"turning data into dollars"

Tom's Ten Data Tips – April 2010

Customer Value Management

Customer value management, together with marketing accountability, are central themes in modern day marketing. Instead of selling products in a market, we take a different tack: you develop customers to their fullest potential. Customers are explicitly acknowledged as the instrumental source of revenues. In Peter Drucker's words: the only profit center is a customer whose cheque hasn't bounced.

In this new marketing paradigm, the focus is on achieving sustainable growth by acquiring, retaining and developing customers cost effectively. Growth is typically achieved by either improving retention, or focusing acquisition on those segments that are most likely to become "heavy spenders."

1. Manage Your Customer Base Like A Portfolio

Very few customer bases are so homogenous that a blanket treatment will work for all. Not all customers are created alike, and neither should their treatment be uniform. This can be as "obvious" as demarketing customers with a negative Life Time Value. In many businesses, publicity risks make it undesirable (or too risky) to actively abandon customers. Then at least you want to spend as little as possible on these customers.

On the positive end of the spectrum there are probably some customers worth pampering. The more skewed your customer profitability distribution is, the more important it becomes to differentiate. Although this sounds so obvious, orchestrating an entire corporation to "dance" in unison is quite a challenge (see also tip# 9). And unless *everybody* treats your best customers exceptionally well, it doesn't work. Marketing says you're such a valued customer, but accounts payable immediately puts the boot in when you're one day late. Besides management and cultural aspects, this almost always involves an IT component as well.

2. Star Schema's Opened Up A New "Perspective"

With the evolution in data modeling a new way of representing data has become the norm (at least for end-users): star schema's. In the

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old days of COBOL programming and hierarchical files, it was typical to have "slices" of history represented in separate files. So for a particular business domain, the data would be organized in separate (and largely duplicate) snapshots for a time frame, either a month or a year in many cases. Nowadays, users are accustomed to star schema's where dimensions are organized around central fact tables. And one of the dimensions will be time.

In the old situation you had to perform significant programming effort to match multiple time slices. Now, a star schema makes longitudinal analysis evident and easy. This new way of representing data enables looking at customer development, where time is modeled as an explicit dimension. Whether this was cause or effect of the "new" perspective on marketing is impossible to tell, but advances in data modeling (and data warehousing) have certainly helped enormously to analyze customer development.

3. Trade To Innovate

Innovation in value propositions, or customer dialogue strategies can rarely if ever be spurred by direct input from customers. From customer research we learn time and time again that they can't envision a *revolutionary* new way of interacting. Customers relate to needs they are familiar with, and therefore tend to come up with evolutionary (piecemeal) improvements.

For radically new ideas, what Kim & Mauborgne (2005) refer to as "Blue Ocean Strategy", you need the courage to challenge existing components of your proposition, and in return provide completely new value. By scrapping costly parts of your current proposition, you enable investments in new services. *Together* this can open up completely new markets. Like Cirque du Soleil did away with animals, and introduced elements from "conventional" theatre in their circus acts, for instance.

4. Exchange Of Information Needs To Entail A Quid Pro Quo

Many consumers are tired of getting (even) more surveys. And most business inquiries are so blatantly aimed at selling that it ticks people off. But all isn't lost. On a basis of sufficient trust, consumers often *are* willing to impart information, but they need to get something back. Not necessarily money. What might that "something" be?

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Most consumers are prepared to trade personal information if they get a noticeable service improvement in return. All too often customers provide information only to find that companies don't act on it. The Customer Contact Center asks a question, but the response may not be available to marketing. Unless the information gleaned from customer dialogue is shared *throughout* the organization, you risk frustrating your customer (again). Nobody likes to provide the same information twice (or worse…). The more personal the information you seek, the more you must cede control over its use to the customer. That convenant absolutely needs to strengthen the customer's trust, not threaten it.

5. Does Cross-Sell Really Prevent Churn??

In every consumer business we have done analysis there was an inverse relation between cross-sell (number of products held) and churn. Customers with more products are less likely to end the relationship. This observation is then often used to justify marketing investments in cross-sell. Life Time Value has a strong inverse relation with attrition, and this association is used as a financial justification. How much a sale is really worth is a non-trivial question, though.

Confounding masks a false relation between correlation and causation. The relation between cross-sell and retention may or may not hold (testing it is a fairly complex endeavor). The problem is that customers who "like" you better will *both* buy more products *and* be less prone to churn. Marketing resources aimed at these "platinum customers" could be overspent. If customers would buy *without* an offer (or worse: a premium) you incur net losses on a campaign that on the face of it seems successful. If you want to infer a causal relationship, there is no substitute for carefully controlled experimentation.

