Fourth Edition

Managing Customer Experience and Relationships

A Strategic Framework

Don Peppers • Martha Rogers

WILEY

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FOURTH EDITION

Don Peppers

Martha Rogers

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Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

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Library of Congress Cataloging-in-Publication Data is Available:

ISBN 9781119815334 (Hardback)
ISBN 9781119815358 (ePDF)
ISBN 9781119815341 (ePub)

Cover Design: Wiley
Cover Image: © Den Rise/Shutterstock

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Foreword

The View from Here

It's been five decades since I first started studying and writing about marketing. Back then, the Industrial Age was in its prime. Manufacturers churned out products on massive assembly lines and stored them in huge warehouses, where they patiently waited for retailers to order and shelve boxes and bottles so that customers could buy them. Market leaders enjoyed great market shares from their carefully crafted mass-production, mass-distribution, and mass-advertising campaigns.

What we all learned from the Industrial Age is that if an enterprise wanted to make money, it needed to be efficient at large-scale manufacturing and distribution. The enterprise needed to manufacture millions of standard products and distribute them in the same way to all of their customers. Mass producers relied on numerous intermediaries to finance, distribute, stock, and sell the goods to ever-expanding geographical markets. However, in the process, producers grew increasingly removed from any direct contact with end users.

Producers tried to make up for what they didn't know about end users by using a barrage of marketing research methods, primarily customer panels, focus groups, and large-scale customer surveys. The aim was not to learn about individual customers but about large customer segments, such as "women ages 30 to 55." The exception occurred in business-to-business marketing, where each salesperson knew each customer and prospect as an individual. Well-trained salespeople were cognizant of each customer's buying habits, preferences, and peculiarities. Even here, however, much of this information was never codified. When a salesperson retired or quit, the company lost a great deal of specific customer information. Only more recently, with sales automation software and loyalty-building programs, have business-to-business enterprises begun capturing detailed information about each customer on the company's mainframe computer.

As for the consumer market, interest in knowing consumers as individuals lagged behind the business-to-business marketplace. The exception occurred with direct mailers and catalog marketers who collected and analyzed data on individual customers. Direct marketers purchased mailing lists and kept records of their transactions with individual customers. The individual customer's stream of transactions provided clues as to other items that might interest that customer. For example, in the case of consumer appliances, the company could at least know when a customer might be ready to replace an older appliance with a new one if the price was right.

As the twentieth century progressed, direct marketers became increasingly sophisticated. They supplemented mail contact with the adroit use of the telephone and telemarketing. The growing use of credit cards, and customers' willingness to give their credit card numbers to merchants, greatly stimulated direct marketing. The emergence of fax machines further facilitated the exchange of information and the placing of orders. The Internet and email facilitated direct marketing. Customers could view products visually and order them easily over the phone or online, receive confirmation, and know when the goods would arrive.

As the 21st century drove interactivity between customers and companies, and among each other, even companies that don't really understand social networking realize they have to get on board. If 33 million people are in a room, you have to visit that room.[1]

But whether a company was ready for *customer relationship management* depended on more than conducting numerous transactions with individual customers. Companies needed to build comprehensive *customer databases*. Companies had been maintaining product databases, sales force databases, and dealer databases. Now they needed to build, maintain, mine, and manage a customer database that could be used by company personnel in sales, marketing, credit, accounting, and other company functions.

As customer database marketing grew, several different names came to describe it, including individualized marketing, customer intimacy, technology-enabled marketing, dialogue marketing, interactive marketing, permission marketing, and one-to-one marketing.

Modern technology makes it possible for enterprises to learn more about individual customers, remember those needs, and shape the company's offerings, services, messages, and interactions to each valued customer. The new technologies make mass customization (otherwise an oxymoron) possible.

At the same time, technology is only a partial factor in helping companies do genuine one-to-one marketing. The following quote about customer relationship management (CRM) makes this point vividly:

> *CRM is not a software package. It's not a database. It's not a call center or a Web site. It's not a loyalty program, a customer service program, a customer acquisition program, or a win-back program. CRM is an entire philosophy.*
>
> —*Steve Silver*

Whereas in the Industrial Age, companies focused on winning market share and new customers, more of today's companies are focusing on share of customer, namely, increasing their business with each existing customer. These companies are focusing on customer retention, customer loyalty, and customer satisfaction as the important marketing tasks, and customer experience management and increasing customer value as key management objectives.

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[1]Juliette Powell, *33 Million People in the Room* (Upper Saddle River, NJ: Financial Times Press, 2009), pp. 8–9.

Various kindred customer-focused efforts are more than just an outgrowth of direct marketing and the advent of new technology. As the Interactive Age progresses, mass marketing must give way to new principles for targeting, attracting, winning, serving, and satisfying markets. As advertising costs have risen and mass media has lost some effectiveness, mass marketing is now more costly and more wasteful. Companies are better prepared to identify meaningful segments and niches and address the individual customers within the targeted groups. They are becoming aware, however, that many customers are uncomfortable about their loss of privacy and the increase in solicitations by mail, phone, and email. Ultimately, companies will have to move from an "invasive" approach to prospects and customers to a "permissions" approach. On the flip side, customers—now in contact with millions of other customers—have never been more informed or empowered.

Despite being introduced in enterprises large and small over two decades ago, the full potential of CRM is only beginning to be realized. Of course, every company must offer great products and services. But now, rather than pursue all types of customers at great expense only to lose many of them, the objective is to focus only on those particular customers with current and long-term potential in order to preserve and increase their value to the company.

In this fourth edition of their widely used textbook, Peppers and Rogers offer a careful context as well as modern thinking on how to grow the value of a company by growing the value of the customer base, how to increase profits by using modern technology and behaving ethically, and how to look ahead to what will be coming next.

Philip Kotler
S. C. Johnson Distinguished Professor of International Marketing,
Kellogg School of Management, Northwestern University (Emeritus)

Philip Kotler is widely known as the father of modern marketing. His textbook Marketing Management*, coauthored with Kevin Keller, has become the foundational text for marketing courses around the globe. First published in 1976 by Prentice Hall, it is now in its 16th edition. In addition to his many books and university honors, Dr. Kotler has established the annual international World Marketing Summit, now in electronic format to reach audiences worldwide.*

Preface

The One to One Future: Building Relationships One Customer at a Time was our very first book, and we sent it to the publisher in February 1993 ("paper manuscript only, please; no electronic files allowed"). During the three previous years it took us to write the book, we often referred to it as a work of "business science fiction," in which we were trying to imagine how businesses would compete once interactive technologies became ubiquitously available. And while we thought the future we were describing was technologically inevitable, we also judged that it was still 10 or 20 years away and would most likely arrive when fiber-optic cables were finally connected to individual homes and offices.

On p. 5 of our book, we said that in the 1:1 future:

> products will be increasingly tailored to individual tastes, electronic media will be inexpensively addressed to individual consumers, and many products ordered over the phone will be delivered to the home in eight hours or less. In the 1:1 future businesses will focus less on short-term profits derived from quarterly or annual transaction volumes, and more on the kind of profits that can be realized from long-term customer retention and lifetime values.

We went on to describe some of the social implications of truly ubiquitous, always-on interactivity, suggesting that our vision of the 1:1 future:

> holds immense implications for individual privacy, social cohesiveness, and the alienation and fractionalization that could come from the breakdown of mass media. It will change forever how we seek our information, education, and entertainment, and how we pursue our happiness. In addition to the "haves" and "have nots," new class distinctions will be created between the "theres" and "there nots." Some people will have jobs that require them to *be there*—somewhere—while others will be able to work mostly from their homes, without having to be anywhere.

However, while we thought this future was still a decade or two away, the year after our book was published Netscape released its Navigator web browser, the first commercial product that truly allowed businesses to participate in a completely new interactive medium, the World Wide Web. And commercial interest in the World Wide Web grew explosively. There were just 130 websites at the end of 1993, most operated by academic or government entities, but by 1997 there were more than a million, and by 2001 there were nearly 30 million, almost all of which belonged to businesses.[1]

These businesses all needed advice, help, answers, and suggestions. They wanted to know what the best policies would be for succeeding in a world where their customers were now just a click away from the competition. Our book took off as webmasters working for companies around the world sought out new strategies and best practices for interacting with their customers one at a time, now that they could. The management guru Tom Peters called *The One to One Future* the "book of the year" in 1993, and in 1994 *BusinessWeek* called it the "bible of the new marketing." In 1995 *Inc.* magazine put us on its cover, and George Gendron, the magazine's chief editor, said "Peters was wrong. This is not the book of the year. It's not even the book of the decade. It's one of the two or three most important business books ever written."[2]

So we kept thinking about all this, and we wrote more books, and we began conducting workshops and giving presentations to businesses, associations, and conferences around the world. We formed a consulting company, Peppers & Rogers Group, all the better to help companies come to grips with the powers and limitations of this new type of marketing. Over the years we have consulted for, spoken with, and advised literally hundreds of companies in more than 60 countries around the world, from Algeria, Argentina, and Bulgaria, to Turkey, the United Kingdom, and Vietnam. We know what works and what doesn't, and we also know what works in some cultures but not so much in others. Moreover, when someone—*anyone*—comes up with a promising new idea in this discipline, we rapidly hear about it. And then we speak about this new idea, and we write about it.

We created the IDIC framework (identify-differentiate-interact-customize) in the mid-1990s as a part of our consulting methodology. We tested it and refined it during our consulting work for many different companies before it first appeared in print in our 1999 book *The One to One Fieldbook: The Complete Toolkit for Implementing a 1to1 Marketing Program,* which we wrote with the leader of Peppers & Rogers Group's consulting practice, Bob Dorf. The *Fieldbook* included checklists, questionnaires, exercises, and self-help tools to guide businesses looking to gain more of the advantages offered by the internet, mobile phones, customer databases, and mass-customization technologies. By 2004 this IDIC framework had clearly shown its merits, so we used it as an organizing principle for the first edition of this textbook, and it remains a highly useful organizing principle today.

As we write these words, companies all over the world are hard at work on their digital transformations, customer initiatives, and customer experience programs in an effort that was largely underway, but has been greatly accelerated by the COVID-19 crisis, and is likely to remain highly active even after the virus is finally gone. McKinsey estimated that e-commerce penetration levels alone increased so dramatically that in

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[1] Internet Live Stats, "Total Number of Websites," https://www.internetlivestats.com/total-number-of-websites/, accessed September 23, 2021.

[2] Amazon.com book description, *The One to One Future*, available at https://www.amazon.com/One-Future-Don-Peppers/dp/0385485662, accessed September 23, 2021.

just the first three months of the COVID-19 crisis (2Q, 2020), the United States fully realized *ten years'* worth of e-commerce growth,[3] virtually at all once. Online penetration in the U.S. consumer economy has increased by 35%, on average, from the onset of COVID-19 through July 2021,[4] and figures from around the world show similar jumps. Whether you are contemplating a career in marketing, or your own company is hustling to get its digital act together, or you're simply trying to survive in a digital world where every quarter seems to produce a newly disruptive technology, we hope that the lessons in this revised and updated edition will be invaluable.

We have dramatically increased the emphasis on the financial issues that often confound marketers as they try to justify the business value of a better customer experience that may cost money in the short term. We've also radically reshaped the sections on customer analytics, to empower marketers with the knowledge they need to have intelligent conversations with the quantitative analysts, and to make objective, data-driven decisions without having to write an equation or calculate a standard deviation.

How to Use This Book

Each chapter begins with an overview and includes these elements:

- Glossary terms are printed in boldface the first time they appear in a chapter, and their definitions are located in the full glossary at the end of the book, and all of the glossary terms are included in the index for a broader reference of usage in the book.
- Sidebars provide supplemental discussions and real-world examples of chapter concepts and ideas.
- Food for Thought discussion questions for each chapter appear at the end of Part 1, Part II, and Part III of the book.

We anticipate that this book will be used in one of two ways: Some readers will start at the beginning and read it through to the end. Others will keep it on hand and use it as a reference book. For both groups of readers, we have tried to make sure the index is useful for searching by names of people and companies as well as terms, acronyms, and concepts.

If you have suggestions about how readers can use this book, please share those at peppersrogers1@gmail.com.

[3]Amit Mathradas, "Covid-19 Accelerated E-Commerce Adoption: What Does It Mean for the Future?" *Forbes,* December 29, 2020, at https://www.Forbes.Com/Sites/Forbesbusinesscouncil/2021/12/29/Covid-19-Accelerated-E-Commerce-Adoption-What-Does-It-Mean-For-The-Future/?Sh=2b6c021a449d, accessed September 23, 2021.
[4]"US Consumer Sentiment and Behaviors during the Coronavirus Crisis," McKinsey & Company, August 19, 2021, at https://www.mckinsey.com/business-functions/marketing-and-sales/our-insights/survey-us-consumer-sentiment-during-the-coronavirus-crisis, accessed September 23, 2021.

One more thing: In *The One to One Future* we did make one big prediction that has not come true, at least not yet anyway. Back then, we made this prediction in Chapter 9, which we titled "Make Money Protecting Privacy, Not Threatening It." If anything, recent experience has shown that there are a number of giant, even monopolistic businesses today that show no intention whatsoever to protect their users' privacy. Indeed, some businesses have become very profitable, even though they were built on the premise that the private, personal data of their users is a commodity to be bought and sold to the highest bidder (quite literally). And we say *users* in this case because the consumers who *use* platforms like Facebook, Google, or even LinkedIn are not actual customers at all. Many such social media platforms' *customers* are the advertisers and other businesses that pay to gain access to users' personal data—data about the products or services a user has looked at, or even about the messages a user has exchanged with friends. As the saying goes, if you think an online product is free, that means you're not really the customer—you're the product.

So in this fourth edition we have also added extensively to our discussion of privacy protection—what it means, how it can happen, how it might occur in the future, what regulations are beginning to enforce it, and so forth. But don't get us wrong. We still think that the ultimate future will be one in which the most successful companies will be *trustable*—proactively trustworthy. They will *want* to act in their customers' own interest, because in the long run this will create the most value from each customer. We believe that the moral arc of progress continues to point upward—that, over time, more and more enterprises will find it in their own best interest, not just ethically but *financially*, to embrace a more socially beneficial purpose and to act in their customers' interest. Moreover, we predict that as more businesses embrace trustability, consumers will show less and less tolerance for privacy-abusing companies, even those that offer their services absolutely free to their users.

In the future, we believe, business executives will strive to treat every customer the way they'd like to be treated themselves, if they were the customer. And we very much hope that you will be one of these future business executives. Enjoy our textbook and let us know what you think at peppersrogers1@gmail.com.

Don Peppers and Martha Rogers Ph.D.
January 2022

Acknowledgments

We started the research and planning for the first edition of this book in 2001. Our goal was to provide a handbook/textbook for students of the customer-centric movement to focus companies on customers and to build the value of an enterprise by building the value of the customer base. We have made many friends along the way and have had some interesting debates. We can only begin to scratch the surface in naming those who have touched the current revision of this book and helped to shape it into a tool we hope our readers will find useful.

We are indebted to the chorus of contributors and writers whose voices have helped to make this book what it is. As big as this book is, it is not big enough to include formally all the great thinking and contributions of the many academicians and practitioners who wrestle with deeper understanding of how to make companies more successful by serving customers better. We thank all of you, too, as well as all those at dozens of universities who have used earlier editions of the book to teach courses, and all those who have used the book as a reference work to try to make the world a better marketplace. Please keep us posted on your work!

This book has been greatly strengthened by the critiques from some of the most knowledgeable minds in this field, who have taken the time to review this book as well as earlier editions and to share their insights and suggestions with us. This is an enormous undertaking and a huge professional favor, and we owe great thanks to Becky Carroll, Jeff Gilleland, Mary Jo Bitner, James Ward, Ray Burke, Anthony Davidson, Susan Geib, Rashi Glazer, Jim Karrh, Neil Lichtman, Charlotte Mason, Janis McFaul, Ralph Oliva, Phil Pfeifer, Marian Moore, David Reibstein, and Jag Sheth. Thanks to John Deighton, Jon Anton, Devavrat Purohit, and Preyas Desai for additional insights, and we also appreciate the support and input from Mary Gros and Corinna Gilbert. And thanks to Maureen Morrin and to Eric Greenberg, and to John Westman, co-founder of Novellus, Inc. and adjunct professor at the Harvard Extension School and Boston College Carroll School of Management.

Don's class of "Markets of One" at Menlo College in Spring 2021 contributed to our insights on Facebook and trust. Thanks to Dr. Julie Edell Britton, who team-taught the "Managing Customer Value" course at Duke with Martha for many years, and the smart students there, and to Rick Staelin, who has always supported the work toward this textbook and the development of this field. Additional thanks to all of the marketing faculty members at Duke, especially Christine Moorman, Wagner Kamakura, Carl Mela, and Dan Ariely, and all those who have used and promoted the book and its topics.

Many thanks to David Allison, CEO of Valuegraphics; to Mike Betzer, CEO of Hypergiant and formerly an executive at Khoros and Lithium; to Guy Nirpaz, founder and CEO of Totango; to Zeynep Manco, formerly a consultant in the Istanbul office of Peppers & Rogers Group; to Roger McNamee, venture fund executive, early investor in Peppers & Rogers Group, and author of the book *Zucked,* for his insightful comments on the threat that Facebook poses both to individual privacy and to the future of business competition itself; to Karl Wirth, founder of Evergage (now a part of Salesforce) and author of *One-to-One Personalization in the Age of Machine Learning;* to Steve White, president and special counsel to CEO at Comcast; to Brooks Bell, founder of Brooks Bell, a digital marketing agency; and to Karen Ganschow, head of data sciences at Aware Super in Australia and formerly General Manager Consumer Marketing and Customer Strategy at National Australia Bank.

Much of this work has been based on the experiences and learning we have gleaned from our clients and the audiences we have been privileged to encounter in our work with Peppers & Rogers Group. Dozens and dozens of the talented folks who have been PRGers over the past years have contributed to our thinking—many more than the ones whose citations appear within this book, and more than we are able to list here. Our clients, our consulting partners and consultants, and our analysts are the ones who demonstrate every day that building a customer-centric company is difficult but achievable and very worthwhile financially. Special thanks go to Hamit Hamutcu, Orkun Oguz, Caglar Gogus, Mounir Ariss, Ozan Bayulgen, Amine Jabali, and Onder Oguzhan for their thinking and support. We also thank Tulay Idil, Bengu Gun, and Aysegul Kuyumcu for research. And to Thomas Schmalzl, Annette Webb, Mila D'Antonio, Elizabeth Glagowski, and Mike Dandrea of the 1to1 Media team, and especially Marji Chimes, our gratitude for a million things and for putting up with us generally. We also appreciate the work Tom Lacki has done for this book and our thinking, as well as the work of Valerie Peck, Alan Pennington, and Deanna Lawrence. Special additional thanks for ideas in the original edition that have survived to this version to Elizabeth Stewart, Tom Shimko, Tom Niehaus, Abby Wheeler, Lisa Hayford-Goodmaster, Lisa Regelman, and many other Peppers & Rogers Group alumni as well as professionals who are the winners of the 1to1 Impact Awards and PRG/1to1 Customer Champions, who are best in class at customer value building.

Our executive editor at John Wiley & Sons, Sheck Cho, has been an enthusiastic supporter of and guide for the project since day one. As always, thanks to our literary agent, Rafe Sagalyn, for his insight and patience.

We thank the many professors and instructors who are teaching the first customer strategy or CRM course at their schools and who have shared their course syllabi and suggestions. By so doing, they have helped us shape what we hope will be a useful book for them, their students, and all our readers who need a ready reference as we all continue the journey toward building stronger, more profitable, and more successful organizations by focusing on growing the value of every customer.

The real secret sauce to finishing the many details has been Amanda Rooker—a truly resourceful researcher and relentlessly encouraging and gifted content editor, who has patiently and capably assisted in winding us through the morass of secondary research and minutiae generated by a project of this scope. Cheerfully and brilliantly finding, handling, resolving, and tracking inconsistencies, errata, and potential pratfalls is just part of her genius. If there are any errors left, they are our fault, not hers.

As ever, we remain grateful to our patient and supportive spouses, Pamela Devenney and Dick Cavett.

About the Authors

Don Peppers and Martha Rogers, Ph.D., are often credited with having created, or at least kickstarted, the whole customer-centric approach to business which became known as customer relationship management (CRM). In their first book together, *The One to One Future: Building Relationships One Customer at a Time,* they called the concept "one-to-one marketing." Since then, they have written 10 more books further exploring, elucidating, and expanding the subject (see list at the end of this section).

Over time, the discipline has evolved, new terminologies have been created, and many of the practices Peppers and Rogers included as elements of one-to-one marketing would today be considered to be part of the customer-experience-management discipline. In the B2B space they would be considered part of the account-based marketing (ABM) or customer success management disciplines.

In 1993 they founded the Peppers & Rogers Group, which became a leading customer-centric management consulting firm with offices and clients on six continents. In 2013 they were inducted into the Direct Marketing Association Hall of Fame, and in 2016 they were jointly ranked by Satmetrix (now a unit of NICE) as the world's number-one most influential authorities on customer experience management.

Much sought after as public speakers, Peppers and Rogers have delivered talks or workshops in about 60 countries around the world. Whenever they speak, they make it a point to tailor and adapt their messaging for companies in virtually every business category imaginable. Today, they have once again joined forces to form CX Speakers, a business exclusively designed to deliver keynote presentations, instruction, workshops, and thought-leadership consulting focused exclusively on the customer experience and all its related topics, which range from digital technologies, disruption, and innovation to customer metrics, social selling, customer success, customer advocacy, trust, and corporate culture.

Prior to his career as an authority on customer-centric competition, Don Peppers served as the CEO of a top-20 direct marketing agency, and his book *Life's a Pitch: Then You Buy* (1995) chronicles his exploits as a celebrated new-business rainmaker in the advertising industry. He holds a B.S. in astronautical engineering from the US Air Force Academy and a master's in public affairs from Princeton University's School of Public and International Affairs. He also has a popular voice in business media and is LinkedIn's most widely followed authority on customer experience, with more than 300,000 followers.

Martha Rogers is the founder of Trustability Metrix, a firm designed to help companies understand how to measure and improve their levels of trust by customers, employees, and business partners. After a career in advertising copywriting and management, Rogers has taught at several universities, most recently as an adjunct professor at the Fuqua School of Business at Duke University, where she codirected the Teradata Center for Customer Strategy. Rogers has been widely published in academic and trade journals, including *Harvard Business Review, Journal of Advertising Research, Journal of Public Policy and Marketing*, and *Journal of Applied Psychology*. She has been named International Sales and Marketing Executives' Educator of the Year. Rogers earned her Ph.D. at the University of Tennessee as a Bickel Fellow.

Books by Don Peppers and Martha Rogers, Ph.D:

- *The One to One Future: Building Relationships One Customer at a Time* (Doubleday, 1993).
  - Tom Peters: "Book of the Year" (1993)
  - *BusinessWeek*: "Bible of the new marketing" (1994)
  - *Inc. Magazine:* "One of the two or three most important business books ever written" (1995)
- *Enterprise One to One: Tools for Competing in the Interactive Age* (Doubleday, 1997).
  - *Wall Street Journal* 5-Star Rating
- *The One to One Fieldbook: The Complete Toolkit for Implementing a 1 to 1 Marketing Program* (Doubleday, 1999), coauthored with Bob Dorf.
- *The One to One Manager: Real-World Lessons in Customer Relationship Management* (Doubleday, 1999).
- *One to One B2B: Customer Development Strategies for the Business-to-Business World* (Doubleday, 2001).
  - *New York Times* Business Best Seller
- *Managing Customer Relationships: A Strategic Framework* (Wiley, 2011).
- *Return on Customer: Creating Maximum Value from Your Scarcest Resource* (Doubleday, 2005).
  - One of *Fast Company's* "15 Most Important Reads" of 2005
  - One of *Fast Company's* "25 Best Business Books" in 2007
- *Rules to Break & Laws to Follow: How Your Business Can Beat the Crisis of Short-Termism* (Wiley, 2008).
  - Inaugural title in Microsoft's "Executive Leadership Series"
- *Managing Customer Relationships: A Strategic Framework,* Second Edition (Wiley, 2011).
- *Extreme Trust: Honesty as a Competitive Advantage* (Penguin, 2012).

- *Managing Customer Experience and Relationships: A Strategic Framework,* Third Edition (Wiley, 2016).
- *Extreme Trust: Turning Proactive Honesty and Flawless Execution into Long-Term Profits* (revised and updated Penguin Paperback, 2016).

Books by Don Peppers:

- *Life's a Pitch: Then You Buy* (Doubleday, 1995).
- *Customer Experience: What, How, and Why Now* (BookBaby, 2016).

PART I

Technology's Rainbow

CHAPTER 1

Evolution of Marketing and the Revolution of Customer Strategy

No company can succeed without customers. If you don't have customers, you don't have a business. You have a hobby.

—Don Peppers and Martha Rogers

There can be no doubt that technological progress has irreversibly transformed the nature of business competition, giving customers much greater power, making them ever more knowledgeable, connecting them seamlessly to other customers, and raising their expectations and demands significantly with respect to the products and services they buy.

New technologies also allow an enterprise to **treat different customers differently**, in contrast to the way business was done for virtually the entire twentieth century, when an enterprise would treat all its customers in basically the same way. Except for some high-end products and business-to-business **(B2B)** services, no enterprise could afford the time and expense required to pay attention to individual customers, one customer at a time. Instead, enterprises focused on the most common **needs** of their "average" customer, and then publicized their product **benefits** and **attributes** in the same way to everyone, in hopes of persuading some of these average customers to buy. But because of *technology,* enterprises can now do business in an entirely different way. Using computer databases, an enterprise can easily **identify** and remember its individual customers, one customer at a time, even if it has millions of them, paying close attention to the experience it provides to each customer and to its ongoing relationship with them. Using the internet, along with technologies such as Wi-Fi and smartphones, an enterprise can now **interact** directly with each of its individual customers and prospective customers, responding to inquiries, posing questions, and making different offers or suggestions to different customers.

