

THE SEVEN MYTHS OF CUSTOMER MANAGEMENT

How to be customer-driven without
being customer-led

John Abram
Paul Hawkes



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Introduction

In 1987 we founded a consultancy that specialized in market and customer management. Our work centred on helping our clients make more money by increasing their revenues. While we also advised on how to reduce costs or change processes, the majority of our activity was directed at improving the efficiency, effectiveness and, critically, the profitability of our clients' operations by growing the value of the customers they served.

Over the course of the following 15 years, we were able to work with some of the UK's largest and most successful companies, across many industries. We observed a wide range of strategies being implemented by an extraordinary array of senior managers, who adopted a diverse set of management styles and techniques to address many and varied business challenges.

Irrespective of the differences in objectives, strategies and styles, there was always one common factor. Every organization with which we worked (without exception) relied on its customers to generate the income that paid the bills, the salaries and, of course, our fees! Notwithstanding the ability of financiers to move a company's share price by fancy manipulation such as off-balance-sheet financing, this same income is the fundamental and, arguably, the only lasting source of long-term shareholder value.

Although we worked in an exceptionally competitive consultancy market and competed against firms that were many times larger than our own, we nevertheless grew our practice steadily, year by year developing a blue-chip client list and a top-quality consulting team. The success of our business undoubtedly stemmed from our focus on generating profit for our clients by maximizing the value of both existing and potential customers. Of course all our competitors had something to say on the subject too, but what we said was, usually, quite different. Fortunately, it was sufficiently compelling that organizations as diverse as Thomas Cook, Norwich Union, GUS and Switch, to name just four, were prepared to listen and take our advice.

The fundamental beliefs that governed our approach can be summarized as follows:

- Customers are an asset of the business and the primary source of long-term shareholder value.
- Like any other asset, customers have to be managed positively to maximize the return on the investment in them.
- Unlike any other asset, customers constantly change and thus a deep and insightful understanding is required to manage them successfully.
- Any investment in the acquisition or ongoing management of customers must only be made if there is an acceptable probability that the investment will yield a satisfactory return.

These may seem statements of the obvious. They are, but the fact is that these principles are unrecognized, or ignored, by many companies and the 'experts' who often advise them.

Over the years we observed one specific trend that continually baffled us. Many organizations increasingly invested vast sums in the purchase and implementation of extremely sophisticated customer management technology. Yet many of them failed to achieve even a small fraction of the benefits that had been promised when the investment decision was made. Despite this, hardware, software and consultancy suppliers continued to thrive, selling ever more complex solutions at ever higher prices.

It seemed to us that at the heart of the failure lay a lack of understanding of the principles described above. The belief seemed to be that a sprinkling of the magic dust of expensive technology was all that was required. Our opinion was, and remains, that while technology can be a very powerful enabler of many aspects of customer management, its introduction to a business that has not addressed the basics will almost always fail.

This book is about those basics.

We agreed to sell our consulting business at the end of 1999 and had both left by the spring of 2002 to pursue other interests – one of which was writing this book. We wanted to challenge some of the nonsense we had read and observed; to argue the case for a different approach based on our experience of what actually works – and what does not; and, most importantly, to provide all managers concerned with the management of customers and revenues with a fresh perspective.

The book is called *The Seven Myths of Customer Management* because in many organizations the basic tenets according to which customers are managed are founded more in mythology than reality. Of course everyone pays lip service to the need to treat customers well, everyone recognizes that they are important. But does everyone balance the need for a strong customer orientation with sound commercial common sense? It is sadly true that, despite the fact that only customers generate revenues and profits, many organizations remain unclear of how to unlock their potential value.

We hope you will find the book interesting and challenging. You may not agree with everything we say; we would expect nothing else. There is no single 'right' answer, or the definitive manual would have been written years ago. We simply offer our perspective gained from (far too many) years of observation and experience.

*Paul Hawkes & John Abram
London
January 2003*

Chapter 1

The Seven Myths of Customer Management

Debunking some Established Wisdom

It isn't that they can't see the solution. It is that they can't see the problem.

