Reinventing Customer Management – Lessons from the Best of the Best

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„The problem with our organization is that we have our face to the boss and our backside to the customer!“ This statement – quoted recently by the CEO of a major manufacturing corporation – expresses the frustration many managers have felt in their efforts to realize their vision of truly customer-driven operations. At the invitation of Arthur D. Little, executives representing the „Best-of-the-Best“ companies in customer management met earlier this year to discuss their vision of the future customer-driven company, as well as the challenges that lie in the path toward that ideal.

While most companies recognize the need for a stronger external orientation, few have been able to realize it in practice. They know the value of customer loyalty. They are aware that a 5 percent increase in customer retention can generate a 25 to 85 percent improvement in profitability. They know that it costs five to ten times more to get a new customer than it does to retain an existing one. They recognize that their customers' expectations are rising at unprecedented rates, competition is intensifying, and customers are becoming far more rigorous in choosing vendors. And they realize that as customer choice and negotiating power increase, they must find new ways to differentiate their offerings through characteristics other than price – while managing their costs. However, very few have succeeded in their efforts to institutionalize their customer-driven objectives.

Why Customer Management?

A customer-driven orientation makes sound business sense. It contributes to a synergistic, self-reinforcing set of relationships we call the virtuous circle (Exhibit 1).

The virtuous circle suggests that sustained profitable growth is driven by customer loyalty.[1] The work of several experts in the field illustrates the inherent interconnectedness between customer loyalty, profitability, and employee effectiveness. It suggests that the longer a customer stays, the more profitable the relationship becomes. Loyal customers create value through increased purchase volume, reduced cost to serve, and word-of-mouth referrals or testimonials. The lifetime value of a loyal pizza eater or a Cadillac owner is worth some $8,000 to a pizza franchise or $320,000 to a car dealer, according to the experts.

If loyal customers drive profits, what creates loyal customers? In a word: satisfaction. Satisfied customers sing a company's praises more effectively than the best-trained sales force. However, satisfaction is achieved only by meeting or exceeding customer expectations.

Exhibit 1

The Virtuous Circle

L.L.Bean, one of the Best-of-the-Best companies, has always had a policy of ensuring 100 percent satisfaction. Recognizing that customer expectations vary, the company lets each customer determine what satisfaction means to him or her. While this policy created a significant financial burden for the company early on, Bean's unswerving commitment to unconditional customer satisfaction became the foundation of its enduring success.

Customers perceive value in terms of the end result they receive (i.e., the perceived quality of products and services) compared to the cost of obtaining that result (i.e., price and nonmonetary costs, such as time and effort). Since price is frequently set by the market and there is little perceived difference among the products of major suppliers, companies have found that the greatest opportunities for differentiation lie in the service component of the value equation. By improving service or lowering the nonmonetary cost of acquisition, companies have heightened the perceived quality and value of their offering.

Frontline employees play a key role in delivering service and thus in creating value for customers. *To* be highly effective, frontline staff must be carefully recruited, trained, empowered, and rewarded so that they are motivated to satisfy the customer at each and every point of contact. This kind of alignment and support at the front line requires a reinvestment of profits into operations, management, and technology that typically flows from satisfied owners, who receive attractive rates of return. In this way, the virtuous circle is completed.

A case in point: Ms. Alondo Martinez works at the counter of a FedEx office in Los Angeles, another Best-of-the-Best Customer Management company. She received a phone call from a customer who wanted to know the status of a package containing construction documents for a sealed bid. Martinez quickly discovered that the parcel had been missorted. When no agent could assure her that it would arrive in time to meet the bid deadline later that day, Martinez got in her own car and drove 115 miles to deliver the package herself. The bid was worth millions of dollars in new business to the customer – and they won the job. For her effort, Martinez received a Golden Falcon Award, presented each year to those FedEx employeees who exemplify the company's well-documented commitment to delivering more than just a package.

Although most companies believe in the concepts of the virtuous circle, few have been able to achieve the dramatic benefits it can produce. Every year the average company turns over 20 to 50 percent of its shareholders, 10 to 20 percent of its employees, and 10 to 30 percent of its customers. It stands to reason that this turnover undercuts not only a firm's performance, but its ability to sustain profitable growth.