(*continued*)

And now that enterprises *can* do these things, competition *requires* them to do so. The problem for today's enterprise is that the old marketing strategies and tactics, having been designed to attract as many average customers as possible for whatever product or service an enterprise was selling, don't help much when it comes to planning the best way to *treat different customers differently*. Instead, an enterprise needs a **customer strategy**, designed to meet different individual customers' different individual needs, and to maximize the amount of business an enterprise is able to do with each different customer.

The goal of this book is not just to acquaint the reader with the techniques of managing **customer experiences** and relationships. The more ambitious goal of this book is to help the reader understand the essence of customer strategy and how to apply it to the task of managing a successful enterprise in the 21st century.

This relatively new task that enterprises are now taking on, treating different customers differently, goes by a number of different labels and buzzwords. Some refer to it as "**customer centricity**" or "customer engagement." Others may refer to it as "customer management" or "**customer focus**." But no matter what term is used, the central premise is that an enterprise should seek to engage its customers, one at a time, in long-lasting, **mutually** valuable relationships, based on trust.

Moreover, to do this successfully, an enterprise must be able to see itself through a customer's own eyes. It must learn how to *experience* what each different customer experiences, and then take steps to ensure that this experience becomes better, easier, more convenient, and even more enjoyable for the customer, over the lifetime of that customer's relationship with the business. And businesses do this because their managers understand, intuitively, that when a customer has a better experience, the business will be *creating more value*, which means that the relationship with this customer now has a higher likelihood of increased profitability.

The dynamics of the customer-enterprise relationship have changed dramatically over time. Customers have always been at the heart of an enterprise's long-term growth strategies, marketing and sales efforts, product development, labor and resource allocation, and overall profitability directives. Historically, enterprises have encouraged the active participation of a sampling of customers in the research and development of their products and services.

But until recently, enterprises have been structured and managed around the products and services they create and sell. Driven by assembly-line technology, mass media, and mass distribution, which appeared at the beginning of the twentieth century, the Industrial Age was dominated by businesses that sought to mass-produce products and to gain a competitive advantage by manufacturing a product that was perceived by most customers as better than its closest competitor. Product innovation, therefore, was the important key to business success. To increase its overall market share, the twentieth-century enterprise would use **mass marketing** and mass advertising to reach the greatest number of potential customers.

As a result, most twentieth-century products and services eventually became highly **commoditized**. *Branding* emerged to offset this perception of being like all the other competitors; in fact, branding from its beginning was, in a way, an expensive substitute for relationships companies could not have with their newly blossomed masses of customers. Facilitated by lots and lots of mass-media advertising, brands have helped add value through familiarity, image, and trust. Historically, brands have played a critical role in helping customers distinguish what they deem to be the best products and services. A primary enterprise goal has been to improve *brand awareness* of products and services and to increase *brand preference* and brand loyalty among consumers. For many consumers, a brand name has traditionally testified to the trustworthiness or quality of a product or service. Today, though, more and more, customers say they value brands, but their opinions are based on their "relationship with the brand." As a result, brand reputation is becoming *one and the same* with customers' experience with the brand, product, or company (including relationships).[1] Indeed, consumers are often content as long as they can buy one brand of a consumer packaged good that they know and respect.

The two-way brand, or *branded relationship,* transforms itself based on the ongoing dialogue between the enterprise and the customer. The branded relationship is "aware" of the customer (giving new meaning to the term *brand awareness*).

For many years, enterprises depended on gaining the competitive advantage from the best brands. Brands have been untouchable, immutable, and inflexible parts of the twentieth-century mass-marketing era. But in the interactive era of the 21st century, firms are instead strategizing how to gain sustainable competitive advantage from the *information* they gather about customers. As a result, enterprises are creating a *two-way brand,* one that thrives on customer information and interaction. The two-way brand, or *branded relationship,* transforms itself based on the ongoing dialogue between the enterprise and the customer. The branded relationship is "aware" of the customer (giving new meaning to the term *brand awareness*) and constantly changes to suit the needs of that particular individual. In current discussions, the focus is on ways to redefine the brand reputation as more customer oriented, using phrases such as "brand engagement with customer," "brand relationship with customer," and the customer's "brand

Companies are realizing that what customers say about them is more important than what the companies say about themselves.

[1]Vikas Kumar, "Building Customer-Brand Relationships through Customer Brand Engagement," *Journal of Promotion Management* 26, no. 7 (July 2020), p. 986–1012, doi:http://dx.doi.org/10.1080/10496491.2020.1746466, accessed June 7, 2021. Also, Christof Binder and Dominique M. Hanssens report research on brand valuation of a company at the time of merger or acquisition. They discovered that over a 10-year period from 2003 to 2013, "brand valuations declined by nearly half (from 18% to 10% [of total company value]) while customer relationship values doubled (climbing from 9% to 18%). Acquirers have decisively moved from investing into businesses with strong brands to businesses with strong customer relationships." See "Why Strong Customer Relationships Trump Powerful Brands," *Harvard Business Review*, April 14, 2015, available at https://hbr.org/2015/04/why-strong-customer-relationships-trump-powerful-brands, accessed August 17, 2021.

experience." Add to this the transparency for brands and rampant ratings for products initiated by **social media**, and it's clear why companies are realizing that what customers say about them is more important than what the companies say about themselves.

> What does it mean for an enterprise to focus on its customers as the key to competitive advantage? It means creating new shareholder value by deliberately preserving and growing the value of the customer base.

ROOTS OF CUSTOMER RELATIONSHIPS AND EXPERIENCE

Once you strip away all the activities that keep everybody busy every day, the goal of every enterprise is simply to get, keep, and grow customers (whether those are business-to-consumer **[B2C]** customers or enterprise business customers [B2B]). This is true for nonprofits (where the "customers" may be donors or volunteers) as well as for-profits, for small businesses as well as large, for public as well as private enterprises. It is true for hospitals, governments, universities, and other institutions as well. What does it mean for an enterprise to focus on its customers as the key to competitive advantage? Obviously, it does *not* mean giving up whatever product edge or operational efficiencies might have provided an advantage in the past. It does mean using new strategies, nearly always requiring new technologies, to focus on growing the value of the company by deliberately and strategically growing the **value of the customer base.**

To some executives, **customer relationship management (CRM)** is a technology or software solution that helps track data and information about customers to enable better **customer service**. Others think of CRM, or one-to-one, as an elaborate marketing or customer service discipline. We even recently heard CRM described as "personalized email." But it's far more than that.

Managing customer relationships is what companies do to optimize the value of each customer, because they understand the customer's perspective and what it is—and should be—like to be a customer. This book is about much more than setting up a business website or redirecting some of the mass-media budget into the call-center database or cloud analytics or **social networking.** It's about increasing the value of the company through specific customer strategies (see Exhibit 1.1).

EXHIBIT 1.1 Increasing the Value of the Customer Base

Get	***Acquire*** more customers.
Keep	***Retain*** profitable customers longer. ***Win back*** profitable customers. ***Eliminate*** unprofitable customers.
Grow	***Upsell*** additional products in a solution. ***Cross-sell*** other products and services. ***Referrals*** and word-of-mouth benefits. ***Reduce*** the cost to serve customers.

Companies determined to build successful and profitable customer relationships understand that the process of becoming an enterprise focused on building its value by building customer value doesn't begin with installing technology, but instead begins with:

- A strategy or an ongoing process that helps shift the enterprise from a focus on traditional selling or manufacturing to a customer focus while increasing revenues and profits in both the current period and the long term.
- The leadership and commitment necessary to cascade throughout the organization, and the thinking and decision-making capability that puts customer value and relationships first as the direct path to increasing shareholder value.

Customer strategy means *increasing the value of the customer base*. CRM can be thought of as a set of business practices designed, simply, to put an enterprise into closer and closer touch with its customers, in order to learn more about each one and to deliver greater and greater value to each one, with the overall goal of making each one more valuable to the firm to increase the value of the enterprise.

The reality is that becoming a **customer-strategy enterprise** is about using information to gain a competitive advantage and deliver growth and profit to the firm by *increasing the value of the customer base*. In its most generalized form, CRM can be thought of as a set of business practices designed, simply, to put an enterprise into closer and closer touch with its customers, in order to learn more about each one and to deliver greater and greater value to each one, with the overall goal of making each one more valuable to the firm to increase the value of the enterprise. It is an enterprise-wide approach to understanding and influencing customer behavior through meaningful analysis and communications to improve customer acquisition, customer retention, and customer profitability.[2] Customer centricity is distinguishable from

[2] Priyanka Meena and Praveen Sahu, "Customer Relationship Management Research from 2000 to 2020: An Academic Literature Review and Classification," *Vision* 25, no. 2 (June 2021): 136–58, https://doi.org/10.1177/0972262920984550; Ju-Yeon Lee, Shrihari Sridhar, Conor Henderson, and Robert W. Palmatier, "Effect of Customer-Centric Structure on Firm Performance," Marketing Science Institute Working Paper Series, Report No. 12–111, available at https://www.msi.org/wp-content/uploads/2020/06/MSI_Report_12-1111.pdf, accessed August 17, 2021; Sunil Gupta and Donald R. Lehmann, *Managing Customers as Investments* (Philadelphia: Wharton School Publishing, 2005); Robert S. Kaplan, "A Balanced Scorecard Approach to Measure Customer Profitability," Harvard Business School's Working Knowledge Web site, August 8, 2005, available at: https://hbswk.hbs.edu/item/a-balanced-scorecard-approach-to-measure-customer-profitability, accessed August 17, 2021; Don Peppers and Martha Rogers, *The One to One Future* (New York: Doubleday Books, 1993); and Fred Reichheld and Rob Markey, *The Ultimate Question 2.0: How Net Promoter Companies Thrive in a Customer Driven World* (Cambridge, MA: Harvard Business Review Press, 2011).

product centricity and from technology centricity. These differences will be discussed more in Exhibit 1.3 later in this chapter.

Customer centricity: An enterprise-wide business strategy that achieves customer-specific objectives by taking customer-specific actions.

Defined more precisely, what makes customer centricity into a truly different model for doing business and competing in the marketplace is this: It is an enterprise-wide business strategy for achieving customer-specific objectives by taking customer-specific actions. It is enterprise-wide because it can't merely be assigned to marketing if it is to have any hope of success. Its objectives are customer-specific because the goal is to increase the value of each customer. Therefore, the firm will take customer-specific actions for each customer, often made possible by new technologies.

In essence, building the value of the customer base requires a business to *treat different customers differently*. Today, there is a customer-focus revolution under way among businesses. It represents an inevitable—literally, irresistible—movement. All businesses will be embracing customer strategies sooner or later, with varying degrees of enthusiasm and success, for two primary reasons:

1. All customers, in all walks of life, in all industries, all over the world, want to be individually and personally served.
2. It is simply a more efficient way of doing business.

We find examples of customer-specific behavior, and business initiatives driven by customer-specific insights, all around us:[3]

- An engaged couple receives **customized** mobile reminders to choose a venue, select wedding attire, hire a photographer, and other key milestones, all at the appropriate time.
- A group of three friends open the web page of the same kitchenware company that they all have ordered from in the past. Each friend views a different offer featured on the company home page on their device.
- A woman receives an email before her eight-month obstetrics appointment that gives information about what to expect at the appointment and her baby's stage of growth. A month later, the same woman receives a notification of her baby's immunization appointment that is triggered when she leaves the hospital with her newborn.

[3]Thanks to the SalesForce Marketing Cloud website for inspiring many of these examples; "Marketing Cloud Customer Stories," Salesforce, available at https://www.salesforce.com/products/marketing-cloud/customer-stories/, accessed April 14, 2021.

- An insurance company not only handles a claim for property damage but also connects the insured party with a contractor in their area who can bypass the purchasing department and do the repairs directly.
- Instead of sending out the same offer to everyone at the same time, a company waits for specific trigger behavior from a customer and increases response rates 25-fold.
- When logging in to buy tickets from a website, a father taking his tween daughter to a concert experiences a very different customer journey than does his twenty-something son who logs into the same site.
- Through the same phone app they used to check their flight status, an airline passenger in the airport waiting to board is offered an upgrade to business class as an **apology** for a 45-minute departure delay.
- An outdoor gear company sees that their tents are being discussed on a social channel and sends a free tent as a trial sample to a consistent product supporter.
- A supervisor orders more computer components by going to a web page that displays the firm's contract terms, their own spending to date, and the departmental authorizations.
- Sitting in the call center, a service rep sees a "smart dialogue" suggestion (see Chapter 8) pop onto a monitor during a call with a customer, suggesting a question the company wants to ask that customer. (The company is not asking all customers who call that week the same question.)
- A **customer service representative** sees a complaint a customer has made on a social channel and, at the same time, is able to view their purchasing history and order status. The service rep uses that information to reply to the complaint via the same social channel.
- An online cosmetics customer receives personalized offers when they open the company website, and promotional coupons are automatically applied to their shopping cart.
- A business sees that a customer has left their website, abandoning a cart with selected products before checkout, and makes sure that when the customer calls up their news online the next day, they get a reminder or a sweetener to go back and complete the order.

Taking customer-specific action, treating different customers differently, improving each customer's experience with the company or product, building the value of the customer base, creating and managing relationships with individual customers that go on through time to get better and deeper—that's what this book is about. Note that in the case of consumers, this can be conducted in a way that is simultaneously customized and yet efficiently automated. In the chapters that follow, we will look at lots of examples. *The overall business goal of this strategy is to make the enterprise as profitable as possible over time by taking steps to increase the value of the customer base.* The enterprise makes itself, its products, and/or its services so satisfying, convenient, or valuable to the customer that they become more willing to devote their time and money to this enterprise than to any competitor. A customer-strategy enterprise interacts directly with an individual customer. The customer tells the enterprise about how they would like to be served. Based on this interaction, the enterprise, in turn, modifies its behavior with respect to this particular customer. In essence, the concept implies a specific, one-customer-to-one-enterprise relationship, as is the case when the customer's input drives the enterprise's output for that particular customer.[4]

The overall business goal of this strategy is to make the enterprise as profitable as possible over time by taking steps to increase the value of the customer base.

A suite of buzzwords have come to surround this endeavor, in addition to customer relationship management (CRM): **one-to-one marketing, customer experience management, customer value management,** customer focus, **customer orientation**, customer centricity, **customer experience journey mapping**, and more.

You can see it in the titles on the business cards—chief marketing officer, of course, but also a host of others, such as:

- Customer success manager (B2B)
- Chief customer officer (B2C)
- Chief relationship officer
- **Customer care** leader
- Customer experience manager
- Customer experience advocate
- Director, customer experience and digital design
- Customer value management director
- Chief revenue officer
- Customer revolutionary

As with all new initiatives, this customer approach (different from the strictly financial approach or product-profitability approach of the previous century) suffers when it is poorly understood, improperly applied, and incorrectly measured and managed. But by any name, strategies designed to build the value of the customer base by building relationships with one customer at a time, or with well-defined groups of identifiable customers, are by no means ephemeral trends or fads any more than computers or connectivity are.

[4] Barton Goldenberg, "CXM: Give Your Customers the Experiences They Want," *CRM Magazine* 21, no. 4 (April 2017): 6; Ranjay Gulati, *Reorganize for Resilience: Putting Customers at the Center of Your Business* (Cambridge, MA: Harvard University Press, 2010). Also see Don Peppers and Martha Rogers, Ph.D., *One to One B2B* (New York: Doubleday Broadway Books, 2001).

A good example of a business offering that benefits from individual customer relationships can be seen in online banking services, in which a consumer spends several hours, usually spread over several sessions, setting up an online account and inputting payee addresses and account numbers, in order to be able to pay bills electronically each month. If a competitor opens a branch in town offering slightly lower checking fees or higher savings rates, this consumer is unlikely to switch banks. They have invested time and energy in a relationship with the first bank, and it is simply more convenient to remain loyal to the first bank than to teach the second bank how to serve them in the same way. In this example, it should also be noted that the bank now has increased the value of the customer to the bank and has simultaneously reduced the cost of serving the customer, as it costs the bank less to serve a customer online than at the teller window or by phone.

Clearly, customer strategy involves much more than marketing, and it cannot deliver optimum return on investment of money or customers without integrating individual customer information into every corporate function, from customer service to production, logistics, and channel management. A formal change in the organizational structure usually is necessary to become an enterprise focused on growing customer value. As this book shows, customer strategy is both an operational and an analytical process. **Operational CRM** focuses on the software installations and the changes in process affecting the day-to-day operations of a firm—operations that will produce and deliver different treatments to different customers. **Analytical CRM** focuses on the strategic planning needed to build customer value as well as the cultural, measurement, and organizational changes required to implement that strategy successfully.

How to Think About Relationships and Customer Experience as Key to Business Strategy

The move to a customer-strategy **business model** has come of age at a critical juncture in business history, when managers are deeply concerned about declining customer loyalty as a result of greater transparency and universal access to information, declining trust in many large institutions and most businesses, and increasing choices for customers. As customer loyalty decreases, profit margins decline, too, because the most frequently used customer acquisition tactic is price cutting. Enterprises are facing a radically different competitive landscape as the information about their customers is becoming more plentiful and as the customers themselves are demanding more interactions with companies and creating more connections with each other. Thus, a coordinated effort to get, keep, and grow valuable customers has taken on a greater and far more relevant role in forging a successful long-term, profitable business strategy.

If the last quarter of the twentieth century heralded the dawn of a new competitive arena, in which commoditized products and services have become less reliable as the source for business profitability and success, it is the new computer technologies and applications that have arisen that assist companies in managing their interactions with customers. These technologies have spawned enterprise-wide information systems that help to harness information about customers, analyze the information, and use the data to serve customers better. Technologies such as enterprise resource planning (ERP) systems, **supply chain** management (SCM) software, enterprise application integration (EAI) software, **data warehousing, sales force automation (SFA),** marketing resource management (MRM), and a host of other enterprise software applications have helped companies to **mass-customize** their products and services, literally delivering individually configured communications, products, or services to unique customers in response to their individual feedback and specifications.

The accessibility of the new technologies is motivating enterprises to reconsider how they develop and manage customer relationships and map the customer experience journey. More and more chief executive officers (CEOs) of leading enterprises have identified shifting to a customer-strategy business model as a top business priority for the 21st century. Technology is making it possible for enterprises to conduct business at an intimate, individual customer level. Indeed, technology is driving the shift. Computers can enable enterprises to remember individual customer **needs** and estimate the future potential revenue the customer will bring to the enterprise. What's clear is that technology is the enabler; it's the *tail*, and the one-to-one customer relationship is the *dog*.

Traditional Marketing Redux

Historically, traditional marketing efforts have centered on the four Ps— product, price, promotional activity, and place—popularized by marketing experts E. Jerome McCarthy[a] and Philip Kotler.[b] These efforts have been enhanced by our greater (and deeper) understanding of consumer behavior, organizational behavior, market research, segmentation, and targeting. In other words, using traditional sampling and aggregate data, a broad understanding of the market has preceded the application of the four Ps, which enterprises have deployed in their marketing strategy to bring uniform products and services to the mass market for decades.[c] In essence, the four Ps are all about the "get" part of "get, keep, and grow customers." These terms have been the focal point for building market share and driving sales of products and services to consumers. The customer needed to believe that the enterprise's offerings would be superior in delivering the "four Cs": customer value, lower costs, better convenience, and better communication.[d] Marketing strategies have revolved around targeting broadly defined **market segments** through heavy doses of advertising and promotion.

This approach first began to take shape in the 1950s. Fast-growing living standards and equally fast-rising consumer demand made organizations aware of the effectiveness of a supply-driven marketing strategy. By approaching the market on the strength of the organization's specific abilities, and creating a product supply in accordance with those abilities, it was possible for the firm to control and guide the

(*continued*)

sales process. Central to the strategic choices taken in the area of marketing were the—now traditional—marketing instruments of product, price, place, and promotion—the same instruments that served as the foundation for Philip Kotler's theory and the same instruments that still assume an important role in marketing and customer relations today.

The four Ps all, of course, relate primarily to the aggregate market rather than to individual customers. The market being considered could be a large mass market or a smaller niche market, but the four Ps have helped define how an enterprise should behave toward all the customers within the aggregate market:

1. *Product* is defined in terms of the average customer—what *most* members of the aggregate market want or need. This is the product brought to market, and it is delivered the same way for every customer in the market. The definition of *product* extends to standard variations in size, color, style, and units of sale as well as customer service and aftermarket service capabilities.
2. *Place* is a distribution system or sales channel. How and where is the product sold? Is it sold in stores? By dealers? Through franchisees? At a single location or through widely dispersed outlets, such as fast-food stores and ATMs? Can it be delivered directly to the purchaser?
3. *Price* refers not only to the ultimate retail price a product brings but also to intermediate prices, beginning with wholesale; and it takes account of the availability of credit to a customer and the prevailing interest rate. The price is set at a level designed to "clear the market," or the highest price that will sell the product easily and widely, assuming that everyone will pay the *same* price—which seems only fair because everyone will get the same product. And even though different customers within a market actually have different levels of desire for the same product, the market price will generally be the same for everybody.
4. *Promotion* has also worked traditionally in a fundamentally **nonaddressable**, noninteractive way. The various customers in a mass market are all passive recipients of the promotional message, whether it is delivered through mass media or interpersonally, through salespeople. Marketers have traditionally recognized the trade-off between the cost of delivering a message and the benefit of personalizing it to a recipient. A sales call can cost between $300 and $500 (a 2012 Center for Exhibition Industry Research study put the average cost of a business-to-business [B2B] sales call at $596),[e] but at least it allows for the personalization of the promotion process. The cost per thousand (CPM) to reach an audience through mass media is far lower but requires that the same message be sent to everyone. Ultimately, the way a product is promoted is designed to **differentiate** it from all the other competitive products. Except for different messages aimed at different segments of the market, promotion doesn't change by *customer* but by *product*.

(*continued*)

[a] E. Jerome McCarthy, *Basic Marketing: A Managerial Approach* (Homewood, IL: Irwin, 1958), is now in its 16th edition, and has been substantially updated.
[b] Philip Kotler, S. C. Johnson Distinguished Professor of International Marketing, Kellogg School of Management, Northwestern University (emeritus), is widely known as the father of modern marketing. His textbook *Marketing Management,* coauthored with Kevin Keller, has become the foundational text for marketing courses around the globe. First published in 1976 by Prentice Hall, it is now in its 16th edition.
[c] Philip Kotler, *Marketing Management: Analysis, Planning, Implementation, and Control*, 9th ed. (Upper Saddle River, NJ: Prentice Hall, 1997), pp. 92–93.
[d] Philip Kotler, *Kotler on Marketing* (New York: Free Press, 1999), pp. 116–120.
[e] Bloomberg Business, "Sales Moves Beyond Face-to-Face Deals onto the Web," January 10, 2013, available at: https://www.bloomberg.com/news/articles/2013-01-10/sales-moves-beyond-face-to-face-deals-onto-the-web, accessed August 17, 2021; "The Cost of a Sales Call," 4D Sales, accessed February 3, 2016, available at: http://4dsales.com/the-cost-of-a-sales-call/, accessed August 17, 2021.

Continuing Roles for Mass Media and Branding

- Communicate to nonusers who have not yet raised their hands.
- Build image and brand identity.
- Establish a brand position with nonusers to help users make a statement about their own image.

INITIAL ASSESSMENT: WHERE IS A FIRM ON THE CUSTOMER STRATEGY MAP?

Recognizing that two families of technology have mandated the competitive approach of building customer value by building customer relationships, we can map any organization—large or small, public or private, for-profit or nonprofit—by the level of its capabilities in the arenas of *interacting* with customers and *tailoring* for them. A company would be rated high on the interactivity dimension if it knows the names of its individual customers and if it can send different messages to different customers and can remember the feedback from each one. A low rating would go to a company that doesn't know its customers' identities, or does but continues to send the same message the same way to everybody. On the tailoring dimension, a firm would rate highly if it mass-customizes in lot sizes of one; it would rate low if it sells the same thing pretty much the same way to everybody. Based on its rating in these two dimensions, a company can be pinpointed on the Enterprise Strategy Map (see Exhibit 1.2), which includes four quadrants:

Quadrant I: Traditional Mass Marketing. Companies that compete primarily on cost efficiencies based on **economies of scale** and low price. Companies in this quadrant are doomed to commoditization and price competition.

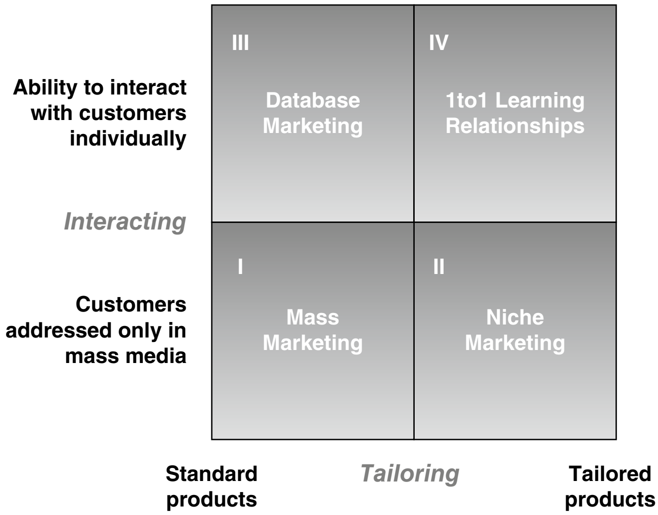

EXHIBIT 1.2 Enterprise Strategy Map
Source: Don Peppers and Martha Rogers, Ph.D., *Enterprise One to One* (New York: Doubleday/Currency, 1997).

