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commentary

If a telecom company's assets really were its customers…

Telecommunications companies, like many others, talk of their customers being their most important assets. This is increasingly true economically, but rarely reflected fully in a company's strategy and operations. As fast as telecom companies are becoming 'customer focused', the customers are moving on: users of prepaid mobile services in Europe and dial-around services in the US are starting to buy telecommunications like toothpaste, transaction by transaction when the last one runs out.

Despite their focus on customer value, few companies are systematically managing their businesses to *milk*, *replenish* and *leverage* their customer assets. Yet each of these dimensions of customer relationship management is critical, not only in the value it brings directly, but in reinforcing the other two.

By pursuing these three aspects of customer relationship management together you can create real and sustainable value from – and for – your customers. Practical opportunities to do this in telecommunications abound, and are being under-exploited.

In this commentary we look at the rewards, implementation challenges and way forward in each approach, and the opportunity for growth companies create when the three approaches interact.

Simon Glynn

Value from the customer asset

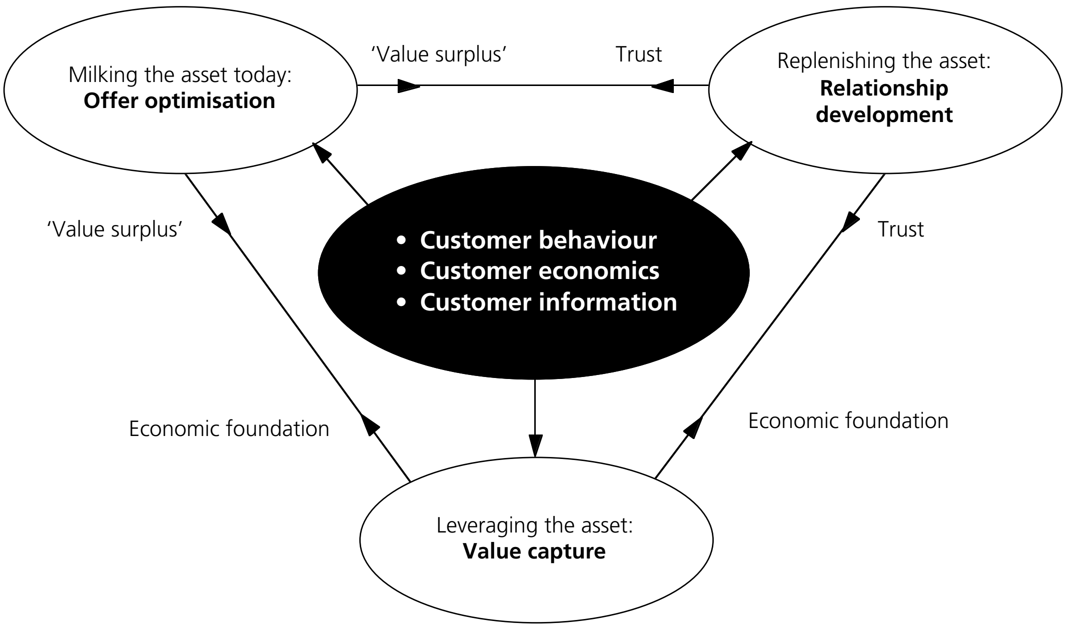
The idea of customers being a company's most important assets is not just a management cliché, but an economic fact. As both the unit costs and differentiation in telecommunications infrastructure decline, the customer relationship gains prominence:

- A typical European mobile network operator will spend marginally more over the next ten years on customer 'capital expenditure' than on network capital expenditure.
- New styles of telecom company, such as Worldcom and Excel Communications, have created huge shareholder value through strong customer bases and little network asset.
- 'Outsiders' such as AOL have the potential to take leading positions in telecommunications service provision through the strength of their customer bases, with no network asset at all.

Despite both the rhetoric and the economics, few telecom companies are systematically managing themselves as customer-centric companies. At the core of a customer-centric company is an understanding of how customer behaviour, customer economics and customer information interact, both qualitatively and quantitatively.

Insights into this interaction are the basis for today's approach to customer relationship management, maximising overall returns on customer investments by milking, replenishing and leveraging your customer assets (see Exhibit 1).