The Five Critical Success Factors

However, there are exceptions. A number of well-known companies have leveraged customer-driven operations with considerable success. These companies, which Arthur D. Little has defined as Best of the Best, have embraced a customer-driven philosophy and have hard-wired a single-minded focus on service into every relevant area of their operations. As a result, these companies have built long-term profitable relationships with their customers while outperforming the Standard & Poor 500 in shareholder value creation by 300 percent over the last five years (Exhibit 2).

MBNA, one of the nation's largest bank credit-card issuers and a Best-of-the-Best Customer Management company, exemplifies the power of a customer-driven organization. The company has installed an internal customer-oriented culture in every aspect of its operations. For example, employees always capitalize the „C“ when writing the word „Customer.“ Above every door in the organization are the words „Think of yourself as a Customer“ to encourage an external orientation. MBNA follows up with all profitable customers who want to drop a VISA or MasterCard and ends up persuading about half of them to change their minds. It tracks and measures over 70 customer service factors every day – from answering phones within two rings to processing credit lines within 30 minutes. To what end? MBNA retains its customers about twice as long as the industry average. Its customers use their cards 22 percent more often than any other card – and run up higher balances. The company's credit losses run a third to a half lower than its competitors'. It retains more than 98 percent of its profitable customers, and in 1994 it realized a 2 8 percent increase in profitability. Participants in the colloquium identified five critical components that must be addressed to achieve effective customer-driven operations: (Exhibit 3):

• Target high-value customers

• Create loyalty strategies

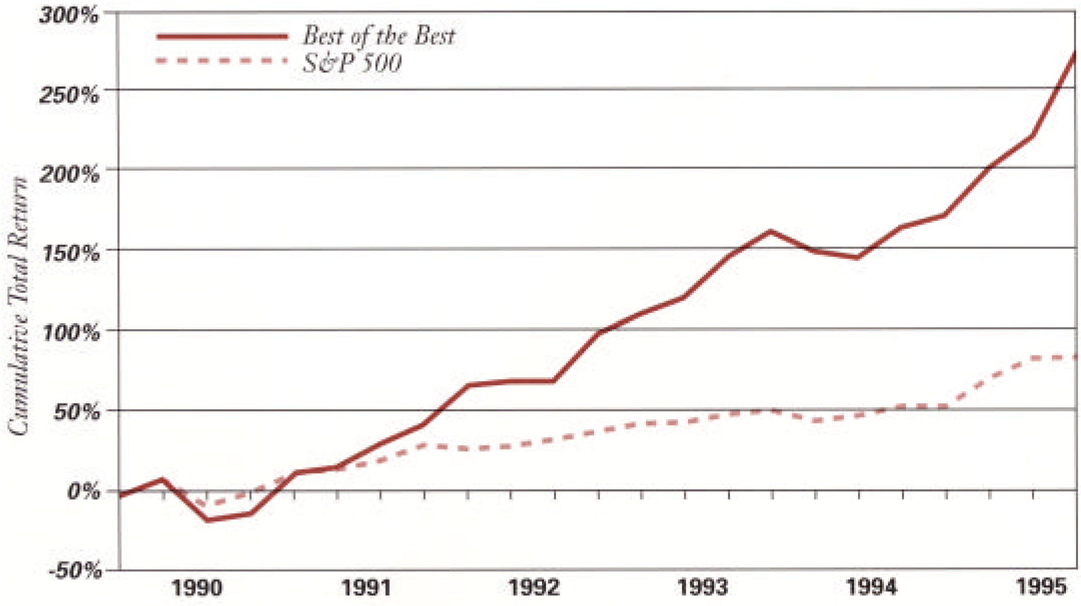
• Improve customer interaction processes