Quadrant II: Niche Marketing. Companies that focus on target markets, or niches, and produce goods and services designed for those defined customer groups. This more strategic and targeted method of mass marketing still offers the same thing the same way to everyone, but for a small, relatively homogeneous group.

Quadrant III: Database Marketing. Companies utilize database management to get better, more efficient use of their mailing lists and other customer information. Generally focused primarily on continuation of traditional strategies but at lower costs to serve.

Quadrant IV: Learning Relationships. These are based on individual analytics. Companies use data about customers to predict what each one needs next and then are able to treat different customers differently and increase mutual value with customers.

In Quadrants I through III, the focus is still primarily on the product to be sold, with an eye to finding customers for that product. In Quadrant IV, the direction of the strategy changes; the Quadrant IV company focuses on a customer and finds products for that customer.

To realize the highest possible return on the customer base, the goal of an enterprise will be to move up and to the right on the Enterprise Strategy Map.

To move up on the Enterprise Strategy Map, an enterprise has to be able to **recognize** individual customers' names and addresses, or at least coded identities, to send different messages to different customers, and to remember the responses of each.

To move to the right on the Enterprise Strategy Map, an enterprise has to be able to increase its production and logistics flexibility. The most flexible production would entail customizing and delivering individual products for individual customers. The least flexible would be mass-producing a standardized product or service for a large market. (We talk more about customization in Chapter 10.)

COMPARING MARKET-SHARE AND SHARE-OF-CUSTOMER STRATEGIES

The story goes that in 1996, the executives at Barnes & Noble bookstores invited Jeff Bezos, the founder of a startup named Amazon.com, to lunch, with a proposition. Amazon.com had not yet made any profit (and would not, for its first 28 quarters in a row), so the nice guys at the well-established bookstore offered, as a favor to Jeff, to buy him out—before they launched barnesandnoble.com, the online version of the bookstore chain. They argued that Jeff's relatively unknown brand would not stand up to their highly popular name and that he should make some money on his software and systems. He declined.

How did that turn out? Twenty-five years after that lunch meeting, Barnes & Noble was acquired by Elliott Management Corporation for US$683 million and Amazon.com had a market cap of US$1.7 *trillion*.[5] When he stepped down as Amazon's CEO in 2021, Bezos was the richest man on earth. So whether the lunch ever really took place or not, the story still serves to illustrate the fundamental difference between a very well run *product-oriented* company (Barnes & Noble, which has stores to populate with products and tries to find customers for those products) and a fairly well run *customer-oriented* company (Amazon.com, which got us all as customers to buy books and DVDs, and now wants to sell each of us everything). *Note:* One of this book's authors, who lives in New York City, found the best selection and service from Amazon.com when she was looking for a refrigerator to buy and have installed in her Upper West Side apartment.

A lot can be understood about how traditional, market-driven competition is different from today's customer-driven competition by examining Exhibit 1.3. The direction of success for a traditional aggregate-market enterprise (i.e., a traditional company that sees its customers in markets of aggregate groups) is to acquire more customers (widen the horizontal bar), whereas the direction of success for the customer-driven enterprise is to keep customers longer and grow them bigger (lengthen the vertical bar). The width of the horizontal bar can be thought of as an enterprise's market share—the proportion of total customers who have their needs satisfied by a particular enterprise, or the percentage of total products in an industry sold by this particular firm. But the customer-value enterprise focuses on **share of customer**— the percentage of this customer's

[5] Colin Dwyer, "Barnes & Noble Set to Be Sold to Elliott Management for about $683 Million," NPR, June 7, 2019, available at https://www.npr.org/2019/06/07/730638739/barnes-noble-set-to-be-sold-to-elliott-management-for-about-683-million, accessed August 17, 2021; "Amazon.com, Inc. Common Stock (AMZN)," Nasdaq, available at https://www.nasdaq.com/market-activity/stocks/amzn, accessed August 17, 2021.

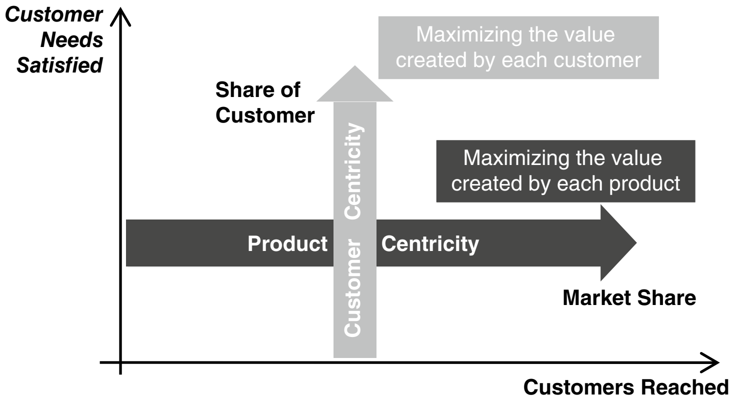

EXHIBIT 1.3 Objective of Customer Centricity

business that a particular firm gets—represented by the height of the vertical bar. Think of it this way: Kellogg's can either sell as many boxes of Corn Flakes as possible to whoever will buy them, even though sometimes Corn Flakes will cannibalize Raisin Bran sales, or Kellogg's can concentrate on making sure its products are on Mrs. Smith's breakfast table every day for the rest of her life, thus representing a steady or growing percentage of that breakfast table's offerings. Toyota can try to sell as many RAV4s as possible, for any price, to anyone who will buy; or it can, by knowing Mrs. Smith better, make sure all the cars in Mrs. Smith's garage are Toyota brands, including the used car she buys for her teenage son, and that Mrs. Smith uses Toyota financing, and gets her service, maintenance, and repairs at Toyota dealerships throughout her driving lifetime.

Although the tasks for growing market share are different from those for building share of customer, the two strategies are not antithetical. A company can simultaneously focus on getting new customers and growing the value of and keeping the customers it already has.[6] Customer-strategy enterprises are required to interact with a customer and use that customer's feedback from this interaction to deliver a customized product or service. Market-driven efforts can be strategically effective and even more efficient at meeting individual customer needs when a customer-specific philosophy is conducted on top of them. The customer-driven process is time-dependent and evolutionary, as the product or service is continuously fine-tuned and the customer is increasingly differentiated from other customers.

The principles of a customer-focused business model differ in many ways from mass marketing. Specifically: The aggregate-market enterprise competes by differentiating products, whereas the customer-driven enterprise competes by differentiating customers.

The traditional, aggregate-market enterprise attempts to establish an actual product differentiation (by launching new products or modifying or extending established

[6] Bernd W. Wirtz and Peter Daiser, "Business Model Development: A Customer-Oriented Perspective," *Journal of Business Models* 6, no. 3 (2018): pp. 24-44; Srividya Sridharan, "Evolve Your Approach to Acquisition and Retention," Forrester Research, Inc., December 12, 2012, available at www.forrester.com.

product lines) or a perceived one (with advertising and public relations). The customer-driven enterprise caters to one customer at a time and relies on differentiating each customer from all the others.

The traditional marketing company, no matter how friendly, ultimately sees customers as adversaries, and vice versa. The company and the customer play a zero-sum game: If the customer gets a discount, the company loses profit margin. Their interests have traditionally been at odds; the customer wants to buy as much product as possible for the lowest price, while the company wants to sell the least product possible for the highest price. If an enterprise and a customer have no relationship prior to a purchase, and they have no relationship following it, then their entire interaction is centered on a single, solitary transaction and the profitability of that transaction. Thus, in a transaction-based, product-centric business model, buyer and seller are adversaries, no matter how much the seller may try not to act the part. In this business model, practically the only assurance a customer has that they can trust the product and service being sold to them is the general reputation of the brand itself.[7]

By contrast, the customer-based enterprise aligns customer **collaboration** with profitability. Compare the behaviors that result from both sides if each transaction occurs in the **context** of a longer-term relationship. For starters, a one-to-one enterprise would likely be willing to fix a problem raised by a single transaction at a loss if the relationship with the customer were profitable long term (see Exhibit 1.4).

EXHIBIT 1.4 Comparison of Market-Share and Share-of-Customer Strategies

Market-Share Strategy	Share-of-Customer Strategy
Treat different products differently.	Treat different *customers* differently.
Maximize the value each product creates.	Maximize the value each customer creates.
Focus on each product's attributes and benefits.	Focus on each customer's *experience*.
Differentiate products from competitors.	Differentiate customers from each other.
Sell *to* customers.	Collaborate *with* customers.
Treat customers as on-off switches.	Treat customers as volume dials.
Task product managers to find a continual stream of new customers for each product.	Task customer managers to meet more needs for each customer.
Use mass media to offer all products to an audience of potential customers.	Use interactive media to learn each customer's need and offer the right product to meet that need.

[7] Marco Bertini and John T. Gourville, "Pricing to Create Shared Value," *Harvard Business Review*, June 2012, available at https://hbr.org/2012/06/pricing-to-create-shared-value, accessed August 17, 2021. See also Don Peppers and Martha Rogers, Ph.D., *The One to One Manager* (New York: Doubleday, 1999).

The central purpose of managing customer relationships and experiences is for the enterprise to focus on increasing the overall value of its customer base—and customer retention is critical to its success. Increasing the value of the customer base, whether through cross-selling (getting customers to buy other products and services), upselling (getting customers to buy more expensive offerings), or customer referrals, will lead to a more profitable enterprise. The enterprise can also reduce the cost of serving its best customers by making it more convenient for them to buy from the enterprise (e.g., by using Amazon's one-click ordering process, or online banking rather than a bank teller).

And although technology accelerates customer relationships, it is not the same as building customer value. While one-to-one customer relationships are enabled by technology, executives at firms with strong customer relationships and burgeoning **customer equity (CE)** believe that the enabling technology should be viewed as the means to an end, not the end itself. Managing customer experiences and relationships is an ongoing business process, not merely a technology.

The central purpose of managing customer relationships and experiences is for the enterprise to focus on increasing the overall value of its customer base—and customer retention is critical to its success.

While enterprises are experimenting with a wide array of technology and software solutions from different vendors to satisfy their customer-driven needs, they are learning that they cannot depend on technology alone to do the job. Before it can be implemented successfully, managing customer relationships individually requires committed leadership from the upper management of the enterprise and wholehearted participation throughout the organization as well. Although customer strategies are driven by new technological capabilities, the technology alone does not make a company customer-centric. The payoff can be great, but the need to build the strategy to get, keep, and grow customers is even more important than the technology required to implement that strategy.

The foundation for an enterprise focused on building its value by building the value of the customer base is unique: Establish relationships with customers on an individual basis, then use the information gathered to treat different customers differently and increase the value of each one to the firm.

The foundation for an enterprise focused on building its value by building the value of the customer base is unique: Establish trustable relationships with customers on an individual basis, then use the information gathered to treat different customers differently and increase the value of each one to the firm.

The firms that are best at building customer value are not the ones that ask, "How can we use new technologies to get our customers to buy more?" Instead they are the companies that ask, "How can we use new technologies to deliver more value to our customers?"

WHAT IS A RELATIONSHIP? IS THAT DIFFERENT FROM CUSTOMER EXPERIENCE?

What does it mean for an enterprise and a customer to have a *relationship* with each other? Do customers have relationships with enterprises that do not know them? Can the enterprise be said to have a relationship with a customer it does not know? Is a relationship possible if the company knows the customer and tailors offers and communications, remembers things for the customer, and deliberately builds customer experience—even if the customer is not aware of a relationship? Is it possible for a customer to have a relationship with a brand? Perhaps what is thought to be a customer's "relationship with a brand" is more accurately described as the customer's attitude or predisposition toward the brand. This attitude is a combination of impressions from actual experiences with that brand, as well as what one has heard about the brand from ads (company-originated communication), from news, and from others (comments from friends and ratings by strangers). Experts have studied the nature of relationships in business for many years, and there are many different perspectives on the fundamental purpose of relationships in business strategies.

This book is about managing customer relationships and experiences more effectively in the 21st century, which is governed by a more individualized approach. The critical business objective can no longer be limited to acquiring the most customers and gaining the greatest market share for a product or service. Now that it's possible to deal individually with separate customers, the business objective must include establishing meaningful and profitable relationships with, at the least, the **most valuable customers**, and making the overall customer base more valuable. Technological advances during the last quarter of the twentieth century have mandated this shift in philosophy.

Managing the customer relationship is all about what the company does, and customer experience is what the customer feels like as a result.

In short, the enterprise strives to get a customer, keep that customer for a lifetime, and grow the value of the customer to the enterprise. Relationships are the crux of the customer-strategy enterprise. Relationships between customers and enterprises provide the framework for everything else connected to the customer-value business model, even if the customer is not aware of the relationship. After all, the customer is aware of what they experience with the company. In fact, we could say that *managing the customer relationship is all about what the company does, and customer experience is what the customer feels like as a result*. The exchange between a customer and the enterprise becomes mutually beneficial, as customers give information in return for personalized service that meets their individual needs. This interaction forms the basis of the **Learning Relationship**, based on a collaborative dialogue between the enterprise and the customer that grows smarter and smarter with each successive interaction.[8]

Who Is the Customer?

Throughout this book, we refer to *customers* in a generic way. To some, the term will conjure up the mental image of shoppers. To others, those shoppers are *end users* or *consumers,* and the customers are upstream businesses in the distribution chain—the companies that buy from producers and either sell directly to end users or manufacture their own product. In this book, *customer* refers to the constituents of an organization, whether it's a business-to-business (B2B) customer (which could mean the purchasing agent or user at the customer company, or the entire customer company) or business-to-consumer (B2C) customer (an individual or a family/household)—or, for that matter, a hotel patron, a hospital patient, a charitable contributor, a voter, a university student or alumnus, a blood donor, a theme-park guest, and so on. That means the *competition* is anything a customer might choose that would preclude choosing the organization that is trying to build a relationship with that customer. The word *customer* includes both current and prospective buyers and users.

How to Think about Customer Experience

In our view, any useful definition of customer experience should be based on straightforward language, while at the same time clearly differentiating the term from all the other marketing terms and buzzwords, such as customer service, brand preference, customer satisfaction, CRM, or customer loyalty. (See Chapter 3 for a deeper dive into customer experience.)

Customer experience is the sum total of a customer's individual interactions with a product or company, over time.

- *Individual* means that we are talking about each different customer's own individual perception or impression of the experience. What you intend to provide a customer is not nearly so important as how the customer perceives what you provide.
- *Interactions* occur in **addressable** or reciprocal channels, that is, outside of mass media. Marketing campaigns, taglines, and brand messages may be important, but they aren't interactions, so they lie outside the domain of customer experience. By contrast, improving your mobile app by, for instance,

[8] B. Joseph Pine II, Don Peppers, and Martha Rogers, Ph.D., "Do You Want to Keep Your Customers Forever?" *Harvard Business Review* 73, no. 2 (March–April 1995): 103–114.

(*continued*)

embedding voice or chat connections into it would definitely improve your customer experience. Similarly, when a company makes it easier for a prospect to find information about its product, that company is improving the customer experience even though the prospect may never actually become a customer.

- When we talk about customer experience, we are only including direct contact. On the one hand, the interactions a customer has in person or online with *other* people or companies about a brand, product, or company are *not* really part of the customer experience. On the other hand, how your company actually *engages* with customers and prospects within various social channels is a direct interaction, and thus part of the customer experience.
- Customer experience applies to all of a company's marketing, selling, and servicing entities. This includes dealers and distributors, marketing and advertising agencies, any retailers that sell your product, and any service firms that install or repair your company's product or that handle customer inquiries or interactions of any kind. For each of these interactions, you can contract out the task but not the responsibility—at least not as far as the customer is concerned.
- Each customer's experience is not an isolated event; it accumulates through time. For instance, a company improves its customer experience by making it easier for a repeat customer to pull up what they ordered before, or configured before, and do it instantly, or when a call-center agent already knows what a prospect was recently looking up on the website.
- A company cannot improve customer experience without considering all of these issues, including how each one impacts the others. Integrating all interaction channels is one of the first, and possibly the most important, steps a company can take to improve customer experience.

LEARNING RELATIONSHIPS: THE CRUX OF BUILDING CUSTOMER VALUE

The basic strategy behind Learning Relationship (Quadrant IV in Exhibit 1.2) is that the enterprise gives a customer the opportunity to teach it what they want so the company can remember it, give it to them, and keep their business. The more the customer teaches the company, the better the company can provide exactly what the customer wants, and the more the customer has invested in the relationship. Ergo, the customer will more likely choose to continue dealing with the enterprise rather than spend the extra time and effort required to establish a similar relationship elsewhere.[9]

The Learning Relationship works like this: If you're my customer and I get you to talk to me, and I remember what you tell me, then I get smarter and smarter about you. I know

[9] B. Joseph Pine II, Don Peppers, and Martha Rogers, Ph.D., "Do You Want to Keep Your Customers Forever?"

something about you that my competitors don't know. So I can do things for you my competitors can't do, because they don't know you as well as I do. Before long, you can get something from me you can't get anywhere else, for any price. At the very least, you'd have to start all over somewhere else, but starting over is more costly than staying with me. As long as you like me and trust me to look out for your best interests, you're likely to do more of your business with me.

This happens every time a customer buys groceries by updating their online grocery list or adds a favorite movie to "My Stuff" on their favorite streaming provider. Even if a competitor were to establish exactly the same capabilities, a customer already involved in a Learning Relationship with an enterprise would have to spend time and energy—sometimes a lot of time and energy—teaching the competitor what the current enterprise already knows. This creates a significant **switching cost** for the customer, as the value of what the enterprise is providing continues to increase, partly as the result of the customer's own time and effort. The result is that the customer becomes more loyal to the enterprise because it is simply in the customer's own interest to do so. It is more worthwhile for the customer to remain loyal than to switch. As the relationship progresses, the customer's convenience increases, and the enterprise becomes more valuable to the customer, allowing the enterprise to protect its profit margin with the customer, often while reducing the cost of serving that customer.

Learning Relationships provide the basis for a completely different arena of competition, separate and distinct from traditional, product-based competition. An enterprise cannot prevent its competitor from offering a product or service that is perceived to be as good as its own offering. Once a competitor offers a similar product or service, the enterprise's own offering is reduced to commodity status. But enterprises that engage in collaborative Learning Relationships with individual customers gain a distinct competitive advantage because they know something about one customer that a competitor does not know. In a Learning Relationship, the enterprise learns about an individual customer through their transactions and interactions during the process of doing business. The customer, in turn, learns about the enterprise or the website through their successive purchase experiences and other interactions. Thus, in addition to an increase in customer loyalty, two other benefits come from Learning Relationships:

1. *The customer learns more about their own preferences from each experience and from the firm's feedback,* and is therefore able to shop, purchase, and handle some aspect of their life more efficiently and effectively than was possible prior to this relationship.
2. *The enterprise learns more about its own strengths and weaknesses from each interaction and from the customer's feedback,* and is therefore able to market, communicate, and handle some aspects of its own tactics or strategy more efficiently and effectively than was possible prior to the relationship.[10]

[10] Steve Blank, "Why the Lean Startup Changes Everything," *Harvard Business Review*, May 2013, available at https://hbr.org/2013/05/why-the-lean-start-up-changes-everything, accessed August 17, 2021; Katherine Lemon, Don Peppers, and Martha Rogers, Ph.D., "Managing the Customer Lifetime Value: The Role of Learning Relationships," working paper.

Cultivating Learning Relationships depends on an enterprise's capability to elicit and manage useful information about customers. Customers, whether they are consumers or other enterprises, do not want more choices. Customers simply want exactly what they want—when, where, and how they want it. And technology is now making it more and more possible for companies to give it to them, allowing enterprises to collect large amounts of data on individual customers' needs and then use that data to customize products and services for each customer—that is, to treat different customers differently.[11] This ability to use customer information to offer a customer the most relevant product at the right price, at the right moment, is at the heart of the kind of customer experience that builds loyalty and share of customer.

> Customers, whether they are consumers or other enterprises, do not want more choice. Customers simply want *what they want,* when, where, and how they want it.

One of the implications of this shift is an imperative to consider and manage the two ways customers create value for an enterprise. We've already said that a product focus tends to make companies think more about the value of a current transaction than the long-term value of the customer who is the company's partner in that transaction. But building Learning Relationships has value only to a company that links its own growth and future success to its ability to keep and grow customers, and therefore commits to building long-term relationships with customers. This means we find stronger commitments to customer trust, employee trust, meeting community responsibilities, and otherwise thinking about long-term, sustainable strategies. Companies that are in the business of building the value of the customer base are companies that understand the importance of balancing short-term and long-term success. We talk more about that in Chapters 6 and 11.

[11] David C. Edelman and Marc Singer, "Competing on Customer Journeys," *Harvard Business Review* 93, no. 11 (November 2015): 88–100.

CHAPTER 2

Treat Different Customers Differently: How Learning Relationships Lead to Better Experiences and Higher Profit

Things have never been more like they are today in history.

—Dwight D. Eisenhower

Enterprises that foster relationships with individual customers pave a path to profitability. Thus, a **customer-strategy enterprise** seeks to organize all its value-creating activities around individual customers, **treating different customers differently**, so as to treat *each* customer more relevantly, with the knowledge that by doing so the enterprise will also enjoy more profit for itself. For most companies, the problem is that the metrics, reporting structures, and processes that operate well in terms of operating a product-centric enterprise conflict with what is required to operate in a **customer-centric** way.

FOCUS ON RELATIONSHIP EQUITY

When it comes to customers, businesses are shifting their focus from product sales transactions to **relationship equity**. Most soon recognize that they simply do not know the full extent of their profitability by customer for a variety of reasons.[1]

But they also know that not all customers are equal. Some are not worth the time or financial investment of establishing **Learning Relationships**, nor are all customers willing to devote the effort required to sustain such a relationship. Enterprises need to decide early on which customers they want to have relationships with, which

[1]Justin M. Lawrence, Andrew T. Crecelius, Lisa K. Scheer, Ashutosh Patil, "Multichannel Strategies for Managing the Profitability of Business-to-Business Customers," *Journal of Marketing Research* 56, no. 3 (2019), 479–497, https://doi.org/10.1177/0022243718816952.

they do not, and what type of relationships to nurture. (See Chapter 6 on customer value **differentiation**.)

The advantages to the enterprise of growing Learning Relationships with valuable and potentially valuable customers are immense. Because much of what is sold to the customer may be **customized** to his precise **needs**, the enterprise can, for example, potentially charge a premium (as the customer may be less price sensitive to customized products and services in exchange for convenience or specificity) and increase its profit margin.[2] The product or service is worth more to the customer because he has helped shape and mold it to his own specifications. The product or service, in essence, has become ***decommoditized*** and is now uniquely valuable to this particular customer.

THE STRATEGY: TREAT DIFFERENT CUSTOMERS DIFFERENTLY (TDCD)

Managing customer relationships effectively is a practice not limited to products. When establishing **interactive** Learning Relationships with valuable customers, customer-strategy enterprises remember a customer's specific needs for the basic product but also the goods, services, and communications that surround the product, such as how the customer would prefer to be invoiced or how the product should be packaged. Even an enterprise that sells a commodity-like product or service can think of it as a bundle of ancillary services, delivery times, invoicing schedules, personalized reminders and updates, and other features that are rarely commodities. The key is for the enterprise to focus on customizing to each individual customer's needs. A teenager in California received a text from her wireless phone service suggesting her parents could save money if she texted "4040" in an offer to switch her to a cell phone plan that was a better fit for her and the way she actually uses the service. She was so impressed she made a point of telling us about it. And of course, she told all her friends at school—and on TikTok, Snapchat, and Instagram. The coverage, the hardware, the central **customer service**, and the brand all remained the same. But the **customer experience**, based on actual usage **interaction** with the customer—information not available to competitors—improved the customer relationship, increased loyalty and **lifetime value** of the customer, and positively influenced other customers as well.

As other chapters in this book will demonstrate, a customer-centric business strategy can be a highly measurable process for increasing enterprise profitability and shareholder value. The foundation for growing a profitable customer-strategy enterprise lies in establishing stronger relationships with individual customers, paving a path to profitability by focusing on the different experiences of individual customers and fostering stronger relationships with them over time. The challenge to be considered throughout this text is understanding how best to establish these relationships, optimize them, and create more value from customers. Learning Relationships provide a ready path for generating long-term, competitively strong customer value.

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[2]In B. Joseph Pine II, "Customering: The Mindset of a Revolutionary Model," *Strategy & Leadership* 47, no. 6 (2019): 2-8, https://doi.org/10.1108/SL-08-2019-0124, Pine describes "customering" as "efficiently serving customers uniquely.""

But we need to have a stronger understanding of the specific qualities that underlie a better customer experience, and why these qualities are likely to create value for the customer-strategy enterprise.

When a customer teaches an enterprise what they want or how they want it, the customer and the enterprise are, in essence, ***collaborating*** on the sale of the product. The more the customer teaches the enterprise, the less likely the customer will want to leave. The key is to design products, services, and communications that customers *value,* and on which a customer and a marketer will have to collaborate for the customer to receive the product, service, or **benefit**.