Exhibit 1
Complementary approaches to maximising customer value



Most telecom companies are succeeding in at least one of these dimensions today. The real value, however, is not in any one of the dimensions, but in the mutual support that the overall system can provide:

- Optimising your offers for different target customers milks the assets today. Optimisation involves targeting and tailoring your offers to reflect differences not only in customer needs, but also in purchasing and usage behaviour and in economics, in order to maximise margins. Offer optimisation creates the value surplus both to share with the customer (sustaining the relationship) and to provide the economic leverage for the company's strategic position.

- Developing the customer relationship from an emotional point of view replenishes the asset. Relationship development involves all customer communication, beyond making targeted product offers. The relationships that you develop maintain the trust that both underpins customers' positive response to your offer optimisation, and provides the relationship leverage for the company's strategic position.

- Capturing value from the customer relationship leverages the asset. The value you capture is a reflection of your overall business design – your ability to earn more from each customer than you could as a traditional, undifferentiated network operator. By securing your share of the total margins available from the customer, value capture provides the sustainable economic foundation for the first two dimensions.

What happens if your customer strategy is one-dimensional? You can get a short-term economic advantage from optimising offers; but you will lose it if you do not replenish the relationship asset on which the advantage is built. (Your offers may even damage that relationship, by alienating customers not favoured for particular offers, or by being too demanding of customer information in 'relationships' that customers see as only one-sided.) You can increase loyalty, and improve churn statistics, by developing true relationships with customers; but if you don't attend to the economics of optimisation, and to how you will capture value from the relationships you build, your approach to customer care will soon become unaffordable. And you can create the best business design in the world, but unless you can feed it with the customer trust and value surplus coming from your day-to-day operations, it will perform as effectively as any other engine does without fuel.

Conversely, companies that pursue these three aspects of customer relationship management together can create real and sustainable value from – and for – their customers. Practical opportunities to do this in telecommunications abound, and are being under-exploited.

Offer optimisation: milking the asset today

It is becoming conventional wisdom that consumers of telecommunications services vary hugely in value; and that by targeting (as well as tailoring) product and tariff offers you can grow the value of your customer base – whether you are an incumbent protecting your best customers or a new entrant poaching them.

Many telecom companies now have a complicated choice of tariff structures, including special programmes for their highest-value customers and points-based rewards. Many also make ad hoc offers and promotions, as well as reactive offers such as handset upgrades for customers threatening to leave a mobile network.

As in other sectors where these differential marketing techniques are used, such as financial services and retail, the leverage you can gain from your marketing spend can be enormous. We have constructed a rewards programme in mobile communications costing 3% of revenue, that proved as attractive to customers as a cash discount costing several times that. By understanding how different customers perceive value, and how they respond to your offers, you can target your spend in ways that customers most appreciate, and at the customers that are both valuable and responsive.

The potential gains are large, but often not achieved. It is easy to spend large amounts of money on your customers and get little change in customer value. The often-missed trick is simple: *your aim is to change the future, not just reward the past*. Prioritise your customer initiatives not according to backward-looking accounting measures of customer value, but according to expected returns on future marketing investment.

What does this mean in practice? Our work in offer optimisation in telecommunications services suggests two simple rules:

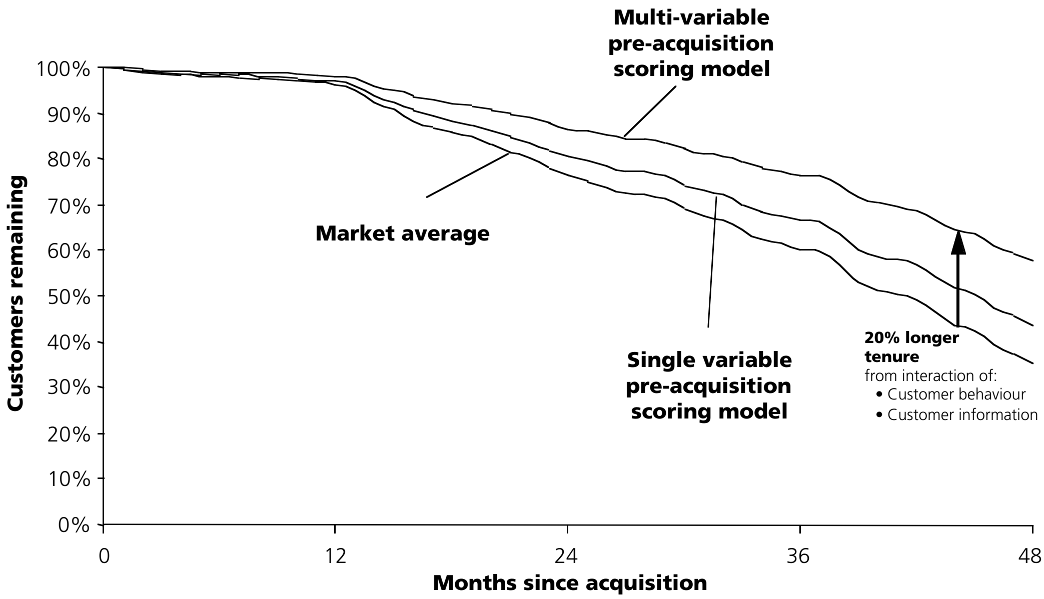
Start early in the customer relationship