The Scandal of Father Brown, GK Chesterton

How many annual reports have you read in which the chairman or chief executive proclaims to shareholders about how 'customer led' the organization is, or is becoming? How many conferences have you attended where speaker after speaker provides advice and counsel on the merits of customer leadership? How many journals, magazines and books have you read that lecture senior executives on exalting in the primacy of the consumer and becoming customer led?

THE DANGERS OF CUSTOMER LEADERSHIP

It has become almost a mantra: to be led by customers is 'good' and is the way of the future, while to adopt any other posture is 'bad' and should be consigned to the past. This has been said so frequently, by so many eminent writers, thinkers and practitioners,

that it has become woven into the fabric of business lore. Only a heretic would challenge the assertion – step forward the non-believers!

What Does Customer Leadership Mean?

We should take a moment to think about what being customer led means. There is no commonly accepted definition, so let us consider a range of statements with which you might agree. Being customer led requires listening to customers. It involves taking their complaints seriously and acting to ensure that similar problems are not repeated. It means recognizing and valuing customers for their importance to the business. It implies attempting to understand customer needs and then providing what they want, when they want it, through the channels of their choice, with the very highest standards of service. It means focusing on long-term customer satisfaction, even if this has a potentially damaging impact on today's business in terms of cost or lost revenues. It requires a restless dissatisfaction with the status quo and a continual drive to improve the customer's lot. In short, to be customer led is to recognize that the customer should be in prime position and to align the organization to achieve it.

Who Is Leading Whom?

The above are all sentiments with which any chief executive worth their salt would undoubtedly concur – or would they? If you tested some of the largest, most respected and successful companies in the world against these criteria, they would come up woefully short, often by design. Is Microsoft customer led? It listens to its customers and acts on their feedback, but only up to a point. Did the fact that its customers wanted unbundled web browsers make the slightest difference to Microsoft's strategy, or did it continue, as before, embracing its opportunity to maintain market leadership?

Is Sony customer led? The company makes and delivers first-class products and has efficient and effective after-sales service, but it is reputed to consult its customers only rarely during the development of entirely new product concepts. It has been said

that it does not believe that customers have the vision, awareness or even perhaps the interest to be able to provide the company with appropriate insight into products of which they have no previous knowledge or experience.

Is Lloyds TSB customer led? The UK's largest and most profitable bank runs efficient operations; has invested millions in making its banking halls more attractive and customer friendly; and has led the charge in developing innovative new, added-value banking products for which customers are even eager to pay. On the other hand, it is quite prepared to cut the number of retail banking outlets by closing those that are unprofitable. It is content to charge its customers credit interest rates above those of its competitors; and it is sanguine about rationalizing its branch management structure to service customers through centralized telephone call centres.

Are these companies exceptions that prove the rule? Are they living in the past, with the market about to wreak its terrible revenge? Or do they have an alternative model that is not so much about being customer *led*, but more about being customer *focused*?

Adopting A More Commercial Perspective

Microsoft is prepared to listen to its customers if that does not result in its competitors gaining any advantage. Sony will continue to design and manufacture products for which there is no clear evidence of future market demand if it believes in them. Lloyds TSB is more than willing to risk the wrath of its customers if this ensures the bank's long-term growth and the maintenance of its pre-eminent market position. All these organizations have one ear on the market and one very carefully tuned into the needs of their shareholders. None is customer led, but all three are extremely customer focused. Is this distinction mere semantics or is there really a difference?

The respective management teams of Microsoft, Sony or Lloyds TSB would probably all, if pressed, agree with the sentiments behind being customer led. However, their first responsibility is to their shareholders, not their customers. Although they recognize

that customers pay their salaries, they are not willing to accept the customer leadership credo at any cost. They are more than prepared to make tough decisions that sometimes create customer dissatisfaction, or exclude customers from the product design process, or result in higher prices or lower service levels, if this is to the long-term benefit of shareholders.