Enterprises that build Learning Relationships clear a wider path to customer profitability than companies that focus on price-driven transactions. They move from a make-to-forecast **business model** to a make-to-order model, as Dell Computer did when it first created a company that reduced inventory levels by building each computer after it was paid for, using efficient **mass customization** technology. By focusing on gathering information about individual customers and using that information to customize communications, products, and services, enterprises can more accurately predict inventory and production levels. Fewer orders may be lost because mass customization can build the products on demand and thus make available to a given customer products that cannot be stocked ad infinitum. (We will discuss customization further in Chapter 10.) Inventory-less distribution from a made-to-order business model can prevent shortages caused in distribution channels as well as reduce inventory carrying costs. The result is fewer opportunity losses. Furthermore, efficient mass-customization operations can ship built-to-order custom products faster than competitors that have to customize products from scratch.[3] In many ways, ***economies of scale*** have been replaced by ***economies of scope***.[4]

Enterprises that build Learning Relationships clear a wider path to customer profitability than companies that focus on price-driven transactions.

[3]Li Chen, Yao Cui, Hau L. Lee, "On-Demand Customization and Channel Strategies" in Saibal Ray and Shuya Yin (eds.), *Channel Strategies and Marketing Mix in a Connected World*, Springer Series in Supply Chain Management, volume 9 (Springer, 2020), pp. 165–192; Ruchi Chauhan, Varun Kumar, Tapas Kumar Jana, and Arunava Majumder, "A Modified Customization Strategy in a Dual-Channel Supply Chain Model with Price-Sensitive Stochastic Demand and Distribution-Free Approach," *Mathematical Problems in Engineering* 2021, Article ID 5549882, https://doi.org/10.1155/2021/5549882; Kevin Maney and Hemant Taneja, "The End of Scale," *Harvard Business Review*, April 1, 2018, available at https://sloanreview.mit.edu/article/the-end-of-scale/, accessed August 26, 2021. See also Hyun-Hwa Lee and Eunyoug Chang, "Consumer Attitudes toward Online Mass Customization: An Application of Extended Technology Acceptance Model," *Journal of Computer-Mediated Communication* 16, no. 2 (January 2011).

[4]Seyit Hocuk, Pradeep Kumar, Joris Mulder, Patricia Prufer, "Economies of Scope in the Aggregation of Health-Related Data," JRC Working Papers on Digital Economy 2021-01, Joint Research Centre (Seville site), available at https://ideas.repec.org/p/ipt/decwpa/202101.html, accessed October 18, 2021; Don Peppers and Martha Rogers, *The One-to-One Future* (New York: Crown, 1997). Having economies of scale makes it cheaper to make and sell things in the traditional Industrial-Age way. But the current competitive strategy is economies of scope—of information about each customer.

Learning Relationships have less to do with creating a fondness on the part of a customer for a particular product or brand and more to do with a company's capability to remember and deliver based on prior interactions with a customer. An enterprise that engages in a Learning Relationship creates a *bond of value* for the customer, a reason for an individual customer, or small groups of customers with similar needs, to lose interest in dealing with a competitor, provided that the enterprise continues to deliver a good-quality product and service at a fair price and to remember to act on the customer's preferences and tastes.[5] Learning Relationships may also be based on an inherent trust between a customer and an enterprise. For example, a customer might divulge a credit card number to an organization, which records it and remembers it for future transactions. The customer trusts that the enterprise will keep this credit card number confidential. And the enterprise makes it easier and faster for the customer to buy because it is not necessary to reenter the credit card number for each purchase. (Later in the chapter, we'll learn more about the link between emotions and behavior in relationships.)

Learning Relationships have less to do with creating a fondness on the part of a customer for a particular product or brand and more to do with a company's capability to remember and deliver based on prior interactions with a customer.

THE TECHNOLOGY REVOLUTION AND THE CUSTOMER REVOLUTION

Organizations have accelerated their **customer-focused** strategies during the last few years, but managing customer relationships has been a business discipline for many years, since long before the era of **mass marketing** and mass media. Before the Industrial Revolution, and before mass production was born, merchants established their businesses around *keeping* customers.

Small towns typically had a general store, a local bank, and a barbershop. Each proprietor knew each one of their customers individually. The bank teller, for example, knew that Mr. Johnson cashed his paycheck each Friday afternoon. When Mr. Johnson came into the bank, the bank teller already had his cash ready for him in twenties and tens, just as he liked it. If Mr. Johnson unexpectedly stopped cashing his paycheck at the bank, the teller would not wonder why check-cashing service usage was dropping in the bank, but rather would wonder what had happened to Mr. Johnson. In short, the bank depended on the relationship with the individual customer and how much the

[5]Harvard Business Review Analytic Services, "The Age of Personalization: Crafting a Finer Edge," Pulse Survey, August 2018, available at https://hbr.org/resources/pdfs/comm/mastercard/TheAgeOfPersonalization.pdf, accessed June 28, 2021; Pedro S. Coelho and Jörg Henseler, "Creating Customer Loyalty through Service Customization," *European Journal of Marketing* 46, no. 3/4 (2012): 332–356; Pine, Peppers, and Rogers, "Do You Want to Keep Your Customers Forever?" pp. 103–104.

people who worked for the bank knew about that customer. The teller's memory in this example is akin to today's **data warehouses**, which can store millions of data points, transaction histories, and characteristics about customers. Personal memory enabled the teller to fulfill each customer's individual banking needs and, ultimately, to build a profitable relationship with each one. The more the teller knew about a customer, the more convenient banking was for that customer—and the more likely the customer would continue to use the bank.

But during the past century, as enterprises sought to acquire as many customers as they possibly could, the local proprietor's influence over customer purchases decreased. Store owners or managers became little more than order takers, stocking their shelves with the goods that consumers would see advertised in the local newspaper or on television and radio. Mass-media advertising became a more effective way to publicize a product and generate transactions for a wide audience. But now technology has made it possible, and therefore competitively necessary, for enterprises to behave, once again, like small-town proprietors and deal with their customers individually, one customer at a time.

Treat different customers differently.

At the same time, technology has generated a business model that we will refer to as the **trust platform**.[6] Becoming more and more prominent since the last edition of this book, trust platforms are epitomized by companies such as Uber, Airbnb, and Zipcar—and a host of others with brands that will always be in flux, but durable in concept. This kind of business depends on using interactive technology to connect willing buyers with willing sellers, while relying on crowd-sourced feedback to ensure **mutual** trust. Rather than a sharing economy, trust platforms facilitate an *initiative* economy, based on the entrepreneurial initiatives of thousands of individuals, all seamlessly connected to the larger network.

We must note that social interactions are not as manageable as a company's marketing and other functions are. The social interactions a company has with customers and other people can't be directed the same way advertising campaigns or cost-cutting initiatives can. Instead, in the e-social world, what companies are likely to find is that top-down, command-and-control organizations are not trustable, while self-organized collections of employees and partners motivated by a common purpose and socially empowered to take action are more trustable. (We'll address the distinction between trustability and trustworthiness in Chapter 3.)

Customers Have Changed, Too

The technological revolution has spawned another revolution, one led by the customers themselves, who now demand products just the way they want them and flawless customer service. Enterprises are realizing that if they really know little or nothing about their individual customers, they must capture a clearer understanding of each

[6]Thomas L. Friedman, "And Now for a Bit of Good News . . . ," Sunday Review, *New York Times*, July 19, 2014, available at https://www.nytimes.com/2014/07/20/opinion/sunday/thomas-l-friedman-and-now-for-a-bit-of-good-news.html, accessed August 17, 2021.

customer's needs. Customers, meanwhile, want to be treated less like numbers and more like the individuals they are, with distinct requirements and preferences. They are actively communicating these demands back to the enterprise (and, through **social media** and mobile apps, with each other!). Where they once would bargain with a business, they now tell managers of brand retail chains what they are prepared to pay and specify how they want products designed, styled, assembled, delivered, and maintained. When it comes to ordering, consumers want to be treated with respect. The capability of an enterprise to remember customers and their logistical information such as contact information, shipping address, and ordering preferences not only makes ordering easier for customers but also lets them know that they are important. Computer applications that enable options such as one-click, or express, ordering on the web are creating the expectation that good online providers take the time to get to know customers as individuals so they can provide this higher level of service.[7]

And again: *Treat different customers differently.*

The customer revolution is part of the reason enterprises are committing themselves to keep and grow their **most valuable customers**. Today's consumers and businesses have become more sophisticated about shopping for their needs across multiple channels, and more and more CMOs refer to this as **multi-channel marketing** or **omnichannel marketing**. What it really means is that customers will come at companies in various ways, in ways that suit those customers, and companies must be ready to present a logical, coherent response to each customer—not just messages sent through media channels—and to remember what is learned through each interaction and apply that learning to all channels. The idea is not just to make sure that we prepare and send a message, but to make sure each customer receives one. The online channel, in particular, enables shoppers to locate the goods and services they desire quickly and at a price they are willing to pay, which forces enterprises to compete on value propositions other than lowest price.

Contrary to the prevailing belief, a company is not omnichannel just because it is capable of interacting with customers in every possible channel. If the word *omnichannel* is to mean anything at all, it must stand for a customer experience that is seamlessly *integrated* across all the different channels any particular customer chooses.

This means a company can only be considered to have omnichannel capabilities if the history and **context** of each customer's interactions in one channel are flawlessly carried over into the next channel, and the next, and the next. Just because a company can interact with a customer online as well as by phone, and perhaps even by text and chat and social media, it doesn't mean they are an omnichannel company, or that they offer **integrated marketing**. A company may interact with its customers via a number of different channels, but if these interactions aren't linked together from channel to channel by each customer's own context and history, then the customer will be frustrated and experience more friction than is necessary.

[7]See Dave Frankland, "The Intelligent Approach to Customer Intelligence," Forrester Research, Inc., available at www.forrester.com.

A company may have the capability to handle *many* channels, but that doesn't mean it has an *omni*channel capability. We'll talk more about this in Chapter 8.

A company may have the capability to handle *many* channels, but that doesn't mean it has an *omni*channel capability.

WHAT CHARACTERIZES A RELATIONSHIP?

Merriam-Webster defines *relationship* as "the state of being related or interrelated."[8] Because we are talking specifically about relationships between businesses and their customers, it is important that we agree on a few of the elements that make up a genuine relationship. The most important issue for us to consider is how well our own definition of *relationship* helps companies compete successfully in the customer dimension. Rather than settle for a few words from a dictionary, let's list some of the distinct qualities that should characterize a relationship between an enterprise and a customer.

First, a relationship implies *mutuality*. In order for any state of affairs to be considered a relationship, both parties have to participate in it and be aware of its existence. This means that relationships will inherently be two-way in nature. This might seem like common sense. You can't have a relationship with someone if they don't have a relationship with you, right? It's a very important distinction for parsing out what does and doesn't constitute relationship-building activity with customers. Can a person have a genuine relationship with a brand? Well, it doesn't happen just because a customer likes the brand and buys it repeatedly. A customer can have a great deal of affection for a brand but, by our definition, a relationship between the customer and the brand can be said to exist only if the brand (i.e., the enterprise behind the brand) is also aware of the individual customer's existence, creating a new definition with an interesting new twist for the term *brand awareness*.

Second, relationships are driven by *interaction*. When two parties interact, they exchange information, and this information exchange is a central engine for building on the relationship. Information exchange, of course, also implies mutuality. But interactions don't have to take place by phone or in person or online. An interaction takes place when a customer buys a product. Every interaction increases the amount of information a company has about a particular relationship.

This point leads to the third characteristic of a relationship: It is ***iterative*** in nature. That is, mutual interactions between both parties build up a history over time to create a larger context. This increases a relationship's efficiency, because each new interaction is an iteration of all the previous ones. The more you communicate with any one person, the less you need to say the next time around to get your point across. One practical implication of this iterative nature of a customer relationship is that it

[8]Merriam Webster Online Dictionary, "relationship," www.merriam-webster.com/dictionary/relationship, accessed August 17, 2021.

generates a convenience benefit to the customer for continuing the relationship. Amazon remembers your book preferences, your address, and your credit card number, based on your previous interactions with it. To purchase your next book from Amazon, you only need to find it and click on it. If you've already bought enough books from Amazon, you might not even need to search for the next one; the company can do a pretty good job of finding it for you and putting it in your recommendations. The richer the context of any customer relationship, the more difficult it will be for the customer to recreate it elsewhere, and so the more loyal the customer is likely to be. (We find that Amazon recommends to each of us all of the new books we write—not surprising, since they're all very relevant!)

Another characteristic of a customer relationship is that it is driven by an *ongoing benefit* to both parties. Convenience is one type of benefit for customers, but it is not the only one. Participating in a relationship will involve a cost in money, time, or effort, and no customer will engage for long in any relationship if there is not enough continuing benefit to offset this cost. However, precisely because of the context of the relationship and its continuing benefit to both parties, each party in a relationship has an incentive to recover from mistakes. This is because the future value that each party expects from the continued relationship can easily outweigh the current cost of remedying an error or problem.

Characteristics of a Genuine Business Relationship

- Mutual
- Interactive
- Iterative
- Provides ongoing benefit to both parties
- Requires a change in behavior for both parties
- Unique
- Requires—and produces—trust

Relationships will result in a *change in behavior* by both parties—the enterprise and the customer—in order to continue. After all, what drives the ongoing benefit of a relationship is not only its context—its history of interactions, developed over time—but also the fact that each party's current and future actions appropriately reflect that historical context. This is an important characteristic to note separately, because companies sometimes mistakenly believe that interactions with customers need only involve routine, outbound communications, delivered the same way to every customer. But unless the enterprise's actions toward a particular customer are somehow tailored to reflect that customer's own input, there will be no ongoing benefit for the customer, and as a result, the customer might not elect to continue the relationship.

Yet another characteristic of a relationship, so obvious it might not seem worth mentioning, is *uniqueness*. Every relationship is different. Relationships are constituted with individuals, not with populations. As a result, an enterprise that seeks to engage its customers in relationships must be prepared to participate in different interactions, remember different histories, and engage in different behaviors toward different customers. You will not have the same relationship with your waitperson at a restaurant as you do with your business mentor.

Finally, the ultimate requirement and product of a successful, continuing relationship is *trust*. Trust is a quality worth a book all by itself,[9] but fundamentally what we are talking about is the commonsense proposition that if customers develop a relationship with an enterprise, they tend more and more to trust the enterprise to act in their own interest. Trust, and affection, and satisfaction are all related feelings on the part of a customer toward a company with which they have a relationship. They constitute the more emotional elements of a relationship, but for an enterprise to acknowledge and use these elements profitably, it must be able to reconcile its own **culture** and behavior with the requirement of generating and sustaining the trust of a customer. (For more on this issue, see Chapters 3 and 8.)

Over 20 years ago, business professors Jag Sheth and Atul Parvatiyar predicted that companies are "likely to undertake efforts to institutionalize the relationship with consumers—that is, to create a corporate bonding instead of a bonding between a frontline salesperson and consumer alone."[10]

Customer orientation is powerful in theory but, some say, troubled in practice. In some industries, customer satisfaction rates in the United States fall, while complaints, boycotts, and other consumer discontent rise, fueled in magnitude and velocity by social media. Some say there has been a decline in the fundamentals of relationship building among enterprise executives who are more concerned with increasing quarterly profits for their own sake than establishing closer ties to profitable customers. Every aspect of managing customer relationships and experiences is affected by the firm's understanding of relationships in general. Enterprises must fully comprehend the basic foundations of relationships, and the basic principles of the Learning Relationship in particular, before embarking on a customer relationship or customer experience initiative.

Views on business relationships vary, but all provide a relevant perspective to building a relationship framework. We acknowledge that a company may attempt to build a relationship with a customer that the customer has no emotional interest in.

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[9]See Don Peppers and Martha Rogers, Ph.D., *Extreme Trust: Turning Proactive Honesty and Flawless Execution into Long-Term Profits* (New York: Portfolio/Penguin, revised 2016); Stephen M. R. Covey and Greg Link with Rebecca R. Merrill, *Smart Trust: The Defining Skill That Transforms Managers into Leaders* (New York: Free Press, 2012); Chris Brogan and Julien Smith, *Trust Agents: Using the Web to Build Influence, Improve Reputation, and Earn Trust* (Hoboken, NJ: John Wiley & Sons, 2009); and Charles H. Green, *Trust-Based Selling: Using Customer Focus and Collaboration to Build Long-Term Relationships* (New York: McGraw-Hill, 2006).

[10]Jagdish N. Sheth and Atul Parvatiyar, "Relationship Marketing in Consumer Markets: Antecedents and Consequences," *Journal of the Academy of Marketing Science* 23, no. 4 (1995): 265. See also Atul Parvatiyar and Jagdish N. Sheth, eds., *Handbook of Relationship Marketing* (Thousand Oaks, CA: Sage, 1999).

By learning from a customer, or a small group of customers with similar needs and behaviors, the company may be able to offer the right product at the right time and provide convenience to a customer who may not be emotionally attached to the product or company but does more and more business with it because it's easier to continue with the current provider than to switch. In many other cases, of course, the relationship is specifically enjoyed by the customer, at the extreme by the Harley-Davidson customer who tattoos the company's brand on their bicep.

We have discussed the foundation of relationship theory and the benefits of getting, keeping, and growing customers. So far, the discussion has included concepts that foster an often-emotional involvement between the customer and the enterprise. The Learning Relationship is a highly personal experience for the customer that ensures that it is always in the customer's self-interest to remain with the enterprise with which they first developed the relationship. We believe this may go beyond a customer's emotional attachment or favoritism for any enterprise; it may also be derived from some sense of obligation. However, many scholars believe that by establishing a Learning Relationship, the customer-focused enterprise increases customer retention by making loyalty more beneficial for the customer than non-loyalty. Others believe that the relationship exists even if a customer is not aware of it and only benefits from a better customer experience. See Jim Barnes for more views on this subject.[11]

CUSTOMER LOYALTY: IS IT EMOTIONAL? OR BEHAVIORAL?

Definitions of customer loyalty usually take one of two directions: emotional or behavioral. Although each of these directions is valid, when used separately, they have different implications and lead to very different prescriptions for businesses. The most helpful way for businesses to approach the issue of improving customer loyalty is to rely on both these definitions simultaneously.

Emotional loyalty implies that the loyalty of a customer is in the customer's state of mind. By this definition, a customer is loyal to a brand or a company if they have positive, preferential attitude toward it. They like the company, its products, its services, or its brands, and therefore prefer to buy from it, rather than from the company's competitors. In purely economic terms, the emotional definition of customer loyalty would mean that someone who is willing to pay a premium for Brand A over Brand B, even when the products they represent are virtually equivalent, should be considered loyal to Brand A. But the emphasis is on willingness rather than on actual behavior. In terms of attitudes and emotions, increasing customer loyalty is virtually equivalent to increasing their preference for the brand. It is closely tied to customer satisfaction, and any company wanting to increase loyalty, in emotional terms, will concentrate on improving its product, its image, its service, or other elements of the customer experience, relative to its competitors.[12]

[11]James G. Barnes, *Secrets of Customer Relationship Management* (New York: McGraw-Hill, 2001).

[12]Before about 2016, many referred to what we call here "emotional loyalty" as "attitudinal loyalty." But these days and going forward, the common and most-accepted term is "emotional loyalty."

Behavioral loyalty, however, relies on a customer's actual conduct, regardless of the attitudes or preferences that underlie that conduct. By this definition, a customer should be considered loyal to a company simply because they buy from it and then continue to buy from it. Behavioral loyalty is concerned with repurchase activity rather than attitudes or preferences. Thus, it is theoretically possible for customers to be loyal to a brand even if they don't really like it, provided there are other reasons for repeat purchase. For instance, a discount airline with poor service standards but prices that are significantly lower than competitors might have customers who are behaviorally loyal but not emotionally loyal. (Some Londoners lament that they hate RyanAir every weekend they "had" to take it to Mallorca, for a no-frills airfare that is often less than $25 roundtrip!) Similarly, a business-to-business firm selling complex services may rely on long-term contracts in order to ensure it is adequately compensated for high setup costs. (We once participated in a meeting with high-tech executives at their headquarters in which one of the executives joked that their primary customer loyalty tactic was probably the lawsuit.) In its most raw form, behavioral loyalty is similar to what can be described as **functional loyalty,** in that there is no emotional content or sense of attachment to the company on the customer's part.

In the behavioral definition, customer loyalty is not the *cause* of brand preference but simply one *result* of it, and brand preference is not the only thing that might lead to behavioral loyalty. A company wanting to increase behavioral customer loyalty will focus on whatever tactics will increase the amount of repurchase. These tactics can easily include improving brand preference, product quality, or customer satisfaction, but they may also include long-term legal contracts or prices so low that service is almost nonexistent.

Behavioral customer loyalty is easier to measure because it can be objectively observed, while assessing emotional loyalty requires more expensive and subjective polling and surveying techniques. Positive emotions and attitudes do tend to drive positive behaviors, but even if a firm observes loyal *behavior*, if the customer has no genuine *emotional* loyalty, then the relationship will be highly vulnerable to competition. If a competitor enters the market at a comparable price, for instance, the customer once loyal to your discount product can easily disappear.[13]

The truth is, if an enterprise wants a clear and unambiguous guide to action, it needs to pay attention to both definitions of customer loyalty. Emotional loyalty without behavioral loyalty has no financial benefit for a firm, but behavioral loyalty without emotional loyalty is unsustainable. Defining loyalty purely as an emotional response is not very useful, because that attitude can exist completely apart from any continuing relationship on the part of a customer, and this simply flies in the face of the common English definition of the word *loyalty*. Customer A and Customer B might have an equally loyal attitude toward the image of a high-end perfume brand, but what if Customer A has terrible allergies to perfume, and could never consume the product,

[13]Thanks to Doug Pruden (http://customerexperiencepartners.com), Esteban Kolsky (https://estebankolsky.com/), Wim Rampen (https://wimrampen.com/), and Mark Ratekin (https://walkerinfo.com/) for their insights provided in comments on our Strategy Speaks blog post: http://www.peppersandrogersgroup.com/blog/2009/10/customer-loyalty-is-it-an-atti.html#more.

while Customer B has consumed it regularly in the past? Moreover, emotional loyalty and brand preference seem to be redundant, so why introduce a separate term at all? However, defining loyalty in purely behavioral terms is equally unsatisfactory. Case in point: Monopolies have behaviorally loyal customers.

> Emotional loyalty without behavioral loyalty has no financial benefit for a firm, but behavioral loyalty without emotional loyalty is unsustainable.

A better insight into what customer loyalty really means can be gained by examining the policies companies introduce to improve it. A credit card company or mobile phone carrier, for instance, often concerns itself with reducing its **customer churn rates**. *Churn* is a term meaning defection or **turnover**. These companies often can count the customers who voluntarily elect to leave their franchises every month, and it is a legitimate and time-honored business practice to try to reduce this churn rate. A company usually tackles the churn problem with both reactive and proactive tactics. Reactive tactics can include predictive modeling to **identify** those customers who are most likely to try to leave the franchise in the near future and then trying to intercede in advance; or actively trying to persuade churning customers not to leave at the point they announce they want to defect; or perhaps attempting to win defectors back immediately with offers of special pricing or improved services. Proactive tactics, however, can include identifying as many of the service and pricing problems that cause customers to want to leave in the first place, and trying to fix them; or perhaps designing new, customized products and services that do a better job of locking customers in for convenience reasons; or improving service friendliness and competence to increase customer affection for the brand.

A company trying to reduce its customer churn—and thereby increase its customer loyalty—shouldn't think of customer churn as a disease but as the symptom of a disease, somewhat like a fever. If a fever is severe enough, the doctor will want to treat it immediately and directly, but they also know that the only long-term solution to reducing a fever is to cure the underlying disease causing it. If we pursue this analogy, we could visualize a lack of behavioral loyalty in our customer base as a fever that is affecting our company while the actual disease causing this fever is a lack of emotional loyalty.[14]

When dealing with the issue of customer loyalty, a firm should try to forge as direct a connection as possible to loyalty's actual financial results. That is, we ought to be able to connect whatever strategies and tactics we employ to increase our customers' loyalty with their actual economic outcomes. The customer-strategy enterprise will want to quantify the benefit of a customer's increasing loyalty, and the most direct and unambiguous metric to deploy for this task is the customer's *lifetime value,* as described in Chapter 6.

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[14]Thanks to former Peppers & Rogers Group consultant Ozan Bayulgen for this very useful analogy.

CUSTOMER RETENTION AND ENTERPRISE PROFITABILITY

Enterprises strive to increase profitability without losing high-margin customers by increasing their customer retention rates or the percentage of customers who have met a specified number of repurchases over a finite period of time. A retained customer, however, is not necessarily an emotionally loyal customer. The customer may give business to a competing enterprise for many different reasons. As far back as the 1990s, Royal Bank of Canada (RBC) developed superior computing and database power, along with sophisticated statistical programs, to analyze customer information and test specific actions it should take with specific customers. Only then could the bank's frontline personnel deliver more effective personal contact and attention to individual customers.

> A retained customer is not necessarily an emotionally loyal customer.

To learn the most about its customers, RBC has undertaken an intense, ongoing statistical analysis of them. It is always developing and refining the prototype for an algorithm to model the long-term lifetime values of its individual customers. Part of this effort includes a client-potential model that measures how growable certain kinds of customers are to the bank. The bank also analyzes a customer's vulnerability to attrition and tries to flag the most vulnerable before they defect, in order to take preventive action in a focused, effective way.

To expand **share of customer**, RBC also tries to predict statistically which additional services a customer might want to buy, and when. RBC not only makes different offers to different customers, but it also equips its sales and service people with detailed customer profiles. Thus, rather than providing a one-size-fits-all service, the bank's customer-contact people spend their time and energy making on-the-spot decisions based on each customer's individual situation and value.[15] Note that this type of business practice not only *benefits* from individual customer interactions, but it also *requires* individual interactions to achieve the greatest success. As an RBC executive told the authors of this book, the bank discovered it "could lift **contributions** and penetration rates by up to 10% by virtue of the contact alone."

