are accountable for those things. So if a company wants to make wise investments in developing customer knowledge, it will need to make managers accountable for the profitability of customer segments. Those managers will have to guide those customer-knowledge investments—and drive them to the ledger.

5 A culture that enthusiastically examines customer data, uses it to form hypotheses, experiments, and applies the results.

IN ANY COMPANY, DIFFERENT PEOPLE respond to data in different ways, some useful, others counterproductive. We saw an excellent example of the latter at a major global retailer. During a review, managers excitedly told the company's senior marketing executive that a study had discovered that the top 1 percent of customers accounted for about 25 percent of the company's total credit card sales. But the executive wouldn't believe it. With millions of customers coming into the firm's stores every day, it simply couldn't be true that a mere 1 percent were that important. Intent on proving his own intuition, he attacked the data and the design of the study—and resisted an insight that might unlock a new value proposition for his most important customers. His passionate subordinates eventually prevailed—a year later.

The best companies evaluate the data without prejudice, make inferences, and figure out ways to use it. At Fidelity, managers sift through the data every day, looking for insights. The culture is similar at Travelocity.com, the largest player in the largest category of e-commerce. The culture must endorse such behavior and penalize the more common unproductive responses to customer data.

6 A record of merging operations successfully, with zero decline in satisfaction among the most valuable customer segments.

IN ANY COMPANY MORE THAN A FEW years old, customer data probably resides in several computer systems across the enterprise—marketing, production, shipping, billing. Putting those together is a big job, but in many companies it's even bigger because the company has recently gone through a merger.

Obviously no organization can form a complete picture of its customers until it combines data from all of its component companies, a massive infotech assignment. But here again, the greatest challenge is managerial. Consolidating customer data requires employees to cooperate in ways they may not be accustomed to. Making that happen day by day is a specific management task, and some companies are better at it than others. The best are companies with lots of experience in integrating acquisitions. Among those, the very best are the firms that made acquisitions with a customer-centric mind-set.

7 Top management that spends at least 25 percent of its time teaching these principles to all levels of the organization.

FULLY EXPLOITED, ENLIGHTENED USE of customer data will almost always drive a company toward profound organizational changes. That's why top management commitment is indispensable. Just consolidating data can become so contentious a process that it may fail unless participants know that the CEO is watching and expecting it to succeed.

More deeply, a truly customer-centric

It's About Management, Not Technology
(Still, Here's the Technology.)

Finding the software vendors and consultants to help your company wring maximum value from consumer data is so easy it's almost impossible: The list of firms with solutions for sale is virtually endless. But one of the strongest themes we hear from companies wrestling with these issues is that no vendor or combination of vendors provides it all. You'll have to do considerable work on your own to find the right fit.

Customer relationship management (CRM) software—tools that help a company interact with its customers—is a well-defined industry led by firms like Siebel Systems, Oracle, and PeopleSoft. But CRM is only one piece of the challenge. (For a directory of CRM suppliers, go to www.business2.com/webguide.) Managing customer data may also require software for data mining and business analytics, which help data users make savvier decisions. Leading suppliers include Computer Associates, Harte-Hanks, Informatica, and SAS, plus the giants of business software, IBM and Oracle.

All the leading consultants, such as Accenture and PricewaterhouseCoopers, and dozens of boutique firms have built practices in this area. It's also likely to become a fierce battleground between giant computing-consulting firms—notably IBM and the proposed blend of Hewlett-Packard and Compaq. Compaq is already offering a major software-consulting package for customer data analysis.

Remember that while software and consulting vendors can help you create value from customer data, the exact brand isn't the key factor. Tennis star Lleyton Hewitt probably could have won the U.S. Open with any of the three best rackets on the market. Just as his training and skill development were the critical factors for him, the organizational and cultural factors described in the accompanying article will be critical for you.

company is unlike almost anything that now exists. No company that we're aware of has fully adopted all of these principles. How far in that direction can a company go? No one knows, but we'll likely find out in the next few years.