• Support frontline workers

• Institutionalize learning

Exhibit 2

Shareholder Value Creation

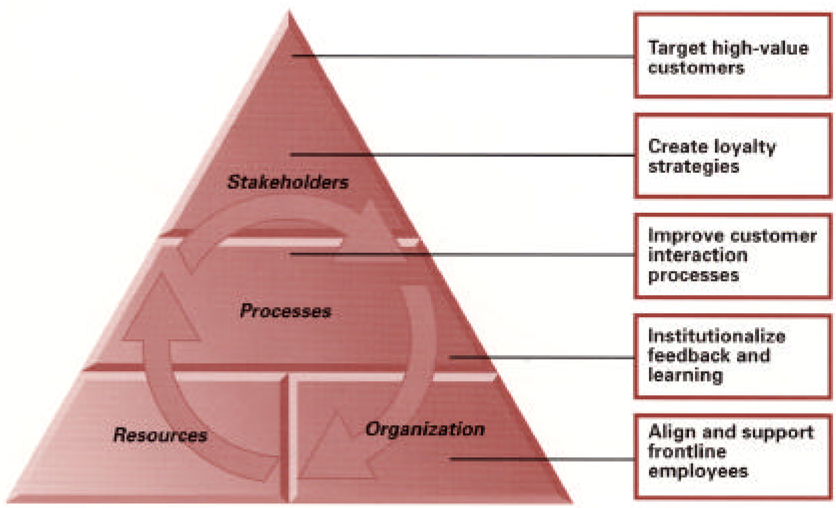


Source: Dow Jones Historical Stock Quote Reporter Service (total shareholder return assuming reinvested dividends).

Target high-value customers. Targeting customers is a critical baseline activity. The fact is, not all customers offer equal potential value. Companies should determine which of their customers are most valuable, using needs-based customer segmentation and estimating the lifetime value of each account, before they formulate strategies to retain them. In this way, companies can determine which customers contribute most to profits and how much they can reasonably invest to retain these customers without diluting shareholder value.

Exhibit 3

High-Performance Customer Management

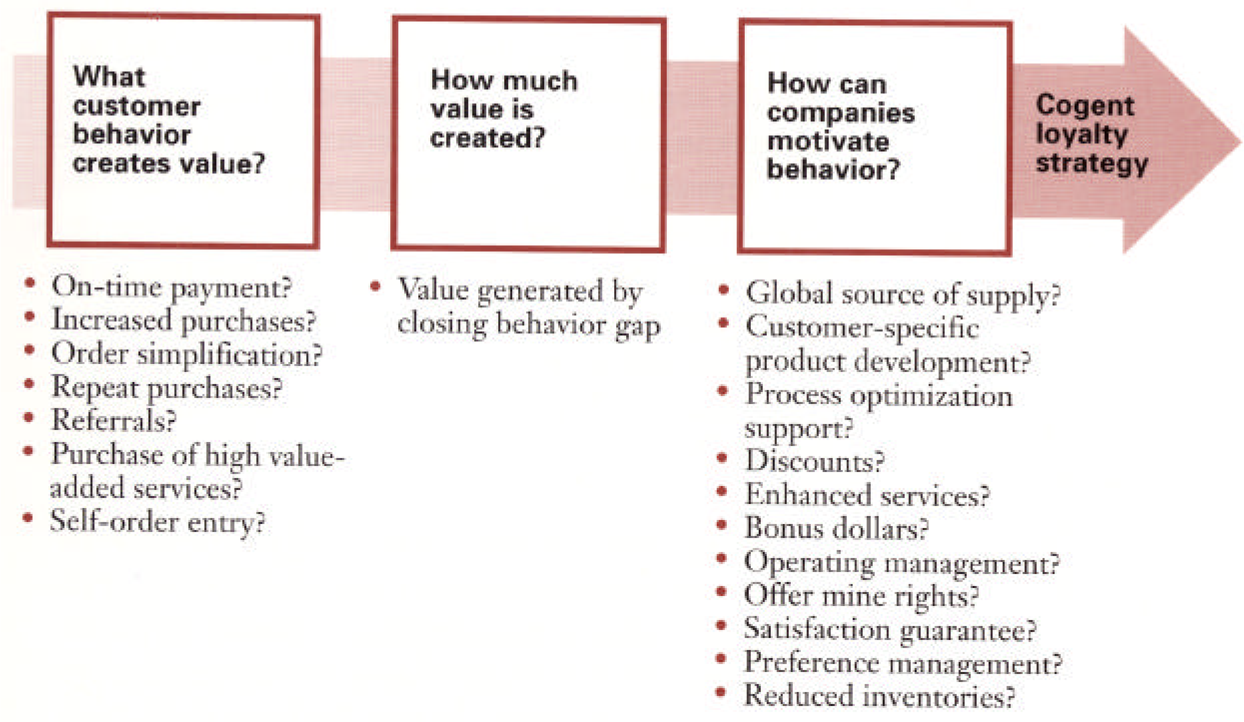


For example, a leading East Coast electric utility discovered through its customer valuation model that the incremental value of a residential customer with electric heat was approximately $4,000 more than one without electric heat. Management now understands how much it can invest in residential customers to encourage them to use electric heat without diluting shareholder value.