In 1990, Fred Reichheld and W. Earl Sasser analyzed the profit per customer in different service areas, categorized by the number of years that a customer had been with a particular enterprise.[16] In this groundbreaking study, they discovered that the

[15]According to the corporate profile on its website, RBC serves more than 17 million personal, business, public sector, and institutional clients through offices in Canada, the United States, and 27 other countries. Available at https://www.rbc.com/our-company/index.html, accessed August 14, 2021.

[16]Frederick F. Reichheld and W. Earl Sasser Jr., "Zero Defections: Quality Comes to Services," *Harvard Business Review* 73 (September–October 1990): 59–75. Fred Reichheld is the father of the Net Promoter Score (NPS), which is a measure of the quality of a company's customer relationships and indicator of profitability. The score is based on what Reichheld calls the ultimate question: "Would you recommend us to a friend?" Customers can be sorted into detractors or promoters based on their answers, and percentages of each category give the NPS. Reichheld lays out the Net Promoter System and gives many examples of standout companies that have high profitability and high Net Promoter ratings in his book *The Ultimate Question 2.0: How Net Promoter Companies Thrive in a Customer-Driven World* (Boston: Harvard Business Review Press, 2011), written with Rob Markey.)

longer a customer remains with an enterprise, the more profitable they become. (Several studies since then have indicated that relationship longevity is not a perfect predictor of profitability, but more often than not, the thesis has been supported by research.) Average profit from a first-year customer for the credit card industry was $30; for the industrial laundry industry, $144; for the industrial distribution industry, $45; and for the automobile servicing industry, $25. But those profits grow over time, the longer a customer does business with a company.

Four factors contribute to the underlying customer profit growth:

1. *Profit derived from increased purchases*. Customers grow larger over time and need to purchase in greater quantities.
2. *Profit from reduced operating costs*. As customers become more experienced, they make fewer demands on the supplier and fewer mistakes when involved in the operational processes, thus contributing to greater productivity for the seller and for themselves.
3. *Profit from referrals to other customers*. Less needs to be spent on advertising and promotion due to **word-of-mouth** recommendations from satisfied customers.
4. *Profit from price premium*. Customer acquisition can benefit from introductory promotional discounts, while long-term customers are more likely to pay regular prices. (But many companies have learned that if they advertise widely about a lower-price offer, they'd better be prepared to give it to current customers who want it too—or better yet, offer it without being asked.)

No matter what the industry, the longer an enterprise keeps a customer, the more value that customer can generate for shareholders.[17] Reichheld and Sasser found in a classic study that for one auto service company, the expected profit from a fourth-year customer is more than triple

No matter what the industry, the longer an enterprise keeps a customer, the more value that customer can generate for shareholders.

[17]Authors' note: This point is not without controversy. Some research has shown that in some instances—especially those where a business is very dependent on one or a very few customers, such as automotive parts makers—a long-term customer has the power to extract so many concessions that the company's margins are squeezed sometimes to the breaking point. But generally, academic research and real-world experience have demonstrated that if a company acquires the right customers, the longer those customers continue to do business, the more profitable they become—for many reasons, especially reduction in churn replacement costs, increasing value to the customer of the relationship, and the positive word of mouth and social networking by a contented or delighted customer. See Peter Fader, *Customer Centricity: Focus on the Right Customers for Strategic Advantage* (Wharton School Press, 2020); Vinicius Nardi, William Jardim, Wagner Ladeira, and Fernando Santini, "A Meta-Analysis of the Relationship between Customer Participation and Brand Outcomes," *Journal of Business Research* 117, September 2020, pp. 450-460, https://doi.org/10.1016/j.jbusres.2020.06.017, accessed October 18, 2021; and Andrei Hagiu and Julian Wright, "When Data Creates Competitive Advantage . . . and When It Doesn't," *Harvard Business Review*, January-February 2020, pp. 94-101.

EXHIBIT 2.1 Profit One Customer Generates over Time

Industry	Year 1	Year 2	Year 3	Year 4	Year 5
Credit Card	$30	$42	$44	$49	$55
Industrial Laundry	$144	$166	$192	$222	$256
Industrial Distribution	$45	$99	$123	$144	$168
Auto Servicing	$25	$35	$70	$88	$88

Source: Frederick F. Reichheld and W. Earl Sasser Jr., "Zero Defections: Quality Comes to Services," *Harvard Business Review* 68:5 (September–October 1990): 106.

the profit that same customer generates in the first year. Other industries studied showed similar positive results (see Exhibit 2.1).

Enterprises that build stronger individual customer relationships enhance customer loyalty, as they are providing each customer with what they need.[18] Loyalty building requires the enterprise to emphasize the value of its products or services and to show that it is interested in building a relationship with the customer. The enterprise realizes that it must build a stable customer base rather than concentrate on single sales.[19]

A customer-strategy firm will want to reduce customer defections because they result in the loss of investments the firm has made in creating and developing customer relationships. Customers are the lifeblood of any business. They are, literally, the only source of its revenue.[20] Loyal customers are more profitable because they

[18]According to Phillip Britt, "Customer Service Becomes a Marketing Tool," *Customer Relationship Management: CRM* 23, no. 10 (Dec 2019): 20-23, accessed June 12, 2021, available at https://www.destinationcrm.com/Articles/Editorial/Magazine-Features/Customer-Service-Becomes-a-Marketing-Tool-135423.aspx?pageNum=2, loyalty is based more on how customers feel after interacting with customer service, rather than on product or price. Also, in the discussion of what drives customer loyalty, we should not forget that both loyalty and trust (always intertwined) may, for some customers, depend on corporate responsibility. See Eunil Park and Ki Joon Kim, "What Drives 'Customer Loyalty'? The Role of Corporate Social Responsibility," *Sustainable Development* 27, no. 3 (2019): 304-311, https://doi.org/10.1002/sd.1901, accessed June 12, 2021.

[19]For a different view of the value of loyalty, see Werner Reinartz and Mark Eisenbeiss, "Managing Customer Loyalty to Maximize Customer Equity," in *Handbook of Research on Customer Equity in Marketing*, eds. V. Kumar and Denish Shah (Northampton, MA: Edward Elgar, 2015), pp. 139–159; and Werner Reinartz and V. Kumar, "The Mismanagement of Customer Loyalty," *Harvard Business Review* (July 2002): 86–94. Reinartz and Kumar's work shows that more loyal customers are not necessarily more profitable as a class, especially using their methodology of one moment in time; but we should also point out that in the case of an individual customer, the more loyalty and the greater share of customer achieved from one customer over time, the more valuable by definition that individual customer will become.

[20]Authors' note: Some may question the statement "Customers are a company's only source of revenue." By definition, however, this is literally true. If a company sells products, for example, then the revenue does not come from the products; it comes from the customers who buy them. And if that same company also runs some ancillary businesses—say, renting out unused real estate space or spare capital—then those who make lease payments or interest payments are also customers.

likely buy more over time if they are satisfied. It costs less for the enterprise to serve retained customers over time because transactions with repeat customers become more routine. Loyal customers tend to refer other new customers to the enterprise, thereby creating new sources of revenue.[21] It stands to reason that if the central goal of a customer-strategy company is to increase the overall value of its customer base, then continuing its relationships with its most profitable customers will be high on its list of priorities.

On average, U.S. corporations have tended to lose half their customers in five years, half their employees in four, and half their investors in less than one.[22] In his classic study on the subject, Fred Reichheld described a possible future in which the only business relationships will be onetime, opportunistic transactions between virtual strangers.[23] However, he found that disloyalty could stunt corporate performance by 25% to 50%, sometimes more. In contrast, enterprises that concentrate on finding and keeping good customers, productive employees, and supportive investors continue to generate superior results. For this reason, the primary responsibility for customer retention or defection lies in the chief executive's office.

Customer loyalty is closely associated with customer relationships and may, in certain cases, be directly related to the level of each customer's satisfaction over time.[24] According to James Barnes, satisfaction is tied to what the customer gets from dealing with a company as compared with what they have to commit to those dealings or interactions.[25] For now, it's enough to know that the customer satisfaction issue is controversial—maybe even problematic. There are issues of relativity (are laptop users just harder to satisfy than desktop users, or are they really less satisfied?) and skew (is the satisfaction score the result of a bunch of people who are more or less satisfied, or a bimodal group whose members either love or hate the product?). Barnes believes that by increasing the value that the customer perceives in each interaction with the company, enterprises are more likely to increase customer satisfaction levels, leading to higher customer retention rates. When customers are retained because they enjoy the service they are receiving, they are more likely to become loyal customers. This

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[21]Philip Kotler and Milton Kotler, *Market Your Way to Grow: Eight Ways to Win* (Hoboken, NJ: John Wiley & Sons, 2013); Philip Kotler, *Kotler on Marketing* (New York: Free Press, 1999).

[22]Fred Reichheld, "Learning from Customer Defections," *Harvard Business Review* 74, no. 2 (March–April 1996): 87–88.

[23]Reichheld, *The Loyalty Effect*.

[24]Authors' note: It is generally a challenge to agree on what we all mean by "customer satisfaction," And that is one of the main reasons most companies now use updated measures of customer engagement and value. See Richard L. Oliver, *Satisfaction: A Behavioral Perspective on the Consumer* (New York: Routledge, 2015). Additionally, Dave Power III has defined customer satisfaction as measuring the difference between what the customer expects to get and what they perceive they get. We are becoming more and more capable of measuring what Pine and Gilmore call "customer sacrifice," which is the difference between what the customer wants exactly and what the customer settles for. B. Joseph Pine and James Gilmore, "Satisfaction, Sacrifice, Surprise: Three Small Steps Create One Giant Leap into the Experience Economy," *Strategy and Leadership* 28, no. 1: 18.

[25]James G. Barnes, *Secrets of Customer Relationship Management* (New York: McGraw-Hill, 2001).

The Financial Payoff of Building Customer Relationships in Financial Services

Managing individual customer relationships has a profound effect on enhancing long-term customer loyalty, thereby increasing the enterprise's long-term profitability. Relationship strategies, for example, have a substantial effect on customer retention in the financial services sector. A study conducted by Peppers & Rogers Group (with Roper Starch Worldwide) found that—looking at a group of "satisfied customers"—only 1% of consumers who rate their financial services provider high on relationship management say they are likely to switch away products to competitors. One-fourth of consumers (26%) who rate their primary financial services provider as low on relationship management **attributes** say they are likely to switch away one or more products during the next 12 months. The financial implications of these findings are staggering (see Exhibit 2.2). Using a conservative average annual profitability per household for U.S. retail banks of $100, a reduction in attrition of 9% represents over $700 million in incremental profits for all U.S. households with accounts. If an individual financial institution with 20,000 customers can reduce attrition by 9 percentage points by providing excellent **customer relationship management** (e.g., **recognizing** returning customers, anticipating their needs, etc.), that institution can increase profits by $180,000. For a similar-size financial institution with an average household profitability of $500, the increase in profitability climbs to $900,000.

Good customer service and:	Percent likely to add one or more products in next 12 months	Percent likely to switch away one or more products in next 12 months
LOW CRM	15%	26%
MEDIUM CRM	21%	10%
HIGH CRM	31%	1%

EXHIBIT 2.2 Benefits of CRM in Financial Services
Source: Peppers & Rogers Group, Roper Starch Worldwide survey.

loyalty leads to repeat buying and increased share of customer. (We will discuss more about the differences between emotional loyalty and behavioral loyalty, as well as ways to measure loyalty and retention, later in the chapter.)

Retaining customers is more beneficial to the enterprise for another reason: Acquiring new customers is costly. Consider the ***customer acquisition cost (CAC)*** for the banking industry. Averaging across channels, banks can spend at least $303 to replace each customer who defects.[26] So if a bank has a clientele of 50,000 customers and loses 5% of those customers each year, it would need to spend $757,500 or more each year simply to maintain its customer base.[27] Many Internet startup companies, without any brand-name recognition, faced an early demise during the 2000–2001 dot-com bubble bust, largely because they could not recoup the costs associated with acquiring new customers. The typical Internet pure-play spent an average of $82 to acquire one customer in 1999, a 95% increase over the $42 spent on average in 1998.[28] Much of that increase can be attributed to the dot-com companies' struggle to build brand awareness during 1999, which caused web-based firms to increase offline advertising spending by an astounding 518%. Based on marketing costs related to their online business, in 1999, offline-based companies spent an average of $12 to acquire a new customer, down from $22 the previous year. Online firms spent an unsustainable 119% of their revenues on marketing in 1999. Even with the advantages of established brands, offline companies spent a still-high 36%.

The problem is simple arithmetic. Given the high cost of customer acquisition, a company can never realize any potential profit from most customers, especially if a customer leaves the franchise.

The problem is simple arithmetic. Given the high cost of customer acquisition, a company can never realize any potential profit from most customers, especially if a customer leaves the franchise. High levels of customer churn trouble all types of enterprises, not just those in the online and wireless industries. The problem partly results from the way companies reward sales representatives: with scalable commissions and bonuses for acquiring the most customers. Fact is, many reps have little, if any, incentive for keeping and growing an established customer. In some cases, if a customer leaves, the sales representative can even be rewarded for bringing the same customer back again!

Although it's always somebody's designated mission to get new customers, too many companies still don't have anybody responsible for making sure this or that particular customer sticks around or becomes profitable. Often, a service company with high levels of churn needs to rethink not only how its reps engage in customer relationships but also how they are rewarded (or not) for nurturing those relationships and for increasing the long-term value to the enterprise of particular customers. Throughout this book, we will see that becoming a customer-value

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[26] Rishabh Rathi, "Customer Acquisition Cost by Industry," March 30, 2020, Startup Talky, available at https://startuptalky.com/cac-by-industry/, accessed August 30, 2021.

[27] Banks' customer acquisition costs can vary wildly, between $150 and $3,600, depending on the source, the product, and the channel, so $200 is a more-than-conservative figure.

[28] Boston Consulting Group and Shop.org, "The State of Online Retailing 3.0: A Shop.org Study" (Silver Springs, MD: Shop.org, 2000).

EXHIBIT 2.3 Customer Acquisition Costs (2020)

Industry	Cost
Travel	$7
Retail	$10
Consumer Goods	$22
Manufacturing	$83
Transportation	$98
Marketing Agency	$141
Financial	$175
Technology (Hardware)	$182
Real Estate	$213
Banking/Insurance	$303
Telecom	$315
Technology (Software)	$395

Source: Rishabh Rathi, "Customer Acquisition Cost by Industry: How to Calculate CAC?" February 14, 2022, available at https://startuptalky.com/cac-by-industry/, accessed February 24, 2022.

enterprise can be difficult, depending on the category. It is a strategy that can never be handled by one particular department within the enterprise. Managing customer relationships and experiences is an ongoing process—one that requires the support and involvement of every functional area in the organization, from the upper echelons of management through production and finance, to each sales representative or contact-center operator.

Customer-driven competition requires enterprises to integrate five principal business functions into their overall **customer strategy**:

1. *Financial custodianship of the customer base*. The customer-strategy enterprise treats the customer base as its primary *asset* and carefully manages the investment it makes in this asset, moving toward balancing the value of this asset to the long-term as well as the short-term success of the company.
2. *Production, logistics, and service delivery*. Enterprises must be capable of customizing their offerings to the needs and preferences of each individual customer. The Learning Relationship with a customer is useful only to the extent that interaction from the customer is actually incorporated in the way the enterprise behaves toward that customer.
3. *Marketing communications, customer service, and interaction*. Marketing communications and all forms of customer interaction and connectivity need to be combined into a unified function to ensure seamless individual customer

dialogue, which includes remembering everything that already happened with this customer anywhere in the organization, so the next interaction can pick up where the last one left off.

4. *Sales distribution and channel management*. A difficult challenge is to transform a distribution system that was created to disseminate standardized products at uniform prices into one that delivers customized products at individualized prices. **Disintermediation** of the distribution network by leaping over the middleman is sometimes one solution to selling to individual customers.
5. *Organizational management strategy*. Enterprises must organize themselves internally by placing managers in charge of customers and customer relationships rather than of just products and programs.[29]

We'll talk a lot more about this in Chapter 13.

Why Do Companies Work at Being Customer-Centric?

Customer-centricity is not always easy, and it's not without controversy. Some believe that employees matter more than customers because without great, engaged employees, an enterprise will have a hard time building strong customer relationships and building **customer equity**. Others continue to focus on cash flow and on making sure that strong product managers are held responsible for product promotion, distribution, and profitability. Ad agencies continued to tend brand promise. But while all of these are important to a successful business, a growing number of firms have recognized that three things are true about a company's customers. Because of these truths, a company stands its best chance of success when it focuses on increasing customer value through outstanding customer experiences and relationships.

1. *Customers are scarce*. There are successful organizations that do not have products, but there is no such thing as a successful firm that doesn't have customers. Despite the fact that the world has billions of people, only so many of them will ever want a particular company's offering. That company's ability to find them, win them, get as much business from them as possible, and keep them for a long time will be the determining factor in how much it can ever grow the size of its business. There are only so many hungry people, right now, within reach of a neighborhood pizzeria, and each of those people can cook for themselves, or go to a competitor, or start a diet today. Customers are scarcer than products, services, new ideas, or channels. For all but those companies in real financial trouble, customers are even scarcer than capital itself. There is no secondary market for customers. They can't be borrowed at the bank and paid back with

[29]Don Peppers and Martha Rogers, Ph.D., *Rules to Break and Laws to Follow: How Your Business Can Beat the Crisis of Short-Termism* (Hoboken, NJ: John Wiley & Sons, 2008).

interest. Once a company's leaders realize this fact, they may make decisions differently, as we will see in Part III.

2. *Customers are the sole source of all a company's revenue*. Products don't pay a company any money, ever. Neither do brands or services, or employees, or marketing programs, or stores, or factories. Only customers generate revenue for a business—the customers the business has today and the customers it will have in the future. All the other stuff is important to a business only to the extent that it contributes to generating more revenue from customers. Thus, the goal will not just be to create value from each product or channel or even the greatest return on the investment of money, but instead to make sure the company creates the greatest value from each of its customers.
3. *Customers create value in two ways*. Today, they are generating profit this quarter (or not), and—also today—the experience they are having with a particular company's product, its brand, its contact center, or any of the rest of what it is selling is also causing them to become more (or less) likely to do more business with the company in the future, to become more (or less) likely to recommend it to friends, to think kindly of it (or not) when they need something else in its category. It's interesting that nearly every company is very, very good at measuring and managing one way that customers create value: Companies know how much they spent making money from customers this quarter and what their revenue was from customers this quarter—since that's the total of the cost and revenue on the quarterly books. But many companies are content not to know the second part of this equation: They don't know, don't measure, and don't manage what is happening to underlying customer equity while the current numbers are falling into place. That means understanding a company's **Return on Customer (ROC)**[30] is as important as understanding its return on investment (ROI).[31] We talk a lot more about ROC in Chapter 11.[32]

[30]ROC is pronounced are-oh-see.

[31]John Drummond, "Long-Term Marketing a New Paradigm Shift," *Guardian*, November 16, 2012, available at http://www.theguardian.com/sustainable-business/blog/marketing-long-term-paradigm-new-markets, accessed August 17, 2021. Also see Dominic Barton, "Capitalism for the Long Term," *Harvard Business Review*, March 2011, accessed August 17, 2021 at https://hbr.org/2011/03/capitalism-for-the-long-term/ar/1. Janamitra Devan, Anna Kristina Millan, and Pranav Shirke also published a research finding in "Balancing Short- and Long-Term Performance," *McKinsey Quarterly*, no. 1 (2005): 31–33. They examined 266 companies and grouped them into four groups of high versus low short-term versus long-term performance over a 20-year period. They discovered that those companies that balanced strong long- and short-term performance had higher total shareholder return (TSR), lasted longer than their more mediocre competitors, enjoyed three years longer incumbency from chief executives on average, and had less volatility in stock prices. Companies with strong short-term performance but weak long-term performance enjoyed less volatile stock prices but came out poorly on other measures. The most successful companies were seen to have "instilled a long-term mind-set."

[32]Don Peppers and Martha Rogers, Ph.D., *Rules to Break and Laws to Follow: How Your Business Can Beat the Crisis of Short-Termism* (Hoboken, NJ: John Wiley & Sons, 2008). Also see Don Peppers and Martha Rogers, Ph.D., *Return on Customer: Creating Maximum Value from Your Scarcest Resource* (New York: Currency/Doubleday, 2005).

ROI answers the question: How much value does your company create for the money it uses?

ROC answers the question: How much value does your company create from the customers it has?

Return on Customer: Measuring and Increasing the Efficiency with Which Customers Create Value

If customers are scarce, if they create all the revenue for a company, and if the value they do create is measurable and manageable in the short term and the long term, as of today, then it's natural for companies to want to understand and remember what customers need and to meet those needs better than a competitor that doesn't know the same things about the customers. Customer information provides a very powerful competitive advantage. Companies want to use this information to provide a positive experience for customers and possibly to engage customers in a relationship that enables the company to provide better and better service.[33]

Most business executives would agree, intellectually, that *customers* represent the surest route to business growth—getting more customers, keeping them longer, and making them more profitable. Most understand that the customer base itself is a revenue-producing asset for their company—and that the value it throws off ultimately drives the company's economic worth. Nevertheless, when companies measure their financial results, they rarely if ever take into account any changes in the value of this underlying asset, with the result that they are blind—*and many financial analysts are blind*—to one of the most significant factors driving business success.

Think about your personal investments. Imagine you asked your broker to calculate your return on investment for your portfolio of stocks and bonds. She would tally the dividend and interest payments you received during the year, and then note the increases or decreases in the value of the various stocks and bonds in the portfolio. In other words, she needs to calculate and report both current income plus underlying value changes. The result, when compared to the amount you began the year with, would give you this year's ROI (return on investment). But suppose she chose to ignore any changes in the underlying value of your securities, limiting her analysis solely to dividends and interest. Would you accept this as a legitimate picture of your financial results? No.

[33] Vinicius Nardi, William Jardim, Wagner Ladeira, and Fernando Santini, "A Meta-Analysis of the Relationship between Customer Participation and Brand Outcomes," *Journal of Business Research* 117, September 2020, pp. 450-460, https://doi.org/10.1016/j.jbusres.2020.06.017, accessed October 18, 2021; Andrei Hagiu and Julian Wright, "When Data Creates Competitive Advantage . . . and When It Doesn't," *Harvard Business Review*, January-February 2020, pp. 94-101; and Drummond, "Long-Term Marketing a New Paradigm Shift." Also see Peppers and Rogers, *Rules to Break and Laws to Follow: How Your Business Can Beat the Crisis of Short-Termism*.

Yet this is exactly the way nearly all of today's investors assess the financial performance of the companies they invest in, because this is the only way companies report their results. They count the "dividends" from their customers and ignore any increase (or decrease) in the value of the underlying customer assets. But just as a portfolio of securities is made up of individual stocks and bonds that not only produce dividends and interest but also go up and down in value during the course of the year, a company is, at its roots, a portfolio of customers, who not only buy things from the firm in the current period but also go up and down in value.

Return on investment quantifies how well a firm creates value from a given investment—from the money it uses. But what quantifies how well a company creates value from its *customers?*[34] For this you need the metric of Return on Customer (ROC). The ROC equation has the same form as an ROI equation. ROC equals a firm's current-period cash flow from its customers plus any changes in the underlying customer equity, divided by the total customer equity at the beginning of the period.

Source: Excerpted from Don Peppers and Martha Rogers, Ph.D., *Return on Customer* (New York: Currency/Doubleday, 2008), pp. 6–7. Return on Customer will be discussed in more detail in Chapter 11.

A customer-strategy enterprise seeks to create one centralized view of each customer across all business units. Every employee who interacts with a customer has to have real-time access to current information about that individual customer so that it is possible to pick up each conversation from where the last one left off. The goal is instant interactivity with the customer. This process can be achieved only through the complete and seamless integration of every enterprise business unit and process.

So far, our discussion of customer relationships, customer experience, and customer value has shown how businesses are undergoing a vast cultural shift—transforming from the mass marketing, product-siloed thinking of the Industrial Age to the customer-empowered culture of the **Information Age** and the Age of Transparency, where the primary goal is building relationships with individual customers who become measurably more valuable to the enterprise. In this new business era, managing individual customer relationships means an organization will use the knowledge gained from these relationships to improve the quality of the overall customer experience. Consequently, it is incumbent on the enterprise to understand what constitutes a relationship, how relationships are formed, and how they can be strengthened or weakened. Many different perspectives have been developed about what comprises customer relationships and how businesses can profit from them.

By the early 2000s, many companies acknowledged the importance of building relationships with customers—of improving customer experience, taking the customer's point of view, and taking steps to measure and manage customer value. In many

[34]See Chapter 11 for an explanation of companies' "used-up" customers.

cases, companies that had been product-oriented changed their philosophy, their culture, their metrics, and even their organizational structure to put customers at the forefront.

How does a company build a better experience for each customer, keep them longer, get a greater and greater share of their business, and increase their value to the company?

CHAPTER 3

Better Customer Experiences for Better Shareholder Return

Nothing ever becomes real 'til it is experienced.

—John Keats

Treating different customers differently may be the shortest, most succinct way to summarize what is meant by "**customer relationship management**," or by "**one-to-one marketing**." But what does it really *mean* when an enterprise "treats" a customer in some manner? To answer this question appropriately, we must first take our customer's perspective (while remembering that each different customer has their own unique and personal perspective). And from the customer's perspective, the "treatment" a customer receives from the enterprise can be thought of as the customer's "experience" at the hands of the enterprise. So the objective an enterprise has, when treating different customers differently, is to provide different customers with different experiences—experiences that are individually appropriate for each individual customer.