Companies trying to improve customer loyalty generally want immediate results in terms of reduced 'churn', which means investing late in a customer's life to pre-empt an imminent defection. The fact is, however, that many defections today are a consequence of what a company did 18 months ago. Companies recognise this more often when explaining their financial results than when allocating their spending on future reduction in defections.

This focus on immediacy is expensive, because it directs spending towards last-ditch measures such as save teams and reactive deep discounts, and away from the beginning of the customer's life. It is at the beginning that companies can have more influence more cheaply, through customer selection and communication – especially right at the beginning, before the big acquisition investment has been sunk.

Churn prediction software, to tell you which of your mature customers are at most risk of defecting, is therefore useful but insufficient. Adopting techniques from the credit card business, we have found it practicable to predict mobile customers' tenure with the company much earlier, even at the prospecting stage (see Exhibit 2). The result is a much higher return on investment in customer acquisition and development, through selection of high-tenure customers.

Exhibit 2
Scoring mobile prospects before acquisition identified groups with 20% longer tenure



Focus on behaviour change as much as on customer value

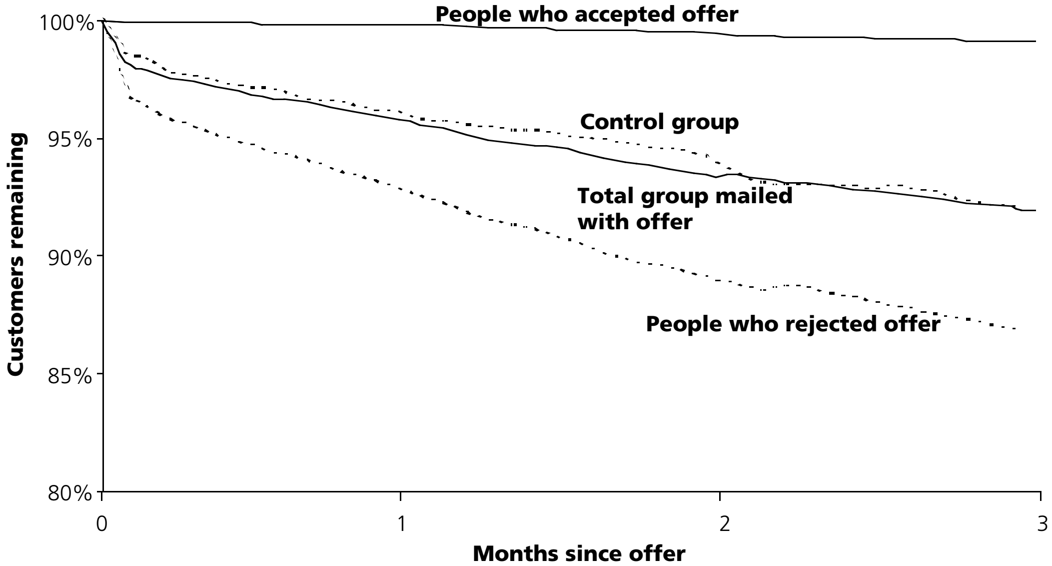
As soon as you calculate the profitability of your high-value customers, the temptation to spend money to keep them is enormous. Rewards programmes, and the like, offer a great way to spend that money efficiently.

