MARKETING

Turn Customer Service into Customer Profitability

JOHN HOLM

To maximize your firm's value, think of customers as a business asset.

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How do you measure the value of your company?

Ask the chief financial officer and he or she will likely mention expected cash flow and stock price. An executive in production will cite technology and the assets in plant and equipment. Your human resources manager will no doubt point to the capabilities and competencies of the firm's employees.

Each of these measures is, of course, critical to the success of any business. Indeed, each is carefully tracked, evaluated and managed. Yet none fundamentally drives the value of a company in quite the same way as customer assets. After all, customers are your firm's only source of revenue and, ultimately, profit. In the final analysis, the stock price, the return on tangible assets and the productivity of employees are determined by how well the firm selects, nurtures and maintains its customer assets. Despite the pivotal nature of these relationships, very few companies have devoted the same time and effort to tracking and managing the value of their customers as they have spent on financial, plant and employee measurement systems.

Today, however, a number of leading-edge organizations are beginning to manage their customer assets as rigorously as they do their finances. This approach is called customer franchise management. In essence, the goal becomes to maximize the firm's value by focusing on the acquisition, development and retention of your most profitable customers.

Underlying customer franchise management is a very simple premise: A company can out-perform its industry's average by better managing its portfolio of customer assets.

Customer franchise management is emerging as an especially effective strategy in both mature industries and those undergoing tremendous structural change. As traditional franchise defenses such as tariffs, technology and regulation are eroded, companies are finding that they must build new franchises by understanding who their most valuable customers are and focusing their efforts on delivering what these customers want, when they want it and where they want it. To achieve maximum franchise value, firms must focus on customer profitability at all three points in the relationship cycle: acquisition, development and retention.

Customer Acquisition

Customer acquisition begins with a detailed understanding of your company's existing and potential customers. Who are they? What do they have in common? How do they make buying decisions? How much does it cost you to serve them? And, most important, how profitable are they to serve?

Probably no single factor has more influence on franchise value than effective customer acquisition. Ted Williams' advice on achieving a high batting average—"First, get a good pitch to hit" —holds for targeting customers as well. Despite the enormous amounts spent on market research and product testing, most companies find that only a small percentage of their overall customer base is truly profitable. Even those successful at acquiring profitable customers usually find that their rates of retaining those customers are disappointing.

Upon close scrutiny, many firms find that about 20 percent of their customers account for almost 80 percent of profits. Imagine the leverage a business could achieve if it increased the representation of those high-profit customers in its portfolios by half?

The most attractive acquisition candidates are those customers that display a relatively high degree of preference for certain products and are likely to be profitable to serve. Those who display high-profit potential but low preference may be reached if the product is redesigned or repositioned.

Conversely, customers who are attracted to the product but likely to generate low profits will consume marketing resources without much return. For example, many cellular phone companies have found that broad-based, expensive customer acquisition programs featuring free telephones and minutes have attracted large numbers of low usage, unprofitable customers with high turnover rates.

Efforts to identify the high-profit customers sometimes produce surprising results. A case in point: at ScrubaDub, a New England car wash chain, those consumers who might be presumed to be the most frequent current customers of the company's services (owners of luxury vehicles) are, in fact, one of the least frequent users. ScrubaDub knows this because it has invested in a state-of-the-art customer information system, based on bar codes on cars, that allows it to closely monitor buying behavior (see Case Study, page 25).

In some instances, customers are targeted for their strategic value beyond the direct profits they generate. Computer trend-setter Silicon Graphics takes customer acquisition very seriously. The company actively targets and courts what it calls "lighthouse customers," those firms with particularly sophisticated or creative needs, frequently changing technical demands and high standards.

Customer Development

Once companies understand who their customers are and which ones represent the greatest opportunity for a profitable relationship, their next challenge becomes applying the right marketing tools and levers to maximize the value of individual relationships. This second dimension is called customer development.

The place to start customer development efforts is with an assessment of the current value of the franchise. For instance, United States Enrichment Corporation, a government entity formed to facilitate privatization of the commercial nuclear fuel business, inherited a set of contracts and relationships from the Department of Energy. Chief executive Nick Timbers established a baseline "franchise" value for the firm and is using this figure to measure success in creating additional value for the U.S. Treasury.