FRICTIONLESS: THE IDEAL CUSTOMER EXPERIENCE MAY BE NO EXPERIENCE AT ALL

When an enterprise seeks to treat different customers differently, to keep them longer and grow them bigger, it must start by trying to see its own business through its customers' eyes, experiencing what the customer experiences, and then treating each different customer in the way that customer wants to be treated. Only by pursuing this goal effectively can an enterprise manage and continually improve the **customer experience** delivered by whatever brand or product the enterprise is selling. In an ideal world, the enterprise would deliver just the right experience to each individual customer at the just right time. The technology to do this has only recently arrived on the business scene, but it continues to evolve rapidly, and technology doesn't slow its pace to allow mere mortals to keep up with it. To be competitively successful, business managers today must upgrade their enterprise's capabilities at a rate that keeps pace with technology's often disruptive cadence.

Over time, every customer can be expected to have a whole series of customer experiences and these experiences compound themselves into the customer's ongoing relationship with whatever enterprise is delivering the experiences. To manage these customer experiences and the relationships they give rise to over time, an enterprise needs data systems, analytics capabilities, and **interaction** platforms. But in addition to these technological tools, the enterprise must also ensure that its organization is properly aligned, so that it can see and manage each customer's experience rationally, even as its processes are being influenced by the actions and reactions of multiple different business units, across the whole range of channels and through time. No matter how advanced technology becomes, it will never be possible to automate everything, and human-to-human interaction is the most direct and perhaps the *only* sufficient way to inject authentic humanity into any system of commerce. As a result, the people within the enterprise will need to have the right **mindset**, one that predisposes them to *want* to make the right decisions with respect to protecting customer interests, and to take the right actions even in the absence of plans, algorithms, or scripts.

Technology, automation, and increasing levels of **artificial intelligence** may be driving this massive, worldwide transformation of business competition, in other words, but the fact remains that an individual customer's own experience, by its very nature, is based on the customer's *humanity*. Computers and automated systems may render products and provide services ever more efficiently, but machines and automated systems have no needs to meet, no problems to solve, no desires to satisfy. Machines never want or need anything. Only people have wants and **needs**, and only people engage in commerce to satisfy these wants and needs. And while they do recognize the **benefits** of services and products that have been personalized by automation, they also crave things that only other humans can provide, including empathy, creativity, humor, irony, praise, social engagement, and the sense of emotional fulfillment or accomplishment that comes from doing new things or mastering new tasks. Technology alone will never be able to fulfill these human cravings, but it can still empower and augment the efforts of an enterprise whose managers and employees seek to do so.

The point is that delivering a better customer experience means delivering a better *human* experience to customers, and because every human being is distinct and different from every other human being, once a business sets out to see things through its customers' eyes and to improve the overall quality of its customer experience, it *must* embrace the idea of treating different customers differently. This poses an immense problem to solve, even for a company with no cumbersome Industrial-Era baggage. With every new interactive platform or mobile app, the urgency of delivering a better, more personal, and compelling customer experience intensifies. At the same time, customers become even more informed and impatient, while an enterprise's competitors are scrambling to do it first.

How Hard Does Your Customer Have to Work for You To Make Money?

Just what *does* constitute a better customer experience? In a word, an ideal customer experience would be absolutely **frictionless**. Except on rare occasions (an entertainment experience, for instance), customers do not really buy from a company just for the enjoyment of the process of acquiring and using some product or service. They buy something because they believe it can help them solve some problem or meet some need. In Clayton **Christensen's** words, "When we buy a product, we essentially 'hire' it to help us do a job. If it does the job well, the next time we're confronted with the same job, we tend to hire that product again. And if it does a crummy job, we 'fire' it and look for an alternative."[1] The customer simply wants to hire an enterprise's product or service to do a job, meeting whatever need the customer has as inexpensively, conveniently, and expeditiously as possible. If the customer's need were simply to be magically resolved, with absolutely no time or effort or purchase and use of any product at all—well, *that* would be an ideal customer experience: no experience at all!

A survey a decade ago involved consumers who had had "a recent service interaction over the web or through calling a contact center," and it found, somewhat counterintuitively, that there was almost no **correlation** at all between a customer's expressed satisfaction with a company and their stated intention to remain loyal to it. Despite this, there was a strong correlation between a customer's expressed *dis*satisfaction with a company and their intended *dis*loyalty. (In fact, the survey found an R-squared, or coefficient of determination, of just 0.13 between satisfaction and loyalty, which is very close to zero. To put this score into perspective, the R-squared correlation between "getting good grades in school" and "achieving career success later in life" is 0.71.)[2]

This study, the authors maintain, demonstrates that when it comes to delivering the kind of customer experience required to generate positive business results, a company should focus much more on eliminating the causes of dissatisfaction, and less on any attempt to surprise and delight customers. To put it simply, customers don't necessarily stay loyal to a product or brand because they're satisfied, but they often leave because they're not.

> The key driver of customer disloyalty is dissatisfaction, driven by unresolved problems or service issues.

Of course, the participants in this particular survey were chosen because they had had a recent **customer service** interaction with a company, and as Forrester analysts Harley Manning and Kerry Bodine point out in their own book,[3] *customer service* and

[1] *Harvard Business Review*, "Know Your Customers' 'Jobs to Be Done'," September 2016.

[2] See Matthew Dixon, Nick Toman, and Rick DeLisi, *The Effortless Experience: Conquering the New Battleground for Customer Loyalty* (New York: Portfolio, 2013); they described a survey of some 97,000 consumers conducted by their employer, the Corporate Executive Board (CEB).

[3] Harley Manning and Kerry Bodine, *Outside In: The Power of Putting Customers at the Center of Your Business* (New Harvest, 2012).

customer experience are not necessarily the same things. Their definition of customer experience is "how your customers perceive their interactions with your company."[4] This closely parallels our own definition: "the totality of a customer's individual interactions with a brand, over time."

> Customer experience is somewhat like a company's trapeze act, while customer service serves as the safety net.
>
> — Harley Manning and Kerry Bodine

Moreover, Manning and Bodine say customer experience is somewhat like a company's trapeze act, while customer service serves as the safety net. On this basis, they maintain that companies are best advised to visualize customer experience success as a kind of pyramid, with three layers. At the foundation is the layer that meets the customer's need. Whatever product or service a company is selling must adequately do whatever job the customer is hiring it to do. Once the experience meets the customer's need, the second layer comes into play: It must be easy. That is, the experience of using the product to meet the need cannot be overly complicated, difficult, or involved. Only if the customer experience "meets the need" in an "easy" way, Manning and Bodine maintain, can a company achieve the top layer of the pyramid: delivering an enjoyable customer experience. This top layer is not limited to business-to-consumer (**B2C**) companies; even business-to-business (**B2B**) customers can become emotionally engaged with a vendor's product or service experience, provided that it first meets their need in an easy manner.[5]

The lesson here is that even if a company's very business consists of *selling* customer experiences that are inherently entertaining or enjoyable in themselves (such as an amusement park, cruise line, fine restaurant, or hotel), it will still be pointless for

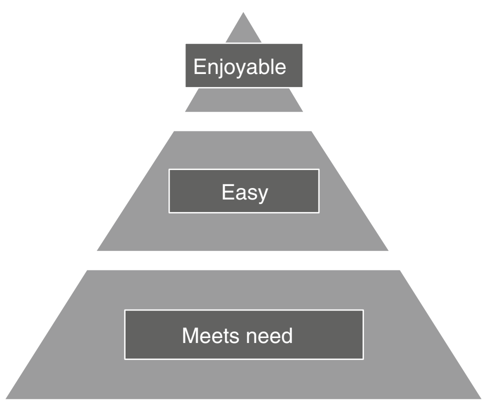

EXHIBIT 3.1 The Customer Experience Success Pyramid

[4]Harley Manning and Kerry Bodine, *Outside In: The Power of Putting Customers at the Center of Your Business* (New Harvest, 2012).

[5]Harley Manning and Kerry Bodine, *Outside In: The Power of Putting Customers at the Center of Your Business* (New Harvest, 2012).

the company to make their experiences enjoyable if they haven't first met the customer's need in an easy way. If, for instance, a restaurant serves the most delightfully enjoyable seared *foie gras*, but the seating is cramped, or the noise is distracting, or the waiter is aloof or inattentive, then the customer experience will not necessarily be enjoyable overall.

The Shoe Salesman's Hidden Motivation

One Saturday afternoon at a shopping mall during the busy Christmas season, a colleague of ours ventured into an athletic shoe store to buy some new running shoes. He was a management consultant who worked with both retailers trying to improve their operations and manufacturers trying to sell products to various retailers. As a result, whenever he went out to buy anything, he was an observant shopper.

He told us that the shoe store seemed to be especially busy that afternoon, so he took a place in line behind two other folks being helped by one of the salesclerks. As he waited, he saw that the salesman offered the same off-brand to each of these customers, who looked like they would have been willing to pay full price for a better brand name. The first customer had been interested in a pair of Nike basketball shoes, but the salesman first brought out this off-brand. They cost about two-thirds the price of the Nikes, and the customer ended up buying them. The same sales process, with the same result, ensued with the next customer, a woman who originally had said she was interested in Reebok cross-trainers. But the salesman talked the customer into trying out the cross-trainers from this off-brand first, and she bought them.

After watching two sales snatched from the jaws of well-known national brands, the consultant's curiosity was aroused. When it was his turn to buy, he first asked the salesman why he had switched the two previous customers to this particular off-brand, which the consultant had never even heard of. After all, he said, these customers seemed to have been willing to pay higher prices for the bigger name brands.

The salesman said that it had nothing to do with pricing or sales commissions, but he seemed a bit nervous at having been found out, and so the consultant persisted. Was the off-brand conducting some contest, then? Or was there perhaps just an extra supply of these shoes that the store needed to liquidate? No, the salesman said, that wasn't it either.

The clerk then looked around and gestured toward all the people crowded into the store on this very busy Saturday afternoon during Christmas season. "Look around," he said. "See how busy it is in here? I don't even have time to slip away for a coffee or a bathroom break on a day like this, that's how crowded it is!"

So what was it about this particular off-brand? "When they ship *their* shoes to our store," the salesman said, "*the laces are already in their shoes*, so it saves us a lot of time, not to have to lace up one of the other brands which all come with the laces in a little zip-lock bag inside the box."

This story perfectly illustrates the importance of removing friction in the customer experience, which is what this off-brand shoe was doing: removing friction in

(*continued*)

the shoe salesman's customer experience. Other businesses in other industries could do the same.

- At a retail bank, when a customer comes to the branch or website to ask about or apply for a second mortgage, the bank could lace up its own shoes simply by filling out all the information on the mortgage application that it already knows about the customer (starting with name, address, and bank account number, for instance).
- An airline could lace up its shoes for a customer whose flight gets canceled by rebooking them on the most likely next flight immediately, and then texting or emailing them the information, rather than simply telling them the flight is canceled and requiring them to call in to rebook themselves.
- A mobile phone company could lace up a new customer's shoes by printing out a sample bill, while they're in the store or signing up for their service, so they can see what the phone service will likely cost, including all the charges, and making sure the format is clear.

Friction is the enemy of a good customer experience. Every ounce of friction removed will improve the experience.

Friction is the enemy of a good customer experience. Every ounce of friction removed will improve the experience.

For each of these reasons, if a company wants to improve customer loyalty and generate additional business with its customer experience, then the very first undertaking should be to remove any reason for the customer *not* to remain loyal—to eliminate whatever friction might lie in the way of meeting each customer's individual need in the easiest manner possible. Remember that in physics, friction is the sworn enemy of efficiency. The Second Law of Thermodynamics is that entropy always increases. This means that some friction is inevitable in any closed system and it slowly undermines the ordered systems (including the universe) through gravity, electrical charges, and other forces. Friction will eventually consume everything, as many billions of years from now the universe itself comes to a final end in what physicists call a heat death, because the sheer *randomness* (entropy) generated by eons of accumulated friction eventually overwhelms all order. But we digress.

Our point is that friction is a waste product, and in a customer's life friction plays a similar role, bleeding energy out of every customer experience. The wasted time required when we are holding on the phone or waiting in the queue before speaking with a service rep represents friction. Friction consists of whatever time and effort we must spend getting an item repaired or replaced when it breaks or runs down. It includes the cost of the gasoline and time required to drive to and from the store for groceries. Trying to remember the name of that restaurant we liked is friction. Even the time and effort spent online trying to figure out which product is better, or which service package makes the most sense, constitutes friction.

But the existence of friction in the customer experience also presents a significant business opportunity to an enterprise, because every time it can reduce the friction in its customer's experience, it is *adding value* to this experience. Value is added. when the friction process is reversed, eliminating waste and adding a bit more order to the customer's life. Identifying and eliminating whatever friction a customer encounters can be very beneficial for an enterprise seeking to gain a competitive advantage, generate new sales, and improve a customer's loyalty and **lifetime value**.

When Ally Bank clearly displays its toll-free number on every page of its website, along with the estimated wait time before speaking with a rep, it is adding value to the customer experience by eliminating friction. When JetBlue automatically credits a flyer's account with the value of a refund due after a delayed or canceled flight without requiring the customer to do anything, it is removing friction from the customer experience. When Netflix recommends a movie to a customer based on the customer's previous selections or ratings, it is adding value to the customer experience by removing friction. When Safelite AutoGlass emails or texts the customer with a picture of the repairman scheduled to come to their house on a service call in advance of arriving, the company is adding value by removing friction. When Amazon sends a refund to a customer in advance of the customer requesting it, friction is drained from the customer experience.

Travelocity, the online travel service, embarked on a friction-removal mission when it set out to improve its online customer experience by ensuring that customers were better able to solve their problems and meet their needs using the website's self-help tools and references. One of the things Travelocity discovered was that there were far more null searches logged by the website than they thought there ought to be. A null search is a search that returns no results. Every null search result likely represented a frustrated customer who had not been able to find what they were looking for, at least not with their first search. Digging into the problem, the company found that its own terminology was often at fault. A customer who was planning a cruise, for instance, might have searched for the term "suitcases," trying to learn the weight limit or number of suitcases allowed on the cruise, or perhaps what the cost of extra luggage might be. But the term "suitcases" would show zero results at all, because Travelocity's references used the industry standard term, which was *baggage*. By reviewing all such null searches and then incorporating additional keywords to accommodate simpler, more common language, Travelocity was able to remove a substantial amount of friction from its customer experience.[6]

A truly frictionless customer experience is one that presents absolutely no obstacles or barriers to the customer's meeting whatever need or doing whatever job they

[6]*Effortless Experience,* Kindle loc. 1012-1019.

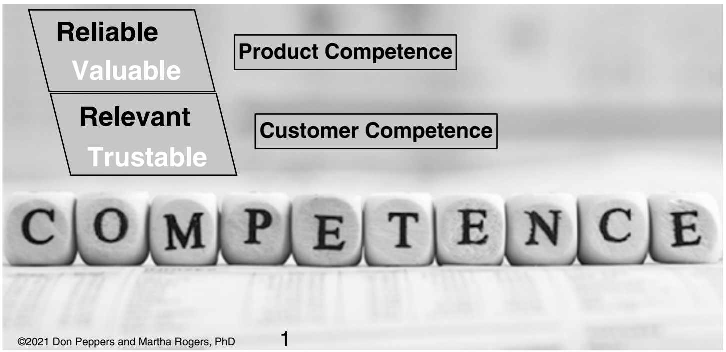

EXHIBIT 3.2 4 elements of frictionless experience

want to hire a company's product or service to do. The frictionless customer experience has to be reliable, valuable, relevant, and trustable. And for a customer experience to be truly frictionless, the enterprise must be both **product competent** and **customer competent**.

PRODUCT COMPETENCE

The term "product competence" can be thought of in terms of both the product or service's reliability and its value. A product-competent enterprise is capable of rendering its products or services on schedule, seamlessly across multiple channels, at reasonable prices, and consistently through time in such a way that they don't need a lot of maintenance, repair, correction, or undue attention from a customer to meet the customer's need. Importantly, product competence is something *every* business must master just to have any reasonable chance for profit at all and it's safe to say that by the end of the twentieth century nearly every business in the industrialized world had mastered the issue of basic product competence, for the simple reason that any company that remained product *incompetent* had either gone out of business already or been absorbed into a more competent firm.

A product or service can be considered *reliable* in the eyes of the customer if it directly and efficiently solves their problem (or does the job they're looking for) without introducing a host of other hassles, problems, or issues. It should perform as advertised, without failing or breaking down. And reliability is required not just of the physical product or service sold to a customer, but also with respect to all the different services that surround that product (e.g., invoicing and shipping, handling inquiries and requests, making repairs or service improvements, and protecting customers' data and privacy). The website should function smoothly and clearly, service should be performed on time, security flaws should be eliminated, and so forth. In addition, customers don't think in terms of departments or silos, so an enterprise that delivers its customer experience through the separate, uncoordinated activities of multiple operating entities or business units isn't likely to appear very reliable to the customer. Regardless of whatever internal elements are involved in running a business, a reliable customer experience can only be delivered by removing managers' internal focus and trying to repair the division between customer-facing and non-customer-facing groups and processes in order to deliver a single, unified experience to each customer. From billing and invoicing to technology implementations and employee training programs, all parts of an enterprise should be cognizant of their role in influencing the customer experience.

Product or service reliability is perhaps the easiest and most straightforward quality for an enterprise to monitor on a regular basis, but the enterprise has to be interested in monitoring it. As SVP of Customer Experience at Fidelity Investments, Parrish Arturi (currently Head of Digital Distribution at TIAA) focused his efforts on one small process improvement at a time to ratchet up the reliability of his company's customer experience. Importantly, he set up a customer experience improvement budget and allowed middle managers to tap it for small amounts of funds to fix these individual problems without having to do fully fleshed out proposals. The company set up a discussion board where employees could flag any problems or flaws in the company's services, and managers could then investigate the issue and follow up as needed. When one of Fidelity's frontline service reps noticed a surprising number of customers appeared to be having trouble simply logging into their accounts through the phone system, for instance, the rep started a thread on the discussion board, which called it to the attention of Arturi's team, who then worked with the phone system vendor to find the cause for the problem and identify a solution for it almost immediately.[7] If Fidelity had not set up a specific employee channel (its discussion board) for raising these kinds of issues, the company might not have become aware of this problem for days, weeks, or even months, until some customer somewhere lodged a complaint.

A customer considers their experience to be *valuable* when the value-for-money ratio is appropriate. No one expects a Bergdorf experience when they go to Costco; no one drives a Lexus expecting it to feel like driving a Ford. But as Warren Buffett once said, "Price is what you pay. Value is what you get." And this is an important point, because value can best be thought of as the total utility or usefulness delivered to a customer. It is an inherently subjective, squishy idea, while price is objective, exact, and easily quantified. On the one hand, price is something concrete that we can write down or divide into percentages. The value of a customer experience, on the other hand, like so much else, is completely in the eye of the beholder. Something has value for me if I say it does. In many situations, the value of the customer experience to a customer is closely related to its reliability. A more reliable customer experience will probably cost the enterprise less to maintain or manage, as well. At Fidelity, for instance, this is exactly what Arturi's team found. The cost of the customer experience team's fix for the phone system was a mere $20,000, but remedying the login problem for customers ended up saving Fidelity some $4 million annually in phone calls that no longer had to be handled by live representatives.[8]

> Price is what you pay. Value is what you get.
>
> —Warren Buffett

[7]*Outside In,* Kindle loc. 287.
[8]*Outside In*, Kindle loc. 288.

Customer Experience Duality

In 1906, the British physicist J. J. Thompson was awarded the Nobel Prize for proving that the electron is a particle. In a deeply ironic twist of fate, 31 years later, in 1937, J. J.'s son George Thompson was awarded his own Nobel Prize for proving that the electron is actually a wave. So, who was right? Was it Thompson the elder or the younger? Actually, they were both right, because of the quantum mechanics principle known as wave-particle duality. A quantum entity can be described as either a particle or a wave, but once it is observed to be either, it will remain in that same observed state for the rest of eternity. It's just the way the universe works.

In the customer experience discipline, we could say there is a kind of customer-experience duality as well. And this principle can be illustrated by a story one of the authors encountered in the late 1990s at Australia's St. George Bank (now part of Westpac). On a consulting visit we had a meeting one morning with the marketing folks at St. George who introduced us to their new ATMs, which had been programmed to remember individual customers and to offer them **customized** services based on their history and their observed preferences. You could put your cash card into the St. George Bank ATM, enter your PIN code, and the machine might display the message "Welcome, Mr. Jackson. Would you like your usual $100 cash from your checking account, no receipt?" and Mr. Jackson could simply press "yes" or "no." Choosing "yes" meant he could get his usual cash withdrawal and leave, while choosing "no" would give him access to all the other ATM's various functions, including deposits, transfers, information lookups, and so forth.

Today, of course, virtually every bank's ATMs operate in a similar way, but at the time (the 1990s) this was a very novel form of personalization. One of the authors banked at Citibank during this period and had to begin every ATM transaction by selecting to use English in addition to identifying which account, how much, receipt or not, and so forth. Every week required inputting the same choices and the same answers. So at St. George Bank we complimented the marketing folks for having cracked the code on personalizing and streamlining their ATM customer experience.

Later that afternoon we met with the computer folks at the bank, and we complimented them, too, on the improved level of service their ATM software was providing to customers. But one of the IT managers scoffed at the very idea that this innovation had been done for customer-service reasons. "Customer service had nothing to do with it," he said. "So why then," we asked, "had the bank programmed its ATMs in this way to make things so much easier for customers?"

The IT manager replied that they were solving a different problem entirely, because real estate for placing ATMs, in Sydney, Australia, was quite expensive and difficult to come by. He explained that these changes allowed an ATM to serve a lot more customers in the same amount of time.

So who's right? Is it better service? Or lower cost? They're both right. It's customer experience duality.

In a valuable customer experience, there are no hidden costs or pricing tricks, and the value proposition should be good for both sides of the transaction—seller as well as buyer. The value that any customer perceives in an enterprise's product or service bears a direct connection to how important or urgent the customer understands their need to be. Since customers have different opinions about these needs, they will have different opinions about the value of an enterprise's offering. We know this to be true because there is an economic principle that someone who considers the value of an offering to be higher than its price will likely buy it, while someone who considers its value lower than its price will likely not. Moreover, the value delivered in any customer's experience will increase directly in proportion to the amount of friction that is removed. Because friction is frequently costly to a company, removing it can also provide compounding benefits for both the customer and the enterprise.

CUSTOMER COMPETENCE

In addition to product competence, however, delivering a frictionless experience requires an enterprise to be customer competent, and this is a much rarer quality among today's businesses. Customer competence depends on two additional qualities in the customer experience: relevance and trustability. These two **attributes** relate directly to the question of whether a business is capable of treating different customers differently. Can the enterprise **recognize** and remember individual customer differences and preferences, and act on that knowledge by tailoring its behavior to meet the different needs of different customers, one customer at a time? Is the enterprise's **business model** structured in such a way as to profit by proactively working to protect the customer's own interest? Unfortunately, most enterprises are not nearly as advanced in their customer competence as they are with respect to their product competence.

A *relevant* customer experience is one in which an enterprise can **identify** and remember individual customers from transaction to transaction, across different channels, products, services, and organizational silos. Then it recognizes the differences among customers in terms of their many different desires from the enterprise and their different values to the enterprise. Unfortunately, a large proportion of companies fail to deliver a very relevant customer experience. Every time we have to tell a contact-center agent our account number again, having just punched it in on our phone, we come face to face with an irrelevant customer experience. Beyond simply remembering individual customer details, however, the fact is that every customer is uniquely individual (because every human being is uniquely individual), and a frictionless customer experience is one that is configured appropriately—i.e., *relevantly*—for each different customer.

Don't Run Your Business on the Goldfish Principle

Certain species of tropical fish have no territorial memory. None. Perhaps this trait evolved because the species inhabited the open sea, where territory was not very important and territorial memory counted for nothing, but the fact is that no matter where such a fish swims today, it never recognizes the fact it has swum there before. We can imagine such a fish swimming around and around in an aquarium or a goldfish bowl and never getting bored, because there's always something new and interesting to see.

Many of today's businesses still operate on "the Goldfish Principle" when it comes to their customers. They evolved in the age of **mass marketing**, before computers made it possible to remember customers individually, so whatever business model they developed didn't rely on remembering an individual customer from transaction to transaction. For instance, we can recognize a company operating on the Goldfish Principle when we sign up for a promotion with our airline or car rental firm, but then we continue to get email blasts urging us to sign up. Another example is when we go online to our credit card website and schedule our payment a few days before the due date, but then they still send us an email reminder that our payment is almost due.

Sometimes when a company is operating on the Goldfish Principle the results can actually be funny. For instance, below is a copy of an email message that a colleague of ours received from Marriott Rewards, with a comically irrelevant message. They might as well be broadcasting a message to the customer saying, "We don't care who you are!"

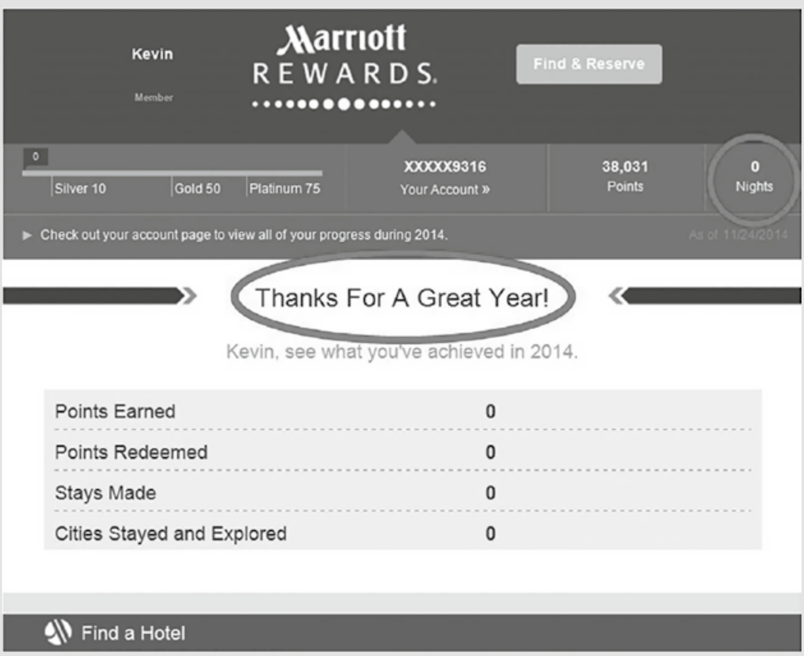

EXHIBIT 3.3 The Goldfish Principle in Action

(*continued*)

With today's information technology there's absolutely no excuse for operating on the Goldfish Principle. It's actually worse than doing nothing, because it demonstrates a level of incompetence that destroys a customer's trust in the business.