Being customer focused is different from being customer led because it overlays hard-edged commercialism. Customer focus includes all the elements of customer leadership, but only in as much as they facilitate or maintain competitive advantage. Customer-focused companies are quite prepared to make difficult decisions because they have a clear long-term vision for the enterprise, and have developed corporate and customer-management strategies designed to realize it. They recognize that not all customers are equally valuable, or potentially valuable, and they invest in their growth and development accordingly. They understand that customer satisfaction must, on occasion, be subjugated to commercial pragmatism. They acknowledge that not all customers are loyal, nor will they ever be so, and they manage them with one eye firmly fixed on both the profit and loss account and the balance sheet.

Most importantly, customer-focused companies recognize that the primary goal of any commercial organization is to create not satisfied customers, but satisfied owners. While they realize that the long-term interests of owners are unlikely to be served by ignoring customers or treating them with disdain, they have not allowed themselves to be misled into believing that the customer is always right. The customer is only right when the organization can afford it.

Successful organizations are *not* customer led. They might say that they are, because this is what analysts and shareholders want and expect them to say. But in reality it is a myth – customer focus is the goal to which they really aspire.

This book is about the achievement of customer focus. Its purpose is to dispel the myths and replace woolly thinking with commercial pragmatism, and to provide all managers involved in the management of customers with practical advice designed to maximize their profitability.

WHAT IS REALLY HAPPENING?

Never has there been so much advice for senior managers on how to manage their customers. Never have there been so many specialist magazines and journals to read; never more business books offering the latest quick-fix solutions; never more consultants fomenting dissatisfaction with the status quo and seeking to earn a crust by extolling the merits of their latest 'paradigm'.

Add to this the rapid development, and extremely skilled promotion, of a wide variety of innovative technologies and software systems, all of which guarantee a brand new set of insights and capabilities that promise the Holy Grail – including more customers acquired and retained, greater levels of customer satisfaction, lower costs and, of course, increased profits. All of these are fine in theory, but largely illusory in practice.

Over the last decade, organizations have professed to be more focused on the needs of their customers than ever before. Billions have been spent on customer relationship management (CRM), both in terms of technological support, marketing communications and staffing. Yet in most industries, and the overwhelming majority of companies, the old order still prevails. Product cross-sales rates are hardly different to those of 15 years ago. Despite massive investment, the High Street banks are still struggling to sell an average of one additional product to their current account customers, and the insurance companies envy their success!

Customers Are No More Satisfied or Loyal

Indeed, many commentators would argue that the growth and introduction of new technologies and routes to market have led to increasing levels of angst among consumers. Take as examples automated telephone menu and queuing systems, online servicing and direct communications, which are allegedly designed to build 'relationships' but, in reality, often confuse and alienate.

Despite the widespread introduction of many so-called loyalty schemes designed to stop customers from switching and provide tangible rewards, customer behaviour has hardly altered. If anything, the evidence suggests that such schemes have contributed to

commoditization and educated an already fickle public to become even more promiscuous as customers.

What Is Going Wrong?

Why, despite huge investment and the best endeavours of many intelligent people, are customers not behaving as we want them to? Apart from sheer managerial incompetence (which, of course, cannot always be ruled out), there are probably two more common reasons: first, an over-reliance on platitudinous theories that are superficially attractive but also superficial in content; second, the adoption of theories that are sound but not understood in any depth by the managers charged with their implementation.

There has been little rigorous exploration of customer-management theories, processes and technologies and even less examination of the results of their implementation. Few companies have been prepared to 'come clean' about the return on investment they have achieved. As a result, a dangerous set of customer-management myths has emerged. Like all good myths they contain grains of truth, but these are often hidden by a mountain of nonsense.

MYTH 1: CUSTOMER RETENTION IS THE KEY TO INCREASED PROFITABILITY

It is during a recession that this particular myth gets trotted out with the greatest regularity. Times are hard and costs must be cut. The marketing and advertising budget is a tempting target and, after all, the received wisdom is that it costs much less to do business with existing customers than to acquire new ones. To make the message even more convincing, a relative cost ratio of 10:1 is often quoted as if it were a scientifically observable fact.