The most attractive development candidates are those with the greatest potential to increase their level of purchases or to shift their buying to higher margin products. Focusing development efforts (cross-selling, for example) primarily on current "best" customers may not be a sound approach, since they could already be fully devel-

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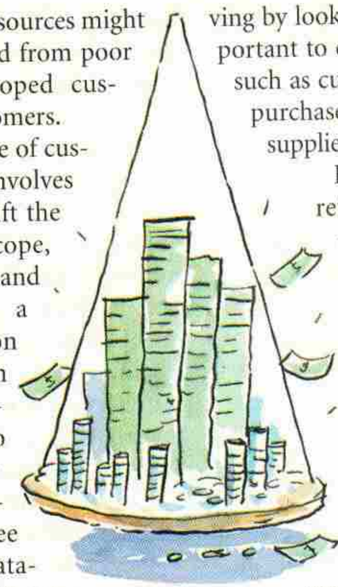
The old 80-20 rule holds true for sales: Many firms find that 80 percent of their sales come from 20 percent of their customers. To leverage the remaining buying power, companies must commit to acquiring, developing and retaining profitable customers.

oped. Instead, development resources might be more effective if redeployed from poor prospects and highly developed customers to high-potential customers.



Building the lifetime value of customer assets frequently involves leveraging information to shift the focus of pricing, product scope, promotion, channel strategies and brand management from a broad, short-term orientation to a selective and long-term view. Many companies are using innovative techniques to develop their franchises by capitalizing on customer information. Starbucks Coffee monitors responses to its catalogues to determine where its potential growth customers are. When the chain identifies a geographic cluster of buyers, it then considers that location for a retail store. Other chains like Staples offer frequent shopper discount cards to use at checkouts, which help track customers' buying habits and preferences.

Perhaps no company uses customer information and behavioral modelling more intensively to maximize customer equity value than Fingerhut. By carefully tracking responses and developing an extensive database of 1,400 elements per household, Fingerhut is able to target its 75 specialty catalogs and build relationships through some 150 personalized mailings annually.

WORKBOOK

To effectively leverage customer buying power, a manager must understand these principles of customer franchise management:

- **Customers are assets. Understand, nurture and protect their lifetime value.**
- **Not all customers are created equal. Chase the profit, not the sales.**
- **Products come and go; customers are forever (you hope!).**
- **Know what you are really selling. Focus on the total customer experience not just the sale.**
- **Customers relate to people, not companies. Empowered employees excite customers.**
- **Expectations are more important than explanations. Point your customer information system forward, not backward.**
- **Customers are known by the company they keep. Build a strong brand.**

Customer Retention

Retention efforts should focus on keeping the most profitable customers. While the value of maintaining profitable relationships is irrefutable, the idea of zero defections can lead companies to embark on aggressive customer retention or recovery programs that cannot be justified economically. Defection analysis, designed to understand the root causes of departures, can be a valuable tool. Relying too heavily on it, however, is like driving by looking in the rearview mirror. It's important to emphasize forward-looking factors such as customer expectations, probability of purchase and willingness to consider new suppliers.

Focusing primarily on customer retention at the expense of acquisition and development efforts can also lead a company to sub-optimize its franchise value. Sometimes a business must take the painful but necessary step of discouraging parts of its existing customer base in order to reposition itself in a more profitable segment.

Using a rigorous activity-based cost analysis, a laboratory services company discovered that the high-volume customers it thought were its core franchise were, in fact, only marginally profitable. Intense competition for the commodity-type services those customers demanded helped make them less profitable than anyone surmised.

At the same time, a smaller but faster growing set of customers who required higher margin, value-added services offered the firm greater long-term profitability. By redeploying its resources away from the commodity segment and toward the value-added customers, this company increased profits even with an initial decline in revenues.

In another case, a money management publication was relatively successful at building a base of loyal, cost-conscious subscribers, many of whom were on fixed incomes. Unfortunately, advertisers didn't find this penny-pinching group an attractive audience. After the magazine repositioned itself to a younger, value-conscious readership, it was able to attract more advertisers.

What are the hallmarks of companies that are building powerful customer franchises? While their individual strategies vary, these companies and others share a number of characteristics. They know that all customers are not created equal and they are keenly aware of the lifetime value of their customers. They invest heavily in knowing those customers and using that information to increase the value of each relationship. Finally, they focus their efforts where they will have the greatest effect on profitability. MR

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