Operating on the Goldfish Principle today doesn't just communicate that you aren't competent enough to run a sound business, it screams that you don't care enough about your customers to even try to be competent.

Relevance in a customer experience can only be delivered by an enterprise that is trying to see the problem through the customer's own eyes. In effect, we could say that delivering a truly relevant customer experience requires an enterprise to have *empathy* for the customer, "feeling the customer's pain," so to speak. And this leads to the second element in customer competence: *trustability*.[9] A trustable customer experience is delivered when the enterprise proactively acts in the customer's interest as it attempts to deal with what the customer experiences, even when there is a cost to the business itself.

Of course, trust has always been important in commerce and it is still essential to any company's economic success. Few companies will prosper long if they cheat their customers, or steal from them, or deceive them. But in today's hyper-interactive world, mere trustworthiness—that is, doing what one says one is going to do and not violating the law—is no longer sufficient to render a truly frictionless customer experience. As the velocity and volume of interactions have increased, customers have come to expect more from the businesses they deal with. Today they expect an enterprise to be *proactively* trustworthy, or *trustable*. A trustable enterprise provides complete, accurate, and objective information, and helps the customer avoid mistakes or oversights. If a customer feels they have to count their change or double-check that they aren't doing something they're going to regret later, this is one more type of friction to be avoided in a streamlined customer experience.

A few good markers of a trustable customer experience would include:

- Facilitating objective customer reviews
- Reminding a customer that the warranty period is nearly up
- Reminding a customer that a subscription renewal is imminent
- Advising a customer that they might be buying more of a product than they need
- Providing a refund when one is due, without waiting for the customer to have to request it

At its core, trustability requires having genuine, human *empathy* for customers, and then applying the principle of reciprocity, treating each customer the way you would want to be treated if you were that customer. We could think of relevance as knowing who the customer is and meeting their individual needs, while trustability

[9]See Don Peppers and Martha Rogers, Ph.D., *Extreme Trust: Turning Proactive Honesty and Flawless Execution into Long-Term Profits* (New York: Portfolio/Penguin, 2016).

ensures that what the individual customer needs is provided without hassles, misinformation, tricks, bias, or any other motive that might not accord with the customer's true interest. In other words, relevance is seeing what the customer sees, while trustability is experiencing what the customer experiences.

UNDERSTANDING CUSTOMER EXPERIENCE THROUGH CUSTOMER JOURNEY MAPPING

In order to strategize, plan, execute, and then track whether the effect of what we're doing for customers is or is not working, more and more companies are engaged in ***customer experience journey mapping (CXJM),*** also known as ***customer journey mapping (CJM)***. The journey mapping tracks what it's like to be our customer now, visualizes what it should be like, and sets up the plan to close the gap, making customer experience journey mapping a key part of the successful **customer strategy** toolkit. Valerie Peck, cofounder and CEO of SuiteCX, a journey mapping tool, helped us think through what mapping is and does, and how to do it.[10]

Customer experience journey mapping begins with customer experience (CX). When CX is done well, it can and should involve every aspect of the company—its strategy, tactics, investments, hiring approaches, products, and services, and how it creates and lives its brand promise. Companies who excel at CX are more profitable and enjoy significant competitive advantage.

Executives estimate that their potential revenue loss for not offering a positive, consistent, and brand-relevant customer experience is 20% of their annual revenue. (That would be $400 million for a $2 billion firm.) And even worse, once lost, 27% of customers are lost forever.[11] Other typical reactions to a poor CX or low trust include:

- Blocked phone numbers (80%).
- Closed accounts (84%).
- Unsubscribing from email lists (84%).
- Deleted apps because of push notifications (82%).
- Unfollowing brands on social channels (86%).[12]

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[10]Full disclosure: One of the textbook's authors (Rogers) serves as the Chairman of the Board, and the other (Peppers) serves on the board of SuiteCX. Valerie Peck formerly served as a Senior Vice President of Peppers & Rogers Group and is also the Founder of East Bay Group Consulting. SuiteCX's competitors include UXPressia, Decooda International, Strativity Group, and MURAL.

[11]Oracle, "Global Insights on Succeeding in the Customer Experience Era," February 2013, available at http://www.oracle.com/us/global-cx-study-2240276.pdf, accessed August 17, 2021.

[12] Martin Hayward, "The Four Futures: The Digital Loyalty Survey," Aimia, 2013, available at https://www.slideshare.net/atsuki/data-whitepaperfourfuturesdigitalloyaltysurvey-49267939, accessed August 31, 2021.

CX is about growth:

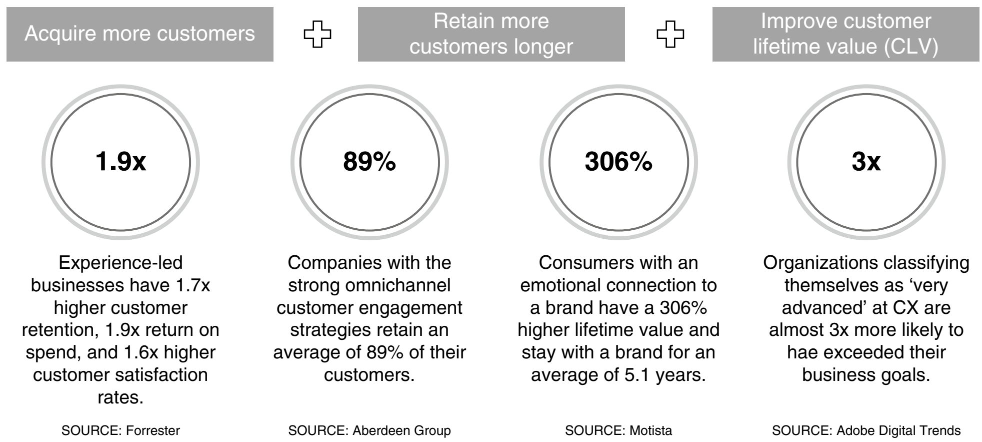

EXHIBIT 3.4 Customer Journey Mapping Goals

As we discuss CX here, we are defining it as the totality of a customer's individual interactions with a brand over time. In other words, this discussion is about what a company can do to make the customer's experience better—not necessarily every possible thing that could happen to a customer, including the kinds of things outside the control of the company. It's about the experience that is intended for a customer at an individual and personal level more than the general experience received. Customer experience is therefore more about *their* "experience" and not generalized to the customer's world.

But understanding customer experience should go beyond the aggregate of the company-controlled aggregate of CX. This is about the actual—real—customer journey solely from the perspective of the customer. Some call it *outside-in.* In some cases, especially at the start of the customer's journey, the company has no idea that they are even being considered. This journey includes stages and activities that go beyond the company to partners and providers. If a company seeks to figure out how to deliver great customer experiences, the first requirement is deep self-awareness—awareness of what it is as a company, of its purpose, values, strengths, and weaknesses. Some companies use customer journey mapping to help put together the myriad puzzle pieces of their own company.

Customer journey mapping (CJM)—or customer experience journey mapping (CXJM)—is a tool for envisioning, designing, and visualizing a holistic experience from the customers' point of view. It helps a company understand the customers' journey from their initial need for a company's product or service, to the way they research the competition, how they select a company, the purchasing process, using the product or service, and repurchasing or churning out.

According to Pointillist, 93% of high-performing organizations have said a customer journey strategy is very or extremely important to their organization's overall success, as compared to 63% of underperformers. The majority of high-performing organizations (68%) have a role or team dedicated to journey management, compared to 31% of underperformers. Overall, slightly more than half (53%) of organizations currently have a dedicated customer-journey-based role or team, 10% plan to add a dedicated role or team, and 19% have aligned their existing roles/teams with a journey-based approach.[13]

And according to Hanover Research, organizations most often use journey maps to guide leadership or strategy meetings and aid in decision making. A majority of respondents report journey maps help them increase customer satisfaction (95%), develop new products or services (92%), and identify gaps in communication touchpoints (91%).

The goal is to help a company gain insights and understand its customers' journey (using service, sales and marketing materials, data, **voice of the customer (VoC)** and voice of the customer from the employee perspective, NPS and other qualitative survey results, etc.) to create visual maps based on compelling rational and emotional evidence.

To create a great CX, a company must first understand the customer's experience. Like similar methods such as human-centered design and design thinking, journey mapping encourages **collaboration** and sharing. By getting everyone at the company on the same page to form the basis of a longer-term strategic plan to build customer value, it also educated and enables change.

One global automotive company saved hundreds of thousands of dollars and improved onboarding satisfaction rates when the journey mapping effort revealed that six separate invitations to join different memberships were going out to new car buyers within the first two weeks of buying their car. By discovering and fixing this issue, the company mitigated customer frustration by creating an interactive portal lowering the number of outbound interactions by two-thirds. They enabled the customer to have one-stop access to all of the benefits and opportunities as well as to sign up for channel preferences and their first service visit. Communications and satisfaction improved almost immediately and costs dropped. Not surprisingly, engagement and **opt-ins** increased. The company now has a team and methods/research approach in place to provide long-term benefits and insights for customers, employees, and leadership.[14]

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[13]Pointillist, "2021 State of Customer Journey Management and CX Measurement," 3rd edition, p. 7, available for purchase at https://www.pointillist.com/resources/.
[14]Thanks to Valerie Peck for this case study.

This drawing presents a typical journey flow:

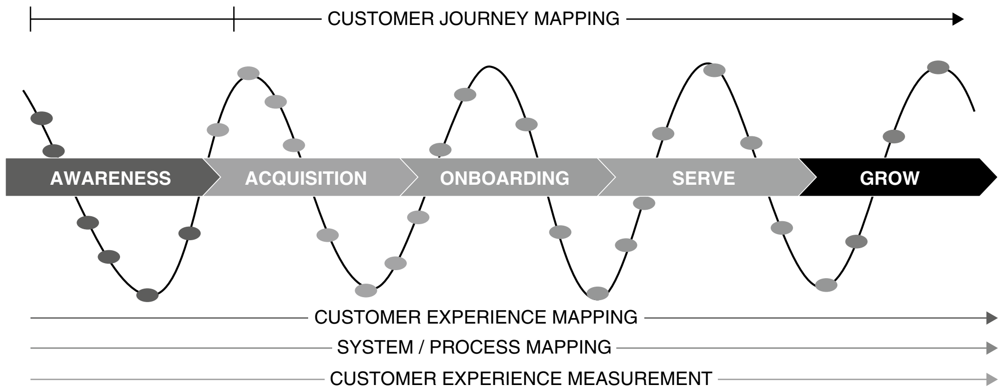

EXHIBIT 3.5 A Sample Customer Journey, Mapped
Source: East Bay Group, 2021

From the company's perspective, **customer life cycles** tend to be continuous and linear, whereas actual customer journeys may not be. Customers tend to approach decisions in a way that may be quite convoluted. It often includes influencers, competitors, and lots of online/offline interactions. This example is a customer's decision-making process in buying an item:

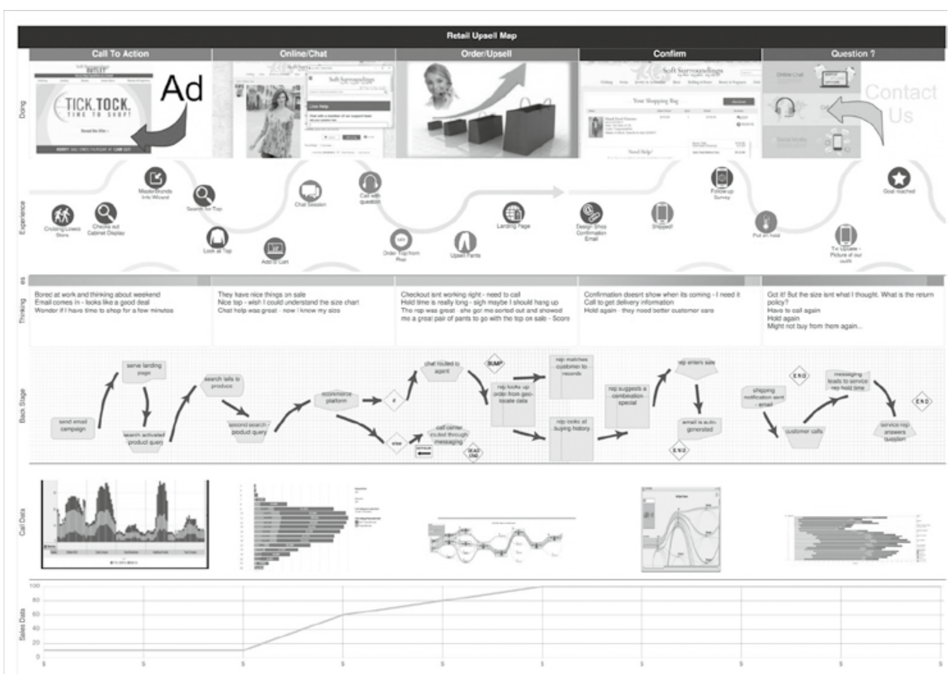

EXHIBIT 3.6 A Sample Customer's Decision-Making Process
Source: East Bay Group, 2021

Using CJM, a company can create the basis for actionable, repeatable documentation of each customer group as they interact with the company from start to finish.

What Is Not Customer Journey Mapping?

Many people mistake journey mapping for an inside-out view of their *interactions to* a customer, not taking into account that the customer is actually doing many things invisible to the company or not actually seeing that outbound lob that a company is pushing out. Many companies also focus on their email or Web sites—the easiest place to track a customer. That results in seeing a digital clickstream that shows the company where its customers move around its mobile or digital properties. Unless that's the company's only way of interacting with its customers and vice versa, then it only sees a portion of the big picture.

CJM is also not looking at a company's database using analytics around aggregate performance or response metrics. Remember, customers are feeling beings who can think, and mapping will need to evaluate emotional elements as well as rational.

Finally, it's not the equivalent of any single-dimension measure, such as **Net Promoter Score** or a social sentiment measure. Both of these elements serve a purpose,

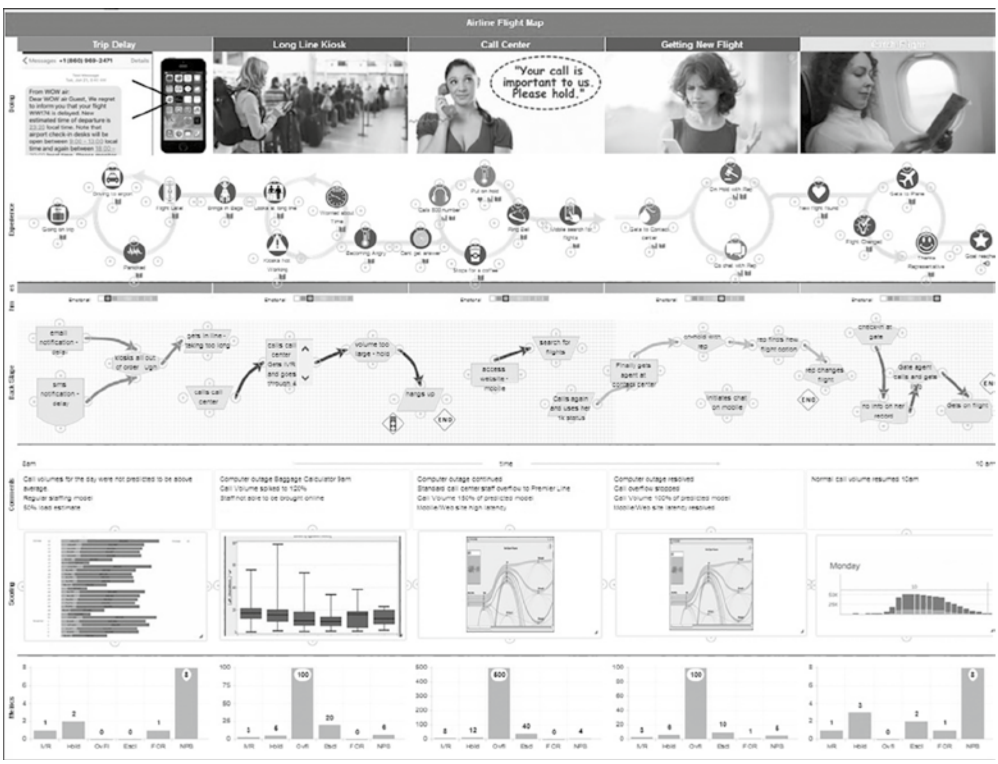

EXHIBIT 3.7 Airline/Flight Customer Journey Map
Source: East Bay Group, 2021

but they tend to measure only those willing to take the time to give a company a score and don't usually measure what or why, which are critical components a decision maker needs to know to create a journey that is frictionless, simple, and effective.

What Makes a Good Map?

The best maps provide:

- A visualization of customer interactions through many filters (emotional/rational) organized by the customer's perspective.
- A living document that evolves with the constantly changing organization it supports.
- A harmonized reflection of the voice of the customer (VoC) as well as the voice of the institution (VoI) and the voice of the employee (VoE).

CJM Outcomes

The outcomes of customer journey mapping are varied. Most at least provide insights into the company that help to bring a reality forward that it's not what *a company* has designed and wants to sell but what *the customer* wants to buy. In addition, it exposes where to spend resources to ensure that the company is competitive and has its finger on the customers' pulse. Some of the more tactical outputs tend to be:

- *Low-hanging fruit*. Quick fixes or opportunities that don't require a lot of time or resources to provide revenue or customer engagement/retention.
- *Performance metrics/dashboard recommendations*. What key pivot points really make a difference versus sometimes too inwardly facing metrics.
- *Input into standard operating procedures (SOP) document*. How you should be interacting, over what channel, and with what messaging and cadence. This ties to communication and precision campaign plans as well.
- *Road map initiative charters*. Next steps for bigger projects.
- *Post-project planning for continuous improvement*. Mapping will be revisited at frequent intervals to ensure that there is progress and to reveal other areas requiring improvement or offering opportunity.

Our goal for this chapter has been to give the reader a grounded perspective of how **Learning Relationships** enable enterprises to develop more personalized and collaborative interactions with individual customers. Our next step is to begin to understand the business sense of building a customer-strategy enterprise. Learning Relationships, after all, result in many pragmatic and financial benefits, not only for the customer but also for the enterprise that engages in them. The objective of increasing the overall **value of the customer base** by getting, keeping, and growing one customer, and then another and another, is achieved through these highly interactive relationships.

The enterprise determined to increase the value of the customer base will start with a commitment to increase customer value through better experiences and then move to implement the strategic levels of the Learning Relationship. The tasks needed to make this happen are: identifying their customers individually, ranking them by their value to the company, **differentiating** them by their needs, interacting with each of them, and customizing some aspect of the business for each. From the enterprise's perspective, these tasks are by no means chronological or finite. We will examine each of them more carefully in the next chapters.

CHAPTER 4

IDIC and Trustability: Building Blocks of Customer Relationships

The purest treasure mortal times can afford is a spotless reputation.

—William Shakespeare

The enterprise determined to increase the **value of the customer base** will start with a commitment to increase customer value and then move to implement the strategic levels of the **Learning Relationship**. The tasks needed to make this happen are: **identifying** their customers individually, ranking them by their value to the company, **differentiating** them by their **needs** and value, **interacting** with each of them, and **customizing** some aspect of the business for each. From the enterprise's perspective, these tasks are by no means chronological or finite. And underlying all of these is a fundamental reciprocal trust in the relationship, without which the business is merely transactional.

IDIC: FOUR IMPLEMENTATION TASKS FOR CREATING AND MANAGING CUSTOMER EXPERIENCES AND RELATIONSHIPS

Setting up and managing individual customer relationships can be broken up into four interrelated implementation tasks. These implementation tasks are based on the unique, customer-specific, and **iterative** character of such relationships. We list them roughly in the sequence in which they will likely be accomplished, although, as we see later in this book, there is a great deal of overlap among them (e.g., an enterprise might use its web presence primarily to attract the **most valuable customers** and identify them individually, rather than as a customer interaction platform), and there may be good reason for accomplishing them in a different order. In the next chapters, we'll explain each of these tasks and capabilities in more detail, but for now, bear them in mind, as the key ingredients of **customer experience**. We will also think about how *trustability*, more than any time since the advent of mass production and **mass marketing**, matters in building valuable customer relationships.

> An enterprise must be able to recognize a customer when they come back, in person, by phone, online, or wherever.

1. *Identify customers*. Relationships are possible only with individuals, not with markets, segments, or populations. Therefore, the first task in setting up a relationship is to identify, individually, the party at the other end of the relationship. For the many companies that don't really know the identities of most of their customers, this first step is difficult but absolutely crucial. For all companies, the "identify" task also entails organizing the enterprise's various information resources so that the company can take a customer-specific view of its business. It means ensuring that the company has a mechanism for tagging individual customers not just with a product code that identifies what's been sold but also with a customer code that identifies the party that the enterprise is doing business with—the party at the other end of the **mutual** relationship. An enterprise must be able to *recognize* a customer when they come back, in person, by phone, online, by mobile app, or wherever. Moreover, enterprises need to know and remember each customer in as much detail as possible—including the habits, preferences, and other characteristics that make each customer unique. For example, when you log in to your Cabela's online account, the company knows about your last order because you've been identified.

> Customers represent different levels of value to the enterprise, and they have different needs from the enterprise.
>
> The customer's needs drive his behavior, and his behavior is what creates value for the enterprise.

2. *Differentiate customers*. Knowing how customers are different allows a company to focus its resources on those customers who will bring in the most value for the enterprise, and to devise and implement customer-specific strategies designed to satisfy individual customers' needs and improve each customer's experience. Customers represent different levels of value to the enterprise, and they have different needs from the enterprise. The customer's needs drive his behavior, and his behavior is what creates value for the enterprise. Although not a new concept, *customer grouping*—the process by which customers are clustered into categories based on a specified variable—is a critical step in understanding and profitably serving customers. Specifically, the task of customer differentiation involves an enterprise which is categorizing its customers by both their value to the firm and by what needs they have. Some contact centers constantly change the order to serve based on the different values of those customers who are waiting on hold. Although it

would be ideal to answer every call on the second ring, when that's not possible, it would be better to vault the customers keeping you in business ahead of the customers of lower value. In most contact centers, this reshuffling is not at all apparent to customers.

> A conversation with a customer should pick up where the last one left off. And a company should never ask the same question twice.

3. *Interact with customers*. Enterprises must improve the effectiveness of their interactions with customers. Each successive interaction with a customer should take place in the **context** of all previous interactions with that customer. For example, a bank may ask one question in each month's electronic statement, and next month's question may depend on last month's answer. A conversation with a customer should pick up where the last one left off. Effective customer interactions provide better insight into a customer's needs and don't waste a customer's time by asking the same question more than once, even in different parts of the organization.
4. *Customize treatment*. The enterprise should tailor the customer's experience based on that individual's needs and value to make the interaction more relevant to the customer, and to make the customer's life a little easier and better. To engage a customer in an ongoing Learning Relationship, an enterprise needs to adapt its behavior to satisfy the customer's expressed needs. Doing this might entail **mass-customizing** a product or tailoring some aspect of its service.[1] This customization could involve the format or timing of an invoice or how a product is packaged.

> The enterprise should adapt some aspect of its behavior toward a customer, based on that individual's needs and value.

This identify-differentiate-interact-customize (IDIC) process implementation model can also be broken into two broad categories of activities: *insight* and *action* (see Exhibit 4.1). The enterprise conducts the first two tasks, identify and differentiate, behind the scenes and out of the customer's sight; they constitute *insight*. The latter two tasks, interact and customize, are customer-facing steps that require participation on the part of the individual customer. Visible to the customer, they constitute *action*. You'll recall from Chapter 1 that interacting and customizing are the two capabilities an enterprise must have in order to engage customers in relationships, and that the degree to which a firm uses each of these capabilities is an easy way to

[1]Marisa Peacock, "Demand for Tailored Customer Experiences Put Brand Loyalty at Risk," CMSWire, March 20, 2013, https://www.cmswire.com/cms/customer-experience/demand-for-tailored-customer-experiences-put-brand-loyalty-at-risk-020137.php, accessed August 18, 2021; and Don Peppers, Martha Rogers, Ph.D., and Bob Dorf, *The One to One Fieldbook: The Complete Toolkit for Implementing a 1to1 Marketing Program* (New York: Doubleday, 1999).