But did you need to spend that money across the board, and what return on investment did it offer? Sometimes competition and the impact of the programme on customer loyalty demand it. But often, although those customers are worth the investment *if necessary*, most were probably going to stay with you anyway. And although they valued the rewards relative to cash, did the programme *change their behaviour*? Ironically, the highest-value customers, on whom you most want to spend the money, are often the least price-sensitive, and so may show little behaviour change as a result.

That customers take up the offers you make, and even express satisfaction, is not enough. You may be a victim of self-selection: the customers that already show the behaviour you want take up the offer you are making them, while the rest ignore it. You spend the money, and see no change in behaviour.

Look at an example of a mobile communications company wanting to reduce churn. It offered incentives to customers who were coming to the end of their contract period, if they signed up for a further fixed-term commitment. Customer *take-up* was encouraging – but the *level of churn* did not change. It turned out that those taking up the offer were largely people who knew they were not going to leave anyway. The subsequent churn behaviour of the *overall* group that had been mailed the offer was no better, at least in the short term, than that of a control group that had not (see Exhibit 3).

Exhibit 3
If offer acceptance is driven by self-selection, the offer has little impact on customer tenure



It is to the credit of this company that it ran a control group and measured the results (in terms of churn behaviour, not just take-up). It was therefore able to modify its programme and direct its spend effectively.

The advice is simple: don't believe anyone who wants to spend your money better serving, rewarding or incentivising your most valuable customers until they have convinced you that it will pay back through *changing* customers' behaviour.

As the examples illustrate, offer optimisation is a data-driven, analytical approach to milking the customer asset. It requires information-based analytical skills and systems to understand customer behaviour and economics in a de-averaged way, as well as the practical processes and discipline to test, measure and learn from putting offers out into the market.

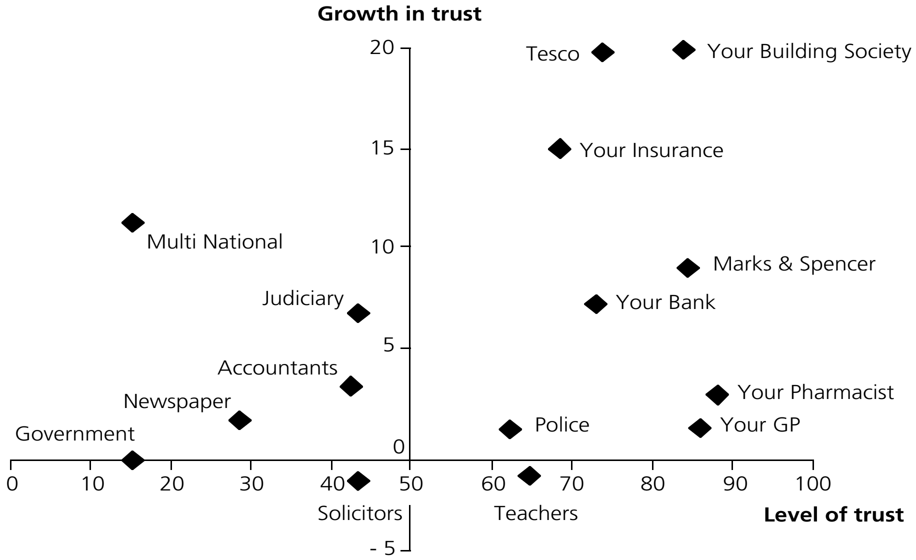
For any given state of your customer relationships, offer optimisation helps you to extract more value from those relationships than a more averaged approach can do. To be sustainable, however, it must not damage the core customer relationship on which it is built. Using differential pricing to derive economic value from the goodwill of non-price-sensitive customers is good business sense. But you need to avoid 'over-fishing' the resource: if customers feel exploited, by being over-charged or under-served, the assets of customer goodwill and trust quickly evaporate. Offer optimisation is only ever a complement to, and not a substitute for, developing the customer relationship.

Relationship development: replenishing the asset

Investing in customer relationships is about generating loyalty through love, rather than lock-in. No amount of cunningly optimised incentive programmes will create the high degree of customer trust and comfort that delivers consistent use, referrals and an eagerness to spread a relationship to other product and service categories. Money can't buy you love.

Is such an emotional bond between you and your customers achievable, and a meaningful business objective? Recent research in the UK suggests it is. Leading players in the retail and financial services sector are achieving high and growing levels of customer trust (see Exhibit 4).