Create loyalty strategies. Once a company identifies its target customers, it can begin to formulate creative strategies to retain and reward them for their loyalty (Exhibit 4). In essence, loyalty strategies are about motivating customer behavior. Leading companies identify the kinds of customer behavior that contribute the most value to their company, determine how much value is created, and conceive ways to share some of the incremental value with the customer to encourage the desired behavior in the future.

Exhibit 4

Loyalty Strategies



Well-thought-out loyalty strategy was developed by MCI Communications Corporation, another 1995 Best-of-the-Best Customer Management company. In 1991, with less than 15 percent of the long-distance telephone market, MCI decided to grow its base and reduce the turnover of its most valuable customers. To grow its customer base, the firm creatively leveraged the loyalty of its existing clients. They introduced the Friends & Family Program™, giving each customer a cash incentive to behave in the desired manner; that is, to generate an additional 20 customers. In return for the value created, MCI shared value back through discount rates to both existing and new customers.

The company then monitored usage to identify high-frequency users, whom it entered in the Customer First Program™. Among its features: best-in-class service for high-spending customers, detailed account information to facilitate MCI representatives' ability to service these key accounts and strengthen relationships, a toll-free number for special services and to handle complaints, and a $50 check for lapsed customers as an inducement to return. The bottom line? MCI created a window of opportunity, grew at twice the industry average, and reduced the churn rate of its high-value customers by some 25 percent. But as this case illustrates, loyalty strategies do have a shelf life. MCI's recent woes can be attributed in part to its inability to keep its loyalty strategies current with the changing competitive environment.

Companies do not always have to share incremental value with customers in the form of incentives or discounts. Many are investing their incremental profits in operations that make it easier for the customers to do business with them. In fact, the Best-of-the-Best companies see the future customer-driven organization as being world-class at leveraging what they term „preference management“ and „mass customization“ to build customer loyalty. By taking the time to listen and record customers' idiosyncratic buying preferences and then tailoring the product and service offerings to meet these individual needs, the leading companies believe they can „own“ the customer relationship. By leveraging this underutilized asset, the leading companies plan to move increasing volumes of their own products and services, as well as those of their suppliers/partners, down this loyalty channel.

USAA, which began as an insurance company for military officers, now offers a wide range of financial services as a result of this strategy. Their customers proclaim, „I will buy anything I need through USAA if they are willing to sell it.“ The company plans to leverage this loyalty in a new initiative they call „event-oriented servicing.“ According to Edgar Bradley, Assistant Vice President-Strategic Planning, USAA has entered into a contract with TeleFloral. „Our members can order flowers delivered to anybody. When they do, we record anniversaries, birthdays, whom they sent the flowers to at Christmas, their mother's address, and all those kinds of things. We build on these events. For example, if a baby is born, we ask about life insurance and educational endowments, and we send a free baby seat with an underwriting cost letter.“

Improve customer interaction processes.

Leading companies use loyalty strategies to guide the improvement and coordination of their customer interaction processes, the third key characteristic of world-class customer management capabilities. They see every point of contact with the customer (e.g., marketing, sales, order entry, order fulfillment, field installation and service, billing and collection, complaint handling, etc.) as part of the interaction process and manage it to support a given loyalty strategy. Since most operational breakdowns occur between functional departments, achieving customer loyalty and retention objectives must be a cross-functional imperative.

To identify key interaction points, leading companies analyze their operations from the customer's viewpoint. They let their customers explain how and where they interact with the organization and what is important to them at each point. They then redesign interaction processes where necessary and coordinate all points of contact across the organization to create a single company image in the mind of the customer. In this high-tech/high-touch approach, technology is used to enhance human interactions, not replace it.

The Lexus Division of Toyota leveraged improved customer interactions at its dealerships to differentiate its luxury car offering and ensure a repeat purchase. Lexus General Manager George Borst explained, „The quality of the product was not the issue. Everyone knew that Toyota could make a top-quality product. Where we saw the hole in the market was in the way dealers treated their customers.“ The company has achieved superior levels of customer service at the dealership by applying lessons learned from Toyota's approach to automobile production – as Richard Chitty, Vice President-Parts, Service, and Customer Satisfaction for Lexus, affirmed, „We don't have a customer satisfaction program, we have a *process.*“ Lexus has identified 17 points of contact between the company and its customers. For each point of contact, it has created a set of flow charts that depict how to create customer satisfaction. The company even uses these flow charts to guide the selection process for new hires. As a result, there are pressure-free sales, the first two scheduled maintenance checkups are free, garages are devoid of grease, customers are given an office and phone while their paperwork is processed, and the dealership maintains a complete medical history of the customer's automobile to facilitate all future interactions. Every employee's compensation is tied to customer satisfaction. The bottom line? Lexus has a 65 percent repeat purchase in an industry that averages approximately 40 percent.

