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Creating a Superior Customer-Relating Capability

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I n most markets, there are one or two companies that outperform their rivals by staying more closely connected to their customers — Enterprise Rent-A-Car, Pioneer Hi-Bred Seeds, Fidelity Investments, Lexus and Intuit are prominent examples. Their advantage, however, does not have much to do with CRM tools and technologies. In fact, information technology is merely a necessary, but not sufficient, condition for achieving this advantage. On its own, as mounting evidence indicates, IT contributes little to creating better relationships with customers.[1] Rather, superior customer-relating capability is a function of how a business builds and manages its organization. In particular, it results from a clear focus on, and deft orchestration of, three organizational components:

The first is an organizational *orientation* that makes customer retention a priority and gives employees, as part of an overall willingness to treat customers differently, wide latitude to satisfy them.

The second component is a *configuration* that includes the structure of the organization, its processes for personalizing product or service offerings, and its incentives for building relationships.

Information is the final component: information about customers that is in-depth, relevant and available through IT systems in all parts of the company.[2]

Although each of these components is, by itself, relatively straightforward, it is only when all three work in concert that a superior capability is created. My research has indicated that the most successful companies — those with the best connections to their customers — are those able to create and maintain that integrated focus on orientation, configuration and information. This finding held true for companies in all types of markets, whether they were growing fast or slowly, were extremely or moderately competitive, had many customers or few, or whether they were selling to businesses or to consumers. (See "About the Research.")

All companies can improve their customer relationships and, consequently, their performance by concentrating on these key components and developing a clearer sense of how they interrelate. To do so, managers must gain a greater understanding of each.

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> Companies with the best connections to their customers unwaveringly focus their orientation, configuration and use of information on the people and businesses that buy from them.
>
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About the Research

A survey was sent to senior managers in 342 midsize to large businesses; the focus was on CRM initiatives and their relationship to competitive strategy. A representative sample of senior marketing, sales and MIS managers and executives was drawn from a database combining information from Dun & Bradstreet and Marketplace. U.S. companies with more than 500 employees and from all 50 states were selected from the manufacturing, transportation, public utilities, wholesale and retail trade, finance, insurance and real estate sectors. In the first mailing, 1,100 surveys were sent out; about four weeks later, a second wave was sent to 900 new contacts. The final response rate from the two mailings was 17%. Data collection was completed in March 2001. In addition to the survey, managers were interviewed from 14 companies, including Dow Chemical, GE Aircraft Engine Business Group, Ford and Fidelity Investments.

Orientation

The most important indicator of an organizational focus on customers is the shared belief that customer retention is a high priority for everyone, not just a concern to be delegated to marketing or sales. Next in importance is the openness of the organization to sharing information about customers. An orientation is counterproductive when one function such as sales believes it owns the customer. Potentially useful information is then held closely by one person who knows the customer and its history, vulnerabilities and requirements and is unlikely to convert that information into knowledge that can be shared by other teams and functions. Similarly, if the mind-set and history of the business celebrates customer acquisitions through individual effort, little energy will be spent on capturing customer information or assembling it all in one place.

A customer-relationship orientation is also shaped to some degree by the belief that different customers should be treated differently, on the basis of their long-run value. Most companies give lip service to this notion, but few have gone as far as IBM did under Lou Gertsner, who made it a company value to take on only the best customers and to do everything possible to cater to their needs. That hard-nosed approach saved IBM from the worst of the problems that HP, Cisco and Compaq encountered by chasing every Internet startup without regard to their long-term ability to pay. The kind of leadership and organizationwide emphasis on customer retention shown by IBM sets leaders apart. In general, companies that embodied the attitudes and values of a true orientation toward customers — about 18% of those studied in my research — enjoyed a significant advantage over their rivals.

Configuration

This term refers to the incentives, metrics, accountabilities and structure that align an organization toward building customer relationships. Configuration is the most influential component of a superior capability and best explains differences between businesses in their success with customers.

The use of incentives is an important means of keeping people in an organization focused on customers. Although this idea is well known, few companies act as though they believe it. A counterexample is Siebel Systems — not surprisingly, perhaps, since it is the leader in CRM software — which ties 50% of management's incentive compensation to measures of customer satisfaction.[3] In addition, 25% of its salespeople's compensation is based on those measures — and is paid a year after the signing of the sales contract, when the customer's level of satisfaction with the results can be determined. In most software companies, salespeople are paid when the contract is signed, a policy that fosters a one-time-transaction mind-set.

Companies with superior configurations are also structured to ensure that their customers have a seamless interaction with all parts of the business. That prevents a customer from having to deal with different functional groups as separate entities within the same company. A seamless connection is often best achieved when accountability for the overall quality of customer relationships is clear. Companies organized around customer groups and processes (rather than products, functions, or geographies) are much better at providing clear accountability than those organized according to products, functions or geographies.