6. A Customer Profitability Model Reflects Your Value Creation Philosophy

It is obvious that customer value management needs to be supported by some customer profitability metric. In particular in diverse businesses with many product lines, squaring all calculations can be quite a challenge. By "squaring" we mean that the sum of all individual customer profitabilities adds up to company profits. Determining which costs should be treated as variable and which fixed may not be all that obvious. And finding an equitable way of allocating different sorts of overhead costs requires committing to a business model, taking a

"view" on how value is created in the exchange between providers and consumers.

An apparently "simple" question whether to allocate fixed overhead at the account or customer level impacts individual profitabilities. This choice rests on some pretty fundamental questions as to *where* money is being made. Another "classic" challenge is how to allocate significant start-up costs for a new product line. It seems hardly fair to "punish" the first few customers with initial development costs – they would all become extremely unprofitable. However, *where* to allocate these costs is not straightforward, either. What these allocation choices have in common, is that they unveil, albeit implicitly, your assumptions about market dynamics and where money (eventually) gets made, your value creation philosophy. Peter Drucker calls this your "theory of the business."

7. You Gotta Give To Get

Customers are willing to pay a premium price, as long as they are getting premium value. The quest for ever higher profits needs to be accompanied by ever better service or products. As soon as a mismatch between price and perceived value occurs, not only will this alienate customers (who might feel "locked in"), it will also open the door to new entrants in your market, or substitute products.

For a while, car satnav equipment was new and quite valuable to customers. So of course they were "willing" to pay hundreds of dollars for technology that costs tens of dollars to produce at the most. And when providers (like TomTom) then started to charge even more for software updates, the market was "opened up" for new competitors. Some consumers managed to hack the software, and a parallel market of unlicensed versions grew on the internet.

Unless you provide additional value, simply charging more for existing products (*even* when customers are locked in), is never "free", but instead a strategy that comes with its own sets of risks. Even cash cows can bite back.

8. Business Models Evolve Ever Faster

Intangible assets are ever more important for companies to create value. When your business model relies less on physical assets you tend to be more nimble, and therefore better able to adapt to changing market circumstances. At an aggregate level, the non-book

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value of companies has grown from about 5% to over 75% in the last 30 years.

Examples of intangible assets are customer satisfaction (accounting rules don't allow customers as assets in your books), IP, and employee loyalty. Historically for the past 30 years, exactly those companies that were best at leveraging their non-tangibles also created dramatically higher shareholder value (Boulton et al, 2000). This pressure has pushed them to become even more agile (to mitigate market volatility), which in turn drives adoption and renewal of business models. There are no signs this trend is about to end.

9. Marketing Has Become A Pan-Company Profession

The World Marketing Association defines: "Marketing is the core business philosophy which directs processes of identifying and fulfilling the needs of individuals and organizations through exchanges which create superior value for all parties." This illustrates how marketeers are held responsible not only for "outside" but also "inside" markets. In line with their role as advocate for customer value, marketers need to direct (internal) resources where they provide the most value.

This change in the role of marketers signifies a much tighter connection within the corporation. Whenever operations have an impact on your dialogue with customers, marketing needs to signal how this influences value creation for the customer. Some processes require prompt responsiveness, in other cases (incidental) delays may be acceptable.

10. Do *Not* Focus On Profit, But Instead On It's Drivers

Companies are under pressure to show short-term profits, and at the same time need to continuously invest in future options for creating long-term growth. That can be a very difficult balance to strike. For example, cutting cost is tempting in the short run, by might harm your brand image in the long run. Shrinking your marketing budget is easy, tangible, and effective for restoring profits in the short term. But it can undermine your leverage on the market. Etcetera. These considerations, of course, are the raison d'être for the balanced scorecard.

Some companies are so focused on profits, that they loose sight of underlying dynamics. If satisfied customers are more profitable (which they usually are), for example, that still doesn't make satisfaction a

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profit driver. Satisfaction is the *outcome* of great service, a compelling value proposition, effective relationship marketing, or whatever else. It is too easy to attempt to drive up "satisfaction." It also doesn't 'work.' The question instead needs to be: what should we *do*, to drive up satisfaction (at a justifiable business cost)? The answer to *that* question leads to a profit driver.

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