USAA has its roots in improving customer interaction processes. The company began by offering a single contact point for military officers' insurance. Prior to its inception, every time officers moved, they had to develop new relationships with different insurance representatives. USAA offered their customers a one-stop shop regardless of where they lived. Now when a customer calls, an ID system routes him or her to the „right“ representative, and the customer's entire history with USAA comes up on the computer screen before the agent even picks up the telephone. The company is now in a position to provide the superior service that generates customer loyalty. It prides itself on having the touch and feel of a small company, but the economy and efficiency of an industrial giant.

USAA continues to enhance its customer interactions through its work on direct access technology. Bradley said, „We need to be prepared to do business with our customers however they choose, not the way we choose to impose upon them.“ USAA is expanding its hours of operations both daily and on weekends. It is also preparing to receive business through personal computers, interactive TV, e-mail, faxes, and any other way their customers choose to do business with them. Not surprisingly, USAA has recently been recognized as the best financial service company in America. It is rated in the top 10 among auto, homeowners, and life insurance, credit cards, and mail order companies, and it has 98 percent membership retention.

Similarly, British Air is experimenting with improved interactions. On the basis of customer feedback, the company is considering ticketless travel, doing check-in at home through a TV satellite, and picking up all passengers and their baggage from the home to all but eliminate the airport experience. It is also looking at voice recognition systems to facilitate caller ID; eliminate the name, address, and account number queries; and capture detailed information about the customers' preferences as they discuss their agenda.

Support frontline workers. Rich Teerlink, CEO of the $1.5-billion-in-sales Harley Davidson, believes people are his company's only long-term sustainable competitive advantage. Leading companies recognize and leverage this wisdom in the fourth characteristic essential to the operations of a truly customer-driven company: the proper alignment and continuous support of the frontline employees. As Scott A. Bryant, Vice President-Customer Satisfaction for L.L. Bean said, „You're only as good as the ability of your frontline people to make the company's reputation a reality in every single contact with every single customer."

Companies committed to service devote considerable attention to attracting and retaining top-notch frontline workers. They then ensure that these employees are properly trained, empowered, and enabled with information and technology to satisfy the customer at the point of contact. According to Harvard University Professor James Heskett, leading companies „hire for attitude and train for skill."

British Air has given considerable thought to the attitude of its frontline staff. They think about employee behavior along a continuum. As Richard Hill, Senior Manager, Customer Relations, related, „Why do members of your team do what they do for a customer? The starting point is they *don't* or they *won't*. In 1980 we had people who turned up for work and just went through the motions. They had no concept of why they should do anything for a customer. We then moved through to the motivation: *I must do it.* This is based on the fear that if I don't do it, I will lose my job. After that *comes I should do it.* This is a value-based decision: I feel I should do it for the customer because that is the right thing to do. Building on the individual's values you go from here to the *I will do it*, and then *I want to do it*. We don't want people to switch on the work situation and then switch it off. We want them to go out there and do it because they want to do it." British Air continues to work on „getting to the want."

Institutionalize learning. USAA calls it ECHO – „every contact has opportunity." Whatever one calls it, leading companies have institutionalized the fifth component of customer management, a measurement and feedback system that serves as the foundation for organizational learning and guides continuous improvement (Exhibit 5). In the end, it is not how good you are but the rate at which you improve that fuels competitive advantage and ensures sustained profitable results. Successful companies recognize the value in continually monitoring their customers' changing expectations and in measuring their relative competitive performance on what the customers say is important. These firms place particular emphasis on customer complaints and defections. They foster cultures in which customer experiences are documented, criticisms reported, trends spotted, and appropriate responses made. In short, they make it easy for the customer to complain and for these comments to surface to top management without recrimination.