The real payoff comes when all the elements of a configuration — metrics, incentives and structures — are properly aligned. Achieving that alignment was the challenge to the General Electric Aircraft Engine Business Group when it found that its jet engine customers were not happy with the service component of the offering, even though the company's internal (six-sigma quality) metrics showed the opposite. The group then began a CRM project that was based on an in-depth study of what customers really wanted in terms of responsiveness, reliability, value added by the services and help in improving their productivity. The project led the group to make wholesale changes

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in its configuration: New metrics based on customer requirements were added to traditional functional metrics (such as product reliability and compliance with standards), and the sales, marketing and product support groups were organized around customer-facing processes rather than functions. A corporate vice president was assigned to each of the top 50 customers for the sole purpose of building the relationship, so each customer had a clear channel to the top of the organization.

To help customers improve their productivity — which was what they wanted most from the relationship — the engine group also put leaders of their six-sigma quality program on site with customers to provide training and work hand-in-hand on engine-service projects and parts inventory management. Working and learning together, employees from GE and its customers found that the Internet was the best tool for personalizing the delivery of parts, and it became part of the CRM project. The technology was not the driver of the project, but it did help to tighten the connections. The last step was to incorporate customer-service metrics into the employee evaluation criteria and provide rewards for superior service. Throughout the capability-building process, all aircraft-group employees were kept informed of new developments — for example, a screen appeared on their workstations each morning with a summary of the group's performance on key customer requirements, as well as current engine-related problems such as delays or aborted takeoffs, so corrective action could be taken swiftly. As a result of its efforts to reconfigure the organization in favor of its customers, the aircraft-engine group now routinely earns high ratings on a range of customer-satisfaction metrics and is seen by its customers as an important contributor to their productivity.

Information

Most companies think of information technology first when they consider CRM capabilities — instead of last, as they should. In distinguishing leaders from followers, it is the least important piece of the puzzle. And yet in interviews, executives confess to spending most of their resources on databases, software and data mining. They often do so reactively or out of fear:

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"Software vendors and consultants keep bringing us new solutions. We know they are making the same pitch to our competitors, and we don't want to fall behind" — this is a representative comment. At the same time, most companies are not happy with the poor quality of their data and their continuing inability to obtain a full picture of their customers' history, activity, requirements and problems. It's the classic Red Queen syndrome: Although the companies are going faster and faster, they stay in the same place.

CRM technologies can help companies gain a coherent and comprehensive picture of customers, better organize internal data to cut service costs, help salespeople close deals faster, and improve the targeting of marketing programs. But they can assist in these ways only if the organization has begun to reconfigure and reorient itself toward customers.

A Battle for Customers

To understand how differences in customer-relationship capability lead to differences in financial performance, consider credit-card providers Capital One and First USA, a subsidiary of Bank One Corp. Despite being half the size of First USA, Capital One has leveraged its superior capability to consistently outperform its bigger rival, earning 40% more interest income from each customer and enjoying double the profit margin.[4]

Strategic differences are at the root of the story. First USA's priority is rapid growth in the "prime market," which is made up of relatively low-risk customers who have established credit histories and can command low-interest cards. Since many other card issuers are chasing the same people, these customers are neither loyal nor especially profitable. First USA has been more successful selling "affinity" cards through organizations like universities, but it otherwise gives little consideration to differences in customers' credit risk or potential profitability. The real thrust of First USA's strategy, according to Richard Vague, the former chairman, is "to be laser-focused on operating efficiency and pass those savings on to customers."

The essence of Capital One's strategy, according to a published mission statement, is to "deliver the right product, at the right price, to the right customer, at the right time." The company has consciously avoided the low-profit, high-churn prime market in favor of the "superprime" and "subprime" segments. In the former, Capital One focuses on "high chargers" who generate large merchant fees in place of interest charges from revolving balances. In the subprime market, the company targets people with limited credit histories such as college students; it hopes that they will remain loyal customers as they become more affluent. Capital One contains risk in this market by issuing cards with low credit limits that are partially secured (by a student's parents, for example).

First USA's strategy is not panning out. As personal debt

mounts, the company has had to deal with a climbing customer attrition rate, declines in revenue and quarterly losses. Efforts to change will be severely hamstrung by an absence of the right orientation, information or configuration needed to forge customer relationships.

The strategic focus on efficiency at First USA contributes to a self-centered orientation that doesn't allow employees to see customers as individuals. This insensitivity has led to some notably wrong-footed decisions. In mid-1999, the company eliminated the grace period for late payments, while raising late fees. The policy was applied across the board; no distinctions were made on the basis of differences in the lifetime value of their customers. Not surprisingly, customers departed in droves, and the bank was forced to rescind the move.