Exhibit 4
Change in level of trust 1994-97 versus level of trust 1997



Source: The Henley Centre, Planning for Social Change 1998

The more successful incumbent telecommunications companies have similarly strong positions of customer trust, which they use as a significant brand advantage in their competition with less known new entrants. 'Trust' is something that customers say describes their perspective on a relationship more accurately than 'loyalty'. As telecommunications companies make their pricing more opaque through complicated tariff structures and differential marketing, a customer's trust becomes ever more important in winning and sustaining a business relationship.

Customer trust is a consequence of a customer's overall experience, and so is affected by all the 'four *P*s' in the marketing mix. A customer's experience of the organisation is at least as influential as his or her experience of the product or service. One management lever is therefore to pursue an overall strategy for customer contact management, providing a consistent and constructive experience whenever customers 'touch' your organisation. The foundation for such a strategy is often in the call centres, which touch the customer at a number of influential times in the relationship: from pre-purchase consultation, through activation and initial use, to help with issues of billing and payment.

Evolving call centres from their traditional role in customer service support, to an expanded role in customer contact management, requires significant changes in management, organisation and measurement (see Exhibit 5). Marketing communications, sales channels and customer service must be managed as a whole if they are to deliver a strategy for customer contact management. Traditional call centre measures of volume and cost must be joined by new measures of consistency, quality, and tailoring based on customer value.

Exhibit 5
Redesigning call centres for customer contact management

	Traditional Role Customer service support	**Emerging Role** Customer contact management
Customer approach	All customers are created equal	Service strategy based on customer value
Capabilities	Service and sales separated	Bundled services and sales
Economic focus	Reduce cost	Reduce cost, enhance revenue and increase loyalty
Organisation	Stand-alone function	Part of integrated operations to present one face to the customer
Management practices	Hierarchical (supervisors) with multi-layered structure	Centres of excellence (coaches) with streamlined structure
Performance measurement	Volume and productivity, with minimal performance incentive	Volume and value focused, balancing quality and productivity; pay for performance
Information management	'Transaction processing': periodic collection, selective availability	'Intelligent enterprise': continuous collection, company-wide availability

Customer value still matters. Spending money on the emotional side of customer relationships does not mean suspending the normal laws of business and customer economics. The right approach to relationship development maximises returns on marketing investments by stimulating more favourable customer behaviour in response to future offers, improving the economics of the initiatives described earlier.

Even more tangibly, unsatisfied customers often generate a direct cost in customer care and communication, in addition to the risk of losing revenue. It is therefore often possible to improve service levels and save money, for example by eliminating the cause of much of the call centre activity. In one mobile communications company, the highest-spending 4% of customers generated one third of the calls to the call centre regarding credit, although this group would not generally be considered a high credit risk. Changes to credit policies in this case could remove concerns and trouble for the elite of the customer base, at the same time as saving nearly 5% of *all* call centre minutes.

Not every company will build emotional bonds with its customers. Across different categories, an individual customer will face more companies seeking such relationships than he or she will want to respond to. Often a more realistic goal for a company is simply to be a practical supplier to stay with – based on a pragmatic, rather than emotional, relationship in which both sides have invested effort in getting to know and work with the other. The importance of the relationship is the same, but your choice of goal must be clear if your relationship development efforts are to be effective.

Value capture: leveraging the asset through new business designs

A combination of offer optimisation and relationship development will yield a strong return from your customer assets – within the traditional context of customers subscribing to a network-based service provider to whom they pay fees for using the network. But this monogamous, subscription-based relationship is under threat. As fast as telecom companies are focusing on their customer relationships, the customers themselves are moving on. The transition from subscriber to consumer is real, not semantic. As in other service sectors such as credit cards, retail, airlines and hotels, telecommunications companies are increasingly having to compete not just for customers but for 'share of wallet'.

- Calling cards, with no fixed charges, were the industry's first exposure to share-of-wallet competition. Many customers hold several different cards; only a minority are actively used.

- The major long-distance carriers in the US were more recently shocked to discover how much business they were losing, from customers whom they thought they had retained. Customers who continued to 'subscribe' to them (i.e. kept them set up as their 'preferred inter-exchange carrier') were increasingly using dialling prefixes to move their business onto other 'dial-around' operators' networks, call by call.