Now add up your scores. Here's how we interpret the total:

0-25: Don't even try extracting more value from your customer data. Until you improve on the basics, applying today's customer knowledge management tools for this purpose will just tie your company in knots.

26-50: You've got a shot at success, but you'll need to improve your lowest scores quickly.

51-70: Go for it. The management challenges won't be easy, but you're better prepared for them than most. Move now and you could build a strong competitive advantage that delivers a premium P/E for your shareowners.

One final observation: In this application of infotech, as in many others, the future could be just the opposite of what the pundits expect. The friction-free, Internetworked world was going to be a place where buyers flitted from vendor to vendor at the click of a mouse. In reality, it may be that the best users of consumer data can learn enough about their customers to create continuously better products and services—a competitive advantage that will just get stronger. If that's the future, then the most customer-centric firms will get even better in the years ahead, and the gap between the strong and the weak will widen.

If you're on the wrong side of that gap, you'd better move fast. ✦

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WebFile To find more information on data mining and customer relationship management, go to **www.business2.com** and type the words **customer data** into the search box or click on the WebFile link.

Boise Cascade Gets That Old Data Religion

A few companies—Amazon, for one—were born to turn customer data to competitive advantage. For most established firms, however, it often takes fundamental, tear-up-the-org-chart reorientation. One company of the latter type is Boise Cascade Office Products, a $4 billion subsidiary of the paper giant and a purveyor to large and midsize businesses of everything from paper to paper clips to office furniture. About two years ago, the company had its "eureka" moment. "Here we had tons of data on our customers and were doing nothing with it," says senior VP for marketing Dave Goudge, the leader of BCOP's customer data initiative. "We could distinguish ourselves in an increasingly competitive industry by collecting that data in one place, organizing it, and then using it to create great customer service."

UNDER THE HOOD

What's behind BCOP's customer data transformation

- **Hardware:** Sun E3500 and E4500 servers
- **CRM software:** Nortel Networks's Clarify eFront Office 10.0, E.piphany E5.02
- **CTI software:** Cisco ICM 4.1.5.5901 and CIS 3.1
- **Systems integration consultant:** KPMG Consulting
- **Business strategy:** Peppers and Rogers Group

Easier said than done. For starters, BCOP's customer information was buried in dozens of separate databases that couldn't speak to one another. Liberating that data and installing a new CRM system without disrupting BCOP's ongoing business would be challenge enough—a bit like changing the tires on a race car in motion. But the organizational hurdles were higher still. For BCOP to make full use of its data, service representatives would have to learn to sell, territorial sales reps would have to share data on their clients, and once-autonomous brands within BCOP would have to be consolidated.

Still, phase one of the initiative dubbed One Boise went into effect on April 1—on time and within 1 percent of the $20 million the firm had budgeted—and life began to get dramatically easier for BCOP clients. Now when you call to place an order (or log on—about 18 percent of sales come via the Web), you key in an identifying number and are soon greeted by name by a rep whose screen shows all of your most recent BCOP interactions. Based on your past dealings with the company, your call might get special routing—to a specialist in a particular kind of merchandise, say, or to a Spanish-speaking rep—all before the rep even picks up the phone. Lost on the website? Click "Need Assistance?," and a pop-up screen asks whether you would like help by instant message or by phone. Choose the former and a rep will be on your screen immediately. Choose the latter and the phone will ring within 30 seconds. "BCOP has taken much of the aggravation out of ordering supplies," says Bob Powell, purchasing manager at Citizens Banking Corp., an $8 billion Midwestern bank. "That lets us spend more time doing what we're supposed to do, which is banking."

Goudge and his team have to live up to preset return-on-investment goals. In this case ROI is admittedly fuzzy, estimated from measures such as customer retention and share of total office-product spending. But Goudge has his own yardstick. "When customers finish placing an order with us," he says, "I want them to say, 'God, that was slick.'" — **ERIC SCHURENBERG**