First USA also lacks the information it needs to build customer relationships. The company grew to its large size by acquiring customer portfolios from other credit-card companies and by using third parties like Affinity Partners to source potential relationships with associations. Because it has acquired many of its customers indirectly, First USA has been unable to obtain the data needed to build warehouses of rich customer information — the raw material of the customer-relating capability.

The configuration of First USA also gets in the way. The company is hierarchically organized according to products or functions like operations, collections and systems. Within the brand-marketing function, which manages all cards under the First USA name, there are separate groups for acquisitions, portfolios and e-business — but no one has responsibility for customer retention. Incentives are also misaligned. Because the information system can't tease out an individual's profitability, frontline employees can't be rewarded for keeping valuable customers. Instead, they try to retain everyone, whether they are good, bad or indifferent long-term prospects.

By contrast, Capital One's orientation is fundamentally shaped by a belief in the microsegmentation of its customers — that is how the company identifies and keeps those who are most valuable. Employees at all levels have implicit permission

> **Capital One's orientation is shaped by a belief in micro-segmentation — that is how the company identifies and keeps its most valuable customers.**

to act as customer advocates, and service representatives are measured not only on their performance but also on how supportive they are to colleagues. The sense of shared values and collaboration contributes to a low turnover rate (5% per year among customer-contact people versus an industry average of 15% to 20%), which improves service and helps keep costs down.

Capital One is also a leader in its use of information. It invests heavily to learn about its customers: In 2001, the company ran 45,000 tests on product variants, procedural changes and customer interactions. Thus whenever a customer calls, for example, computers instantly pull up the full history of the account and cross-reference it with data from millions of customers. Poor prospects are routed to a voice-response unit and allowed to close their accounts. Others are routed to a service rep along with two dozen pieces of information about the cardholder and the likely reason for the call. A representative dealing with a customer who wants to close the account, for example, will find three interest-rate counteroffers displayed by the IT system. Armed with the freedom to negotiate, the contact person can try to persuade the customer to accept a better offer; if the customer stays on at the highest of the new rates, the retention specialist will be rewarded with a bonus.

The alignment of the whole organization with strategy is further reinforced by Capital One's configuration. The company structures its U.S. card business by market-segment groups based on customers' credit quality, their activity with the card, membership in affinity groups and so on. Each segment is treated as a profit center. The manager of the prime segment, for example, has the autonomy and the team to run that part of the operation like a small business. Instead of a cumbersome top-down organization, Capital One is adroit at sensing opportunities from the bottom up and is motivated to pursue them quickly.

Improving the Capability

The process of improving a customer-relating capability has much in common with that of creating a market-driven organization, in which success comes when commitment by the company's leaders signals that they are serious about the initiative, when the key implementers understand the need for change and see what must be done differently, and when there is a sense of urgency.[5] The best impetus for improvement is a realistic assessment of how the company compares with its rivals in orientation, information and configuration. The organization must also consider the consequences of not catching up and possible improvements (or countermoves) by competitors while the initiative is being carried out.

These general guidelines are not sufficient, however, because a program for improving a customer-relating capability introduces

additional complications and pressure points. One recurring problem is that success depends on bringing IT, marketing and sales together. Although these groups are not instinctively adversarial, deep differences in interests, priorities and backgrounds often frustrate cooperation. Divergent approaches may escalate to turf wars. For example, one part of the business may not want to let others tap into its customer database as "free riders" who, in addition, might spoil established relationships. A further complication is that CRM initiatives can be inwardly focused when they are undertaken to fix productivity or service shortcomings. The antidotes are a deep immersion in the customer experience and an understanding of what customers expect from a closer relationship.[6]

Companies must also recognize that the collective mind-set, beliefs and values embedded in an orientation toward relationships is what sets leaders apart. Yet efforts to change this aspect of a culture directly are unlikely to succeed — change happens when behavior patterns are altered and people come to understand how the new behaviors lead to better performance. To gain organizationwide commitment to the improvement program, companies should invest in market understanding and align the configuration; only then should they install CRM technology.

Invest in Customer Understanding

The key to such understanding is segmentation: The more a company can break down its customers into different groups with different needs and expectations, the better it can serve them.

A major publisher of directories shaped its transformation through careful segmentation. The company had always done conventional segmentation studies — which mostly served to satisfy its curiosity about a very diverse customer base. Because the sales force was rewarded for acquiring rather than keeping customers and the other functions were unwilling to disrupt their processes, the organization resisted having different types of relationships with customers of differing value.