- In mobile communications, the rapid growth of prepaid services is undermining the economics of subscription-based relationships. At the same time, the offer of cheap international calls from mobile phones, priced below the rate from a fixed phone, is an early example of the share-of-wallet battle to come between fixed and mobile service offers.

The natural response is to anticipate these trends and take cost out of the customer relationship. Prepaid services in mobile are themselves an example of this approach, removing the need for statementing and collection. The danger is that this approach eats away at the customer asset, reducing the telecommunications company to a supplier of one-off commodity transactions.

How can you resist this trend, and build up your customer asset? How can you *deepen* the relationship, recovering the cost by creating more value and capturing more of it for yourself?

The answer lies in rethinking the basic role of a telecommunications service company. As technology and deregulation destroy the historic commercial structure and profitability of network operation, value is migrating to related areas that are well within the operators' reach. Prime among the new sources of customer value growth are service bundling (generating multiple revenue streams from the investment in a single customer relationship) and media services (aggregating content on behalf of customers, and aggregating demand on behalf of content providers).

Service bundling

The flip side of the diversification of telecommunications services (local and long-distance, fixed and mobile, voice and Internet) is the opportunity to bundle the different services together in a way that adds value to the customer. Maintaining a large number of relationships is costly to the customer, both directly in inconvenience, and indirectly as each relationship becomes an increasing part of the industry's service delivery cost. Bundling often makes economic sense. As American Express discovered when it found itself competing with card issuers such as General Motors, AT&T Universal and the full-product-line retail banks, it is becoming increasingly difficult to sustain the cost of a customer relationship from a single revenue stream.

The question is not whether bundles will happen, but which constituents of the bundle will drive the customer's choice and which will generate the margins. What if voice telephony takes the role the charter airline plays in the package holiday business: a critical and economically substantial part of the customer's purchase, but a low-margin commodity in an industry where vertically integrated players choose to take the margin elsewhere?

At least one incumbent telecommunications operator is making its long-term plans on the assumption that its core product for the last hundred years is something that most people will no longer be prepared to pay money for. It will be bundled in with other, more differentiated, communications-related services – perhaps part of a subscription service you choose for its information or entertainment content, or installed invisibly behind the telephone icon on your computer's desktop. Already cable television operators in the UK are offering their (more differentiated) television service only if customers take their phone service also. Your choice of broadcast entertainment determines the phone network you use.

Telecom companies that are investing in more differentiated, value-added services – often related to content and to communications management – are doing so not just for the additional revenues in their own right, but to ensure they control the part of the bundle that drives consumers' choice.

Media services

Bundling helps to protect and grow the revenue you receive directly from the customers with whom you have relationships. In parallel the media model opens up a totally new source of revenue, by taking on the media roles of both aggregating content on behalf of customers and aggregating demand on behalf of content providers.

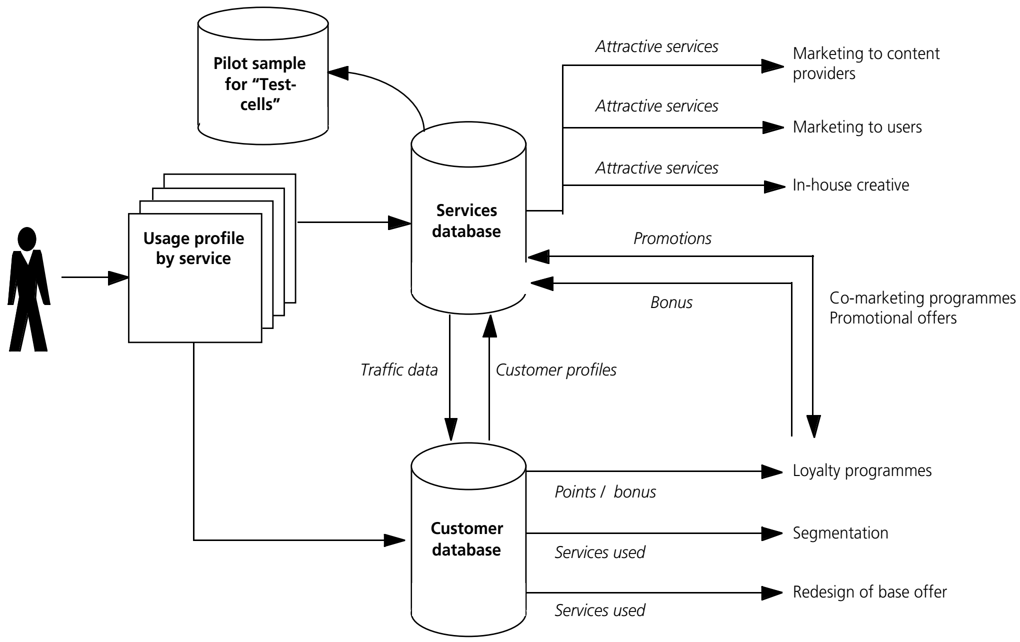
Look at the case of business people using their mobile phones to call taxis when they are travelling. Traditionally, the mobile phone company has provided only a simple connectivity service to their customers – routing the call to the taxi firm, perhaps preceded by finding a suitable number through directory inquiries. Now, one mobile company is aggregating its users' demand, asking users to dial a special short code to call a taxi. Through its new purchasing power – the potential to divert a huge call volume between competing taxi firms – the mobile company has negotiated attractive priority and price deals with taxi firms, which in turn differentiate its mobile service. In this case the 'value surplus' created by aggregating demand has been shared totally with the end user, and the value is captured in the core mobile business, through a strengthened customer relationship. In other examples, only some of the surplus is shared with the end user, while the remainder is captured directly as an additional revenue stream.