There is some truth in this argument, which lends it credibility. Mail-order traders have proven the essential validity of the assertion for nearly a century. All other things being equal, it will cost a great deal less to sell a product or service to an existing customer than to a new one. If you are looking to achieve the maximum

return on your marketing investment, then this is as good a place as any to start. After all, your sales and marketing costs will be lower and existing customers, on whom you depend for ongoing profits, will be retained. Numerous problems arise, however, when you scratch beneath the surface and look at the ways in which this particular piece of 'wisdom' is applied.

Not All Customers Are Good Customers

The first realization, of course, is that not all things *are* equal. Within nearly every customer base there will be some who will buy practically anything offered to them. Unfortunately, there will probably be a far greater number who are more resistant, and many more still who will simply not buy, however attractive your product or proposition. Consider the new car purchaser who is determined to try a new marque, whatever your inducement; the current account customer who prefers to save with one of the new online market entrants for the greater convenience and in order to achieve a higher interest rate; the pension investor who yesterday purchased a new policy from a competitor in order to spread the risk.

But surely it must be more profitable to keep the customers you already have than to recruit new ones or, even more negligently, to allow them to slip away to competitors? Perhaps. The simple fact is that not all customers are the same. Not all customers are good customers. Not all generate profits equally. Some will be disproportionately profitable, while others may even destroy value. For example, some customers will require a greater volume of communication before they can be persuaded to repurchase. Others will use high-cost distribution channels because of their preference for face-to-face contact. Yet others will consume valuable resources in resolving their frequent service issues.

The Pareto principle – that 20 per cent of a phenomenon has 80 per cent of its effects – exists and, in our experience, is often an understatement. The top 20 per cent of customers for one travel-related company with which we worked generated 96 per cent of total contribution to overheads. Conversely, the remaining 80 per cent of customers were responsible for a mere 4 per cent of the value. As can be seen from Figure 1.1, approximately 60 per cent

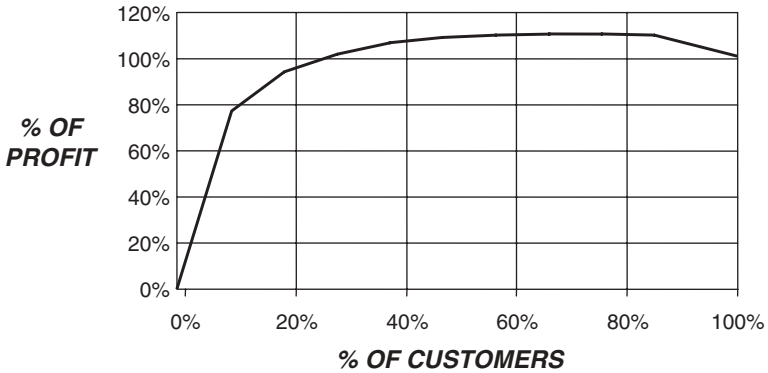


Figure 1.1 Travel company customer contribution

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of the company's customers were actually unprofitable and were destroying value, yet all were being managed in exactly the same way, with exactly the same levels of investment. This was not a result of incompetence but rather ignorance of the composition and dynamics of the customer base; although for management to display such ignorance might well be regarded as incompetence. Consider for one moment the impact on this company's profitability when it became possible to match resources with value.

The maxim that 'all customers are good customers' is simply not true and can lead to dangerous, and expensive, mistakes. A more balanced perspective is required, one that considers the revenues and costs of both customer acquisition and retention – and overlays both with an understanding of performance and behaviour after the initial sale.

Ignore Customer Acquisition at Your Peril

Even if existing customers are proven to be more profitable, it does not mean that customer acquisition can simply be halted when times are hard. New customers acquired today are (or should be) the source of tomorrow's profits. The impact of abandoning customer recruitment is exacerbated by customer defections.

However good a company is at managing its customers, there will always be some who leave, even if only to move to a higher