The turning point came when the publisher set out to understand how its customers viewed the total experience of dealing with the company. The publisher also polled a diverse group of customers, asking each to describe its *ideal* experience. The difference between the expectations of the largest customers (the 4% that represented 45% of the publisher's revenues) and the smallest was startling. The largest customers wanted a single point of contact where they could resolve problems, coupled with service tailored to their needs, consultation on how to use the directory to build relationships, and help in tracking results. The smallest customers wanted a simple, low-risk experience; the predominant view was "Leave me alone unless I need you." They clearly didn't require a sales call, and the economics seldom justified one.

This gave the organization clear signals about how to meet customer expectations better while also cutting costs. Key account managers with industry expertise were assigned to the largest accounts, and the smallest were served over the Internet and by a telephone sales force.

Change the Configuration

Most postmortems of CRM failure trace the problems back to the configuration — the lack of incentives and metrics and the absence of a customer-facing organization. (A common pitfall is to concentrate on the customer-contact processes without making corresponding changes in internal structures and systems.[7]) Superior configurations, such as those of Capital One and Siebel, use incentives that emphasize customer retention.

But before incentives can be established, the right metrics must be in place. Many companies don't know their customer defection rate or their customer-purchase share. But even if those metrics are available, they cannot easily be traced back to specific parts of the organization. Are defections and a declining share of wallet the result of service shortcomings, quality problems or delivery missteps? Or are defectors simply attracted by a competitor or consciously "polygamous"? Many companies rely on customer satisfaction measures, but even these are problematic when as many as 90% of customers do not respond to surveys and those that do may have a courtesy bias and not give a rating below four on a five-point scale.

A better approach is to have a portfolio of metrics that reveals the long-term profitability of the customers. Companies can still measure customer loyalty and satisfaction but should supplement such metrics with those that determine the cost to acquire and serve customers as well as with proxies for direct measurements of loyalty and satisfaction — metrics on employee retention, customer complaints and company performance on attributes that are important to customers, such as on-time delivery and service responsiveness.

Although organizing according to customer groups or segments is a common hallmark of a superior capability, it is not always appropriate. Companies must be willing to treat different kinds of customers differently and to tolerate the accounting and organizational complexities that threaten to erode economies of scale.

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Nokia successfully split its monolithic $21 billion mobile-phone unit into nine customer units, each with its own product R&D, marketing and P&L responsibility.[8] One unit will serve business users, another will focus on barebones handsets for users in developing countries, and so on.

Microsoft, on the other hand, tried to organize according to different types of customers to get product-development groups closer to customers. The intent was admirable but the effort came undone because decisions about products such as Windows were spread across too many of the new divisions. Short of organizing entirely around customer segments, companies can take intermediate steps by using key account managers and orienting customer-contact functions around segments while leaving manufacturing and development organized by product.

Orchestrating Change

Canadian Pacific Hotels has successfully combined deep customer insights with configuration changes to build greater loyalty with business travelers. In 1999, the chain had 27 hotels in the "quality" tier and was proficient with conventions and group travel, but it was not well regarded by business travelers — a notoriously demanding and diverse group but also a very lucrative one. CP Hotels began by investing to learn what would most satisfy this segment of the market. It turned out that business travelers weren't especially interested in earning extra nights in a CP hotel as a reward for loyalty; instead, they wanted "beyond the call of duty" efforts to rectify problems, recognition of their individual preferences, and lots of flexibility regarding arrival and checkout times.

CP Hotels responded by committing to make extraordinary efforts to always satisfy customers in its frequent-guest club. Delivering on this promise proved remarkably difficult. The company began by mapping each step of the "guest experience" from check-in and valet parking to checkout and setting a standard of performance for each activity.[9] From that analysis, it determined what services should be offered, which processes were needed, and what level of staffing was needed in order to be able to honor the commitment.

The biggest hurdle was the company's historic bias toward handling large tour groups, which meant that the skills, mindsets and processes at hand were not the ones needed to satisfy individual executives. Even small enhancements such as free local calls or gift-shop discounts required significant changes in information systems. The management structure was changed so that each hotel had someone with broad, cross-functional authority to ensure the hotel lived up to its ambitious commitment. Finally, the company put systems and incentives in place to make sure every property was in compliance with the new emphasis and performance was meeting or exceeding the standards.

After implementing these changes, CP Hotels' share of Canadian business travel jumped by 16% in a flat market. By all measures, the chain had won greater loyalty from its target segment. Long-term success will take sustained commitment to keep ahead of competitors that want to match or leapfrog the company. Companies that sustain their commitment send a signal to both their employees and customers that their customer-relating capability is one of the centerpieces of their strategy.

More and more companies are turning toward their customers, but there's still a lot of confusion about what that means and how to do it successfully. The widespread disappointments with CRM systems are a warning about how difficult it is to improve a customer-relating capability. The key to a sustainable advantage in this area is the right blend of incentives, metrics and structural changes. These can start to produce a true customer-directed orientation that, when combined with technology to generate and distribute information, can turn a company into a market-driven leader.

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