Targeted advertising and promotion is an example of such an additional revenue stream – not on the telephone itself, where it would be overly intrusive, but through direct mail. One national telecom company has tried targeting airline promotional offers to users, based on network-based observations of which countries they frequently call.

The automatic telephone exchange was originally invented to end the power of the telephone operator in diverting calls to a company's competitors. The inventor, Mr. Strowger (an undertaker) believed he was losing business to a rival whose wife worked as an operator at the local exchange. Technology has now developed full circle, and is able to perform the required information-based call processing automatically.

Today's information-based approach is sophisticated, and is a significant implementation challenge in terms of organisation, decision-making culture, and information systems and processes (see Exhibit 6). For companies that master it, however, it provides an escape from the trap of commodity economics.

Exhibit 6
Capturing value from customer information through targeted services



A key element to winning in media services is to reverse conventional customer-centric thinking and ask, 'how can I leverage my customer relationships to compete for attractive content partnerships?' These partnerships will, in turn, attract and reward your customers, to create a virtuous circle. For most former telecom operators, it is easier to drive this circle looking backwards as described, because delivering a differentiated customer base to content partners plays to your natural strength more than delivering differentiated content services to your customers. The success factors in competing for content partners are such things as the size, value and demographics of your customer base, the richness of your contact and communication with customers, your brand trust, and technical platforms. These are factors in which many telecom companies are able to build an advantage sufficient to drive the virtuous circle described above, until it runs under its own power.

Implications for management

What are the implications of these observations for the senior management of a telecom company, beyond reinforcing the rhetoric of customer-centric thinking?

We have argued that the key to success lies not simply in a company's capabilities in the individual dimensions of customer relationship management, but in the company's ability to balance these dimensions, and create a powerful, mutually reinforcing system. This requirement is not something that can be asked of the head of relationship marketing, or even of the marketing director. It is an issue for senior management, and is directly driven by a company's cross-functional decision-making, organisation and measurement systems.

The need is not for a giant customer information system, providing corporate-level data warehouses and data mining resources. Experience in other industries suggest that such approaches fail, unless focused on specific, short-term marketing objectives.

Instead, the need is to align the organisation behind *consistent* strategies in each of the three dimensions of customer relationship management we have described: offer optimisation, relationship development and value capture. Evaluate performance in each dimension not as an end in itself, but in terms of the support that it provides to the other two.

Consciously plan how the value surplus from optimising your offers, the trust from developing your relationships, and the economic foundation from your mechanisms to capture value, are cashed or reinvested. Align individual operational measures with your customer relationship management goals. Do you have volume-based churn targets that conflict with your value-based goals for offer optimisation? Do you have customer satisfaction measures that are irrelevant to the deeper, trust-based relationships you are trying to develop?

Tick the customer relationship management box on your checklist only once all three of the dimensions are being addressed. Operational excellence in each area is both easier to sustain, and more effective in growing the value of your business, when it is part of a balanced system of customer relationship management.

Simon Glynn is a partner in Mercer Management Consulting's Communications, Information and Entertainment group, based in London.

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