At FedEx, a 1 percent failure rate means they have somewhere in the neighborhood of 40,000 unhappy customers. (FedEx counts both shippers and receivers as customers.) In 1978 they adopted Service Quality Indicators, or SQI. SQI is a comprehensive and proactive statistical measure of overall customer satisfaction and service quality – from the customer's point of view. In developing SQI, FedEx identified and now tracks 12 major causes of aggravation daily, weighing each according to the customer's frustration level. They know on a daily basis what their failure rates are. But even more important is the follow-up work of teams led by senior management, which focus on improving identified processes and reducing the number of failures in the first place.

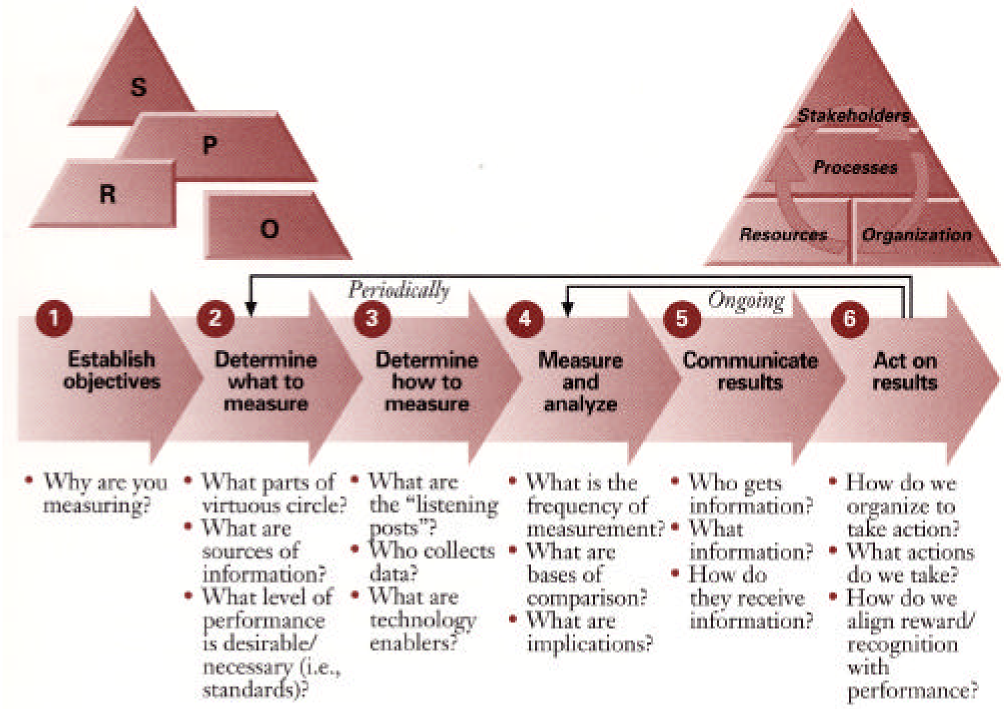
Leading companies have learned the value of measuring the „right things right." For example, Lexus believes the measurement of satisfaction is necessary but not sufficient. The automotive industry has a 90 percent satisfaction rating and a 40 percent repeat purchase rate. A more robust set of measurements will address the value created for the customer that drives satisfaction and, more importantly, customer loyalty. To help the organization translate customer feedback into improvements in day-to-day operations, all 246 people in the Lexus Division, from secretaries to senior executives, must call four customers every month and solicit input on their purchases.

There Are No Silver Bullets

Implementing a customer-driven approach is not an easy undertaking. It requires a commitment to the customer management philosophy that is driven from the top, built from the bottom, and promulgated throughout every part of the organization. It requires both a deep understanding of the needs of the firm's most valuable customers and the ability to fulfill those needs cost-effectively, while sustaining an environment of continuous improvement and learning. And it requires a near-obsessive attention to all the mundane details of cross-functional service delivery.

Exhibit 5

Feedback and Learning



But the rewards are rich. Staples, one of the Best-of-the-Best companies, exceeded $3 billion in sales in less than a decade of existence and will grow by another 40 percent this year. Hewlett-Packard, despite blis tering competition from both Japanese and other American companies, will grow by 20 percent over the same period. Most Harley-Davidson dealerships have one- to two-year waiting lists for new motorcycles. The success stories go on and on.

Companies who become truly customer driven can create solid competitive advantage and reap the enduring benefits of long-term profitable relationships with their most desirable customers.

[1] *See, „Putting the Service-Profit Chain to Work," by Dr. James L. Heskett,* (Harvard Business Review, *March-April, 1994).*

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