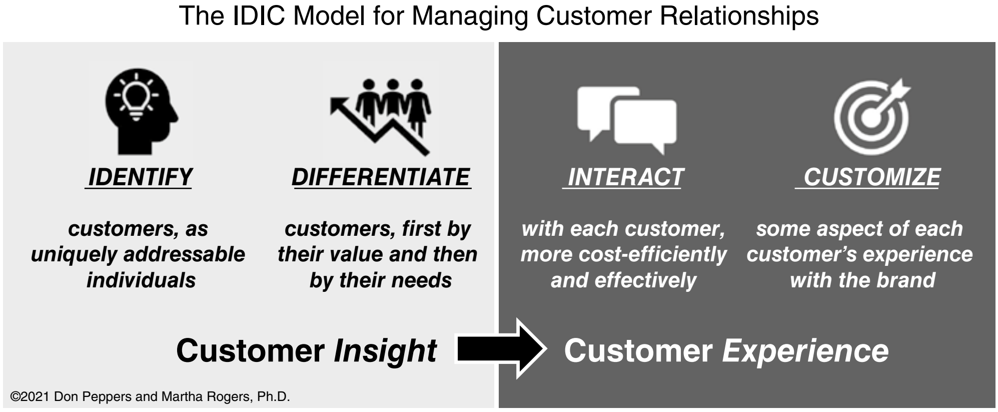

EXHIBIT 4.1 IDIC: Insight and Action

categorize the type of **customer strategy** it is pursuing—mass, niche, database, or one-to-one Learning Relationship. We can also think of the *identify* and *differentiate* steps as the tasks that make up **customer insight**, or **analytical CRM**, while the *interact* and *customize* steps are the tasks involved in customer experience (CX), or operational CRM.

Throughout the rest of this book, we refer back to this set of four implementation tasks as the **IDIC methodology**. As a model for relationship management processes, this methodology can be applied in any number of situations. For instance, it could help a company understand the steps it must take to make better use of its call center for initiating and strengthening customer relationships. Applied to a sales force, it could be used to understand the strengths and weaknesses of a new contact management application or to improve a sales compensation policy. We devote specific chapters in the book to examining all the activities and processes, as well as the pitfalls and problems, associated with each of these four tasks.

Making It Look Easy

Building good customer experiences may look easy. But in order for a firm to build customer value through managed relationships, the company must engage in the four-step IDIC process (*identifying* customers, *differentiating* them, *interacting* with them, and *customizing* for them). These steps represent the mechanics of any genuine relationship, which by definition will involve **mutuality** and customer-specific action. But while the IDIC process represents the *mechanics* of a relationship, generating a customer's trust should be the most important *objective* of that process. Relationships simply cannot happen except in the context of customer trust. but for now, what's important is to get an overview of both the mechanics and the objective of relationship building.

We've seen that the customer relationship idea has many nuances. For instance, there likely will be an emotional component to many successful customer relationships (at least in consumer marketing), but it's important to recognize that the reverse of this statement is not necessarily true: The fact that you have an emotional attachment to a company does not mean you have a relationship with that company.

We can't afford to dismiss entirely the notion that nonemotional relationships between an enterprise and its customer do, in fact, exist. For instance, you probably have no actual emotional connection with one or more banks whose credit cards you carry in your wallet. But, everyone keeps asking, does that mean you have no *relationship* with such a company, even though it communicates with you monthly, tracks your purchases, and (at least in the best cases) proactively offers you a new card configuration based on your own personal usage pattern? Yes, there might be an element of emotion involved in this relationship, but must that always be the case?

Conversely, you might have a highly emotional attachment to an enterprise, but if the enterprise itself isn't even aware that you exist, does this constitute anything we can call a relationship? The simple truth is that, in most cases, your relationship with a brand is analogous to your relationship with a movie star. You might love his movies, you might avidly follow his activities via **social media**, but does he even know who you are? It can be said to be a relationship only if the movie star somehow also acknowledges it—through personally responding to your posts or inviting you to events, for example. This is because, as we said in Chapter 2, the most basic, core feature of any *relationship* is mutuality. Mutual awareness of another party is a prerequisite to establishing a relationship between two parties, whether we are talking about movie star and fan or enterprise and customer. People who are emotionally involved with a brand, not unlike the most avid fans of a rock music group, are usually engaged in one-way affection. There's nothing wrong with this at all. One-way affection for a brand has sold a lot of merchandise. But this kind of affection will be only part of a relationship if the brand is mutually involved, and in the overwhelming majority of cases, it is not.

Let's return to the basic, definitional characteristics of a relationship, and try to derive from this list of characteristics a set of actions that an enterprise ought to take if it wants to establish relationships with its customers through deeper insights that lead to better experiences. A relationship is mutual, interactive, and iterative in nature, developing its own richer and richer context over time. A relationship must provide an ongoing **benefit** to each party; it must change each party's behavior toward the other party and it will therefore be uniquely different from one set of relationship participants to the next. Finally, a successful relationship will lead each party to trust the other. In fact, the more effective and successful the relationship is, from a business-building standpoint, the more it will be characterized by a high level of trust.

We've been looking at relationship characteristics that are part of analytic descriptions of the nature of a relationship while the last characteristic—trust—is a much richer term that could serve as a proxy for all the affection and favorable emotion that most of us associate with a successful relationship.

In any case, what should be apparent from the outset is that we are talking about an enterprise engaging in customer-specific behaviors. That is, because relationships involve mutuality and uniqueness, an enterprise can easily have a wonderful relationship with one customer but no relationship at all with another. It can have a deep, very profitable relationship with one customer but a troubled, highly unprofitable relationship with another. An enterprise cannot have the same relationship with both Mary and Shirley any more than Mary can have the same relationship with both her priest and her tennis instructor.

A business strategy based on managing customer relationships, then, necessarily involves **treating different customers differently**. A firm must be able to identify and **recognize** different, individual customers, and it must know what makes one customer different from another. It must be able to interact individually with any customer on the other end of a relationship, and it must somehow change its behavior to meet the specific needs of that customer, as it discovers those needs. And to build trust, it must act in the customer's best interest as well as its own.

In short, in order for an enterprise to engage in the practice of treating different customers differently, it must integrate the customer into the company and adapt its products and services to the customer's own, individual needs. But as a company begins to understand the customer, interact with them, learn from them, and provide feedback based on that learning, the customer's view of what they are buying from the company will probably also begin to change.

As a company begins to understand the customer, interact with them, learn from them, and provide feedback based on that learning, the customer's view of what they are buying from the company will probably also begin to change.

For instance, a person may shop at L.L. Bean initially to buy a sweater. But over time, they may browse the L.L. Bean website or flip through the catalog to match other clothes to the sweater, or look for Christmas gift ideas, or research camping equipment. Now L.L. Bean has become more than just a place to buy sweaters; it is a source of valuable information about future purchases. Ultimately, this is likely to increase the importance of trust as an element in the relationship. So will the no-questions-asked return policy for a year after purchase, as well as the fast, reasonably priced shipping. The more the customer trusts L.L. Bean, the more likely they will be to accept its offers and recommendations (which, in turn, are based on the customer's own clicks and purchasing history).[2]

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[2]See Madeleine Streets, "How AI Can Take Personalization Beyond Addressed Emails to Offer Curated Shopper Journeys," *Footwear News: FN* (Online), August 19, 2020, https://footwearnews.com/2020/business/retail/formation-ai-personalized-online-shopping-1203043992/, accessed August 18, 2021; Erik Lindecrantz, Madeleine Tjon Pian Gi, and Stefano Zerbi, "Personalizing the Customer Experience: Driving Differentiation in Retail," McKinsey & Company, April 8, 2020, https://www.mckinsey.com/industries/retail/our-insights/personalizing-the-customer-experience-driving-differentiation-in-retail, accessed June 9, 2021, Linn Viktoria Rampl, Tim Eberhardt, Reinhard Schütte, and Peter Kenning, "Consumer Trust in Food Retailers: Conceptual Framework and Empirical Evidence," *International Journal of Retail & Distribution Management* 40, no. 4 (2012): 254–272; Michele Gorgoglione, Umberto Panniello, and Alexander Tuzhilin, "The Effect of Context-Aware Recommendations on Customer Purchasing Behavior and Trust," in Proceedings of the Fifth ACM Conference on Recommender Systems (New York: ACM, 2011), 85–92; Peter Kenning, "The Influence of General Trust and Specific Trust on Buying Behaviour," *International Journal of Retail & Distribution Management* 36 (2008): 461; and Ellen Garbarino and Mark Johnson, "The Different Roles of Satisfaction, Trust, and Commitment in Customer Relationships," *Journal of Marketing* 63 (April 1999): 70–87.

It is customer information that gives an enterprise the capability to differentiate its customers one from another. Customer information is an economic asset, just like a piece of equipment, a factory, or a patent. It has the capability to improve an enterprise's productivity and reduce its unit costs. Individual customer information, if used properly, can yield a return for many years. And because customer information is based on an individual, not a group, it is more useful for its scope rather than its scale. When two enterprises are competing for the same individual customer's business, the company with the greatest ***scope of information*** about that customer and the ability to use it will probably be the more effective competitor. And because technology now makes it possible for businesses of nearly any size to keep track of individual relationships with individual customers, the scale of a company's operations may become less important as a competitive advantage. Cultivating a profitable customer relationship with any one customer will depend primarily on having information about that specific customer and using it wisely. It will matter more than who has the biggest pile of customers.

The company with the greatest *scope of information* about a customer and the ability to use it will probably be the more effective competitor.

Once a company begins to take a customer-specific view of its business, it will begin to think of its customers as assets that must be managed carefully, in the same way any other corporate asset should be managed. From a strictly financial perspective, this kind of strategy will tend to focus more corporate resources on satisfying the needs of those customers offering higher long-term value to the firm, while limiting or reducing the resources allocated to lower-value customers. But, operationally, increasing the long-term value of a particular customer will necessitate addressing that customer's own individual needs, even to the point of tailoring—or at least mass-customizing—individual products and services for individual customers.

Cultivating a profitable customer relationship depends primarily on having information about each specific customer and using it wisely. It matters more than who has the biggest pile of customers. *Treat different customers differently*.

The technologies that allow a company to track individual customers and treat them differently have made it possible to create what is, in effect, an individual *feedback loop* for each customer. This loop ensures that a successful relationship continues to get better and better, one customer at a time. When such a relationship exists between a customer and an enterprise, many traditional marketing principles, formerly held sacred, will simply be irrelevant, at least insofar as that particular customer is concerned. No longer must the enterprise rely on surveys of current or potential customers to determine which action is appropriate for this customer; nor is it necessary to plot the reach and frequency with which its advertising message is getting out, in order to determine its effectiveness with *this* customer. Instead, the customer and the enterprise are mutually engaged in a continuously improving relationship: "I know you. You tell me what makes this work for you. I do it. You tell me if I did it right. I remember that, and I do it even better for you next time."

Relationships and Trust Happen in Unison

However you look at it, trust is probably the single most important ingredient in any personal interaction or relationship. After all, if what you learn from someone else can't be trusted, then it's not worth learning, right? And if you want to have any kind of influence with others, then what you communicate to them has to be seen as being trustworthy. Short of threat of job loss or brute force, in fact, being trustworthy is the only way your own perspectives, suggestions, persuasive appeals, or demands can have any impact on others at all. Whether you're telling or selling, cajoling or consoling, what matters most is the level of trust others have in you.[3]

Most businesses and other organizations think that they're already **customer-centric** and that they are basically trustworthy, even though their customers might disagree. How is the **customer service** at your organization? When surveyed, 75% of CEOs think they "provide above-average customer service," but 59% of consumers say they are somewhat or extremely upset with these same companies' service. In one infamous study reported by Bill Price and David Jaffe, 80% of executives thought their companies provided superior customer service, but only 8% of the customers of those companies thought they received it.[4]

Even though no company can ever be certain what's in any particular customer's mind, companies today do have much more capable technologies for analyzing their customers' needs and protecting their interests. Sometimes, all that's required for a superior experience that leads to a valuable relationship is for a company to use its own processes to help a customer avoid a costly and preventable mistake. Most online grocery delivery services now, for instance, have software that will check with you about a likely typo before you buy something highly unusual ("Do you really want to buy 120 lemons?").

Some of the best companies are also using their greatly improved information technology (IT) capabilities to do a better job of remembering their customers' individual needs and preferences, and then becoming smarter and more insightful over time, and using this insight to create a better customer experience. Imagine how a company might use its own database of past customer transactions for the customer's benefit. For example, if you order a book from Amazon that you previously bought from them, you will be reminded before your order is processed. Other online retailers do the same thing. These are examples of genuinely trustable behavior. In each case, the company's database gives it a memory that can sometimes be superior to the

[3]See Ed Keller and Brad Fay, *The Face-to-Face Book: Why Real Relationships Rule in a Digital Marketplace* (New York: Free Press, 2012).

[4]Bill Price and David Jaffe did some pretty interesting research for their book, *The Best Service Is No Service* (San Francisco: Jossey-Bass, 2008), including looking at the discrepancies between how good companies think their service is and how lousy the customers think it is.

customer's memory. It would not be cheating for Amazon simply to accept your money, but reminding you of a previous identical purchase gives you a good reason to buy all your books (or office supplies, music, or nail polish) in one place.

And note that doing the right thing, at least in this case, is mutually beneficial. Even as Amazon offers you the chance to **opt out** of a purchase you've already made, they also reduce the likelihood that you'll receive the book, realize you already have it, and return it. And that makes it less likely they'll have to execute a labor-intensive and costly refund process, or that you'll think badly of them aloud on Twitter. This is exactly how "reciprocity" is supposed to work—as a win–win.

In addition to the company–customer feedback loop (involving click throughs and purchasing history, customer satisfaction surveys, questionnaires, and even customer complaints across devices), a company may also gain insight about customer wants, needs, or expectations by monitoring customers' social media communications with other customers (see Chapter 8). A company has the opportunity to learn from conversations taking place in online social networks. This is highly important for companies trying to build relationships with their customers for four main reasons:

1. Social networks have high impact on the flow and quality of information. As opposed to believing in impersonal and generic sources, customers prefer to rely on peers and their perspectives.
2. Information within networks disseminates quickly across devices and impacts **word-of-mouth** referrals and recommendations.
3. Social networks of customers also carry the implication of trust as the information becomes more personalized with experience and familiarity of the social network's members.[5]
4. Even beyond known members of a network, strangers who rate products and services on websites are viewed as peers, so their references and recommendations are trusted. This makes Amazon one of the largest **social networking** sites in the world.

The secret to keeping and growing a single customer forever is this feedback loop. Creating it requires the customer's own participation and effort, along with their trust in the company that's getting their information. It is the effort on the part of the customer that results in a better product or service than the customer can get anywhere else from any company that is not so far up a particular customer's learning curve. The successive interactions that characterize such a Learning Relationship ultimately result in the enterprise's capability to make its products and services highly valuable to an individual customer. Because each Learning Relationship is unique to that customer, and because it has been formed in large part from the customer's own participation, it can become *irreplaceably* valuable to that customer, ensuring the customer's long-term loyalty and value to the enterprise.

[5]See Matthew O. Jackson, Brian W. Rogers, and Yves Zenou, "The Economic Consequences of Social-Network Structure," *Journal of Economic Literature* 55, no. 1 (March 2017): 49–95.

HOW DOES TRUST CHARACTERIZE A LEARNING RELATIONSHIP?

Before we begin this journey, we will spend the rest of this chapter discussing in greater detail just what it means to say that trust is a quality that will characterize a good customer relationship. In an enterprise focused on customer-specific activities, any single customer's purchase transactions will take place within the context of that customer's previous transactions as well as future ones. The buyer and seller **collaborate**, with the buyer interacting to specify the product, and the seller responding with some change in behavior appropriate for that buyer. In other words, the buyer and seller, in a relationship, must be willing to trust each other *far beyond the general reputation of the brand*. By extension, we can easily see that the more any series of purchase transactions is like a relationship, the more that trust will become a central element in it.

> The buyer and seller, in a relationship, must be willing to trust each other *far beyond the general reputation of the brand*.

When a company is focused on building **customer equity**, earning customer trust becomes an inherent goal of its decision making. It's not possible to balance the creation of long- and short-term value, to build **Return on Customer (ROC)**, or to focus resources on getting customers to share information that helps us build superior customer experiences unless the company understands that the **lifetime values** of customers are just as important as current sales and profits.

A relationship of trust is one in which both parties feel comfortable continuing to interact and deal with each other, whether during a purchase, an interaction, or a service transaction. Trust rarely happens instantaneously. Even if the trusted source has been recommended by another, a customer must feel the trust from within before they will begin to divulge personal information about themselves.

As Stephen M. R. Covey and Rebecca Merrill describe, "Simply put, trust means confidence. The opposite of trust—distrust—is suspicion. When you trust people, you have confidence in them—in their integrity and in their abilities. When you distrust people, you are suspicious of them—of their integrity, their agenda, their capabilities, or their track record. It's that simple."[6]

Covey and Merrill point out that trust is a function of two things: *character* and *competence*. Character includes your integrity, your motive, your intent with people. Competence includes your capabilities, your skills, your results, your track record. And both are vital.

Covey and Merrill continue by clarifying that the character side of trust is fast becoming the price of entry in the new global economy. However, the differentiating, and often ignored, side of trust—competence—is equally essential. You might think a person is sincere, even honest, but you won't trust that person fully if he or she doesn't

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[6]Stephen M. R. Covey and Rebecca R. Merrill, *The Speed of Trust: The One Thing That Changes Everything* (New York: Free Press, 2006), pp. 5, 30.

get great results. And the opposite is also true: A person might have great skills and talents and a good track record, but if he or she is not honest, you're not going to trust that person.[7]

The authors of this textbook believe it is very important to add a third key element of trust—and that is ***proactivity***—taking care to help, warn, teach, or otherwise prevent the customer from making a mistake without knowing it. It's the difference between the truth and the whole truth. We'll talk more about this later.

According to Covey and Merrill, "the true transformation starts with building credibility at the personal level." The best leaders are those who have made trust an explicit objective, being aware of the quantifiable costs associated with the lack of it in a company or a relationship. One of the simplest ways to look at the quantifiable costs of a so-called soft factor, such as trust, is to think about a simple transaction taking place between two parties. When the two parties in business trust each other, they can act more quickly and minimize the frictional costs of the transaction, such as spending on lawyers, contracts, or due diligence. With the increase in trust in a given relationship, not only are costs lower, but the time required to complete the transaction also goes down significantly. Covey points out that when Warren Buffett's Berkshire Hathaway acquired McLane Distribution from Walmart, the $23 billion acquisition was sealed over a handshake and completed in less than a month because both parties knew and trusted each other completely. Normally, a deal like that would have required six months or more to execute, and perhaps several million dollars of legal and accounting fees.[8]

Consider: The element of trust is an indispensable component of a healthy, growing relationship between a company and its customer, but it may not be an absolute requirement for every relationship. A customer may remain in a relationship with a company either because they desire the relations or simply because they perceive no suitable alternative. It should be obvious, however, which relationship will be the stronger, from the standpoint of increasing the customer's long-term value to the enterprise and encouraging them to be impervious to competitive offers. The customer's own level of commitment to their relationship with a company will depend on the extent to which the relationship derives from dedication, rather than from constraint. Trust-based relationships foster dedication. In one study, researchers determined that "trust, as a higher-order construct," plays "a central role in the relationship customers have with their financial institutions" and in fact, that "trust can have an immediate effect on the decision that customers must make, either to pursue or to end their relationship with a firm."[9]

Enterprises create trust-based customer relationships through the actions of their employees and partners, and through company strategies and policies. There are sound ways to think about the trust-building process and the policies necessary to generate

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[7]Ibid.

[8]Ibid., pp. 13–15. See also Stephen M. R. Covey and Greg Link, with Rebecca R. Merrill, *Smart Trust: The Defining Skill That Transforms Managers into Leaders* (New York: Free Press, 2013).

[9]Nha Nguyen, Andre Leclerc, and Gaston LeBlanc, "The Mediating Role of Customer Trust on Customer Loyalty," *Journal of Service Science and Management* 6, no. 1 (2013), 96–109.

trust. Charles Green lists what he calls the "myths" of trust between customer and supplier. In a series of research investigations, Green and his colleagues found strong evidence that busted open some of the lingering myths about trust, shattering the reasons for not taking the time and effort to build trust deliberately.

Green found that the following statements are *not true:*

- Myth 1: Intimate customer relationships require time and proximity.
- Myth 2: Trust takes time.
- Myth 3: More customized contact is better.
- Myth 4: People trust companies.
- Myth 5: People like to be asked their opinion.

He also discovered two interesting findings which *are true*:

- Finding 1: Women are more trustworthy than men.
- Finding 2: The most powerful trustworthiness factor is intimacy.[10]

We might call it a fact: People do not tend to trust enterprises that act clearly, consistently, and only in the company's own self-interest.

Becoming More and More Trustable to Customers

The more it appears to a customer that the enterprise is acting in its own interest, the less willing the customer will be to trust the enterprise's suggestions and recommendations. And the more a customer trusts an enterprise, the more the customer is likely to want to continue a relationship with it, increase the scope of the relationship, and recommend the company or product to others. It follows that the most secure, most influential, most profitable type of relationship between an enterprise and a customer is one in which the customer actually trusts the enterprise to act in the customer's own interest. In such a relationship, the customer perceives the enterprise to be their **trusted agent**, making recommendations and giving advice that furthers the customer's interest, even when it occasionally conflicts with the enterprise's self-interest, at least in the short term.

With technology reducing barriers between customers and a choice of companies, a seller's reputation is now a distinguishing asset—and one that is continuously

[10]To learn more about these findings and myths, see the original and ongoing work based on "the Trust Equation": Barbara Brooks Kimmel, "'Return on Trust': The Business Case," *Trust Across America,* Spring 2015, available at https://trustacrossamerica.com/documents/index/Return-Methodology.pdf, accessed August 18, 2021; and Trusted Advisor Associates' various articles on the Trust Quotient, an online self- assessment built on the Trust Equation, including Charles H. Green, "Think Expertise Will Make You More Trusted? Think Again" (2015), available at https://trustedadvisor.com/public/files/pdf/TA_White_Paper.pdf, accessed August 18, 2021.

available for inspection by the buyer on a variety of online review sites. Trustworthiness has become more transparent, and as a result even distant strangers can confidently conduct business when integrity has been demonstrated and documented. Trust and fairness make the wheels of commerce turn.[11]

Edelman's Trust Barometer underscores the importance to customers of companies that seek to serve customer interests as well as their own. "Trust is the new brand equity. In the '80s, the legendary brand strategist David Aaker defined brand equity in terms of brand loyalty, awareness, associations, and perceived quality. Now brands will need to operate at the intersection of **culture**, purpose and society. Brands need to be for the people and guided by the people. Why? Because brand trust ranks higher than brand love."[12]

> Trust is the new brand equity.
>
> —Richard Edelman

In a later section on how to manage the company to be more customer-centric in order to make customers more valuable, we'll talk more about even higher levels of trust both supported and mandated by emerging technologies and levels of transparency. For now, let's just look at the basics. Everybody's talking about trust these days, and many use the term as a synonym for what we might call *reputation*, or *regard*, or *popularity*, or *familiarity*. Brand equity like this is valuable and worth pursuing, but it's not the same as trustworthiness, any more than fresh paint and a freshly mown lawn can reveal whether or not a house has a solid foundation.

Some of the best books on business and personal relationships have been written on the broader subject of trust. These books—even just the really good ones—are too numerous to mention here, but we do want to acknowledge the work of Covey, Green, the Edelman Trust Barometer,[13] and Bruce Temkin. There are a host of others, and we suspect you've read at least some of them. What we need to understand is why transparency means that simple trustworthiness is no longer sufficient, and

[11]Don Peppers and Martha Rogers, *Extreme Trust: Turning Proactive Honesty and Flawless Execution into Long-Term Profits* (rev.) (New York: Portfolio/Penguin 2016). See also *FastCompany*, November 14, 2014, available at https://www.fastcompany.com/3038488/the-number-one-thing-consumers-want-from-brands-honesty, accessed August 18, 2021.

[12]Richard Edelman, "Trust, the New Brand Equity," Edelman.com, June 23, 2021, available at https://www.edelman.com/trust/2021-brand-trust/brand-equity, accessed August 31, 2021.

[13]The principle behind the annual Edelman Trust Barometer is this: Unlike reputation, which is based on an aggregate of past experiences with a company or brand, trust is a forward-facing metric of stakeholder expectation. The Edelman Trust Barometer, available at https://www.edelman.com/trust (accessed August 18, 2021), has been surveying the attitudes of the educated toward institutions in 23 countries for more than a decade, and it's a crucial source for understanding global and national trends in public trust of institutional sectors such as business, government, nongovernmental organizations, and the media. According to the Edelman Trust Barometer 2021, after the COVID-19 pandemic, business became the only institution (compared to government, NGOs, and media) seen as both competent *and* ethical. Edelman Trust Barometer 2021, available at https://www.edelman.com/trust/2021-trust-barometer, accessed August 31, 2021.

why a more extreme form of trust—or trustability—will be the standard by which consumers measure the businesses and brands they buy from.[14]

For the most part, the business authors who've written about trust in the past have developed their own taxonomies to catalog the various elements that make up trustworthiness, ranging from dependability and reliability to honesty and authenticity. The most direct way to think about trust is in terms of a combination of *good intentions* and *competence*. In other words, being *trustworthy* requires doing the right thing—and doing things right.

> Brand equity is valuable and worth pursuing, but it's not the same as trustworthiness, any more than fresh paint and a freshly mown lawn can reveal whether or not a house has a solid foundation.

Earning the customer's trust is one of the earliest goals in any enterprise's effort to build a long-term relationship. Only in a relationship of trust can information pass back and forth freely between buyer and seller. Moreover, in a world of increasingly commodity-like products and services, a relationship founded on trust can provide a genuinely sustainable competitive edge. Trust is the currency of all commerce.

It should be noted that trust thrives in sunlight. The Internet Age can be called the age of transparency. Dov Seidman, author of *How,* tells it this way:

> *In the olden days (before about 1995), when people wanted to buy, say, a toaster, they would pick a local store known for its good selection or good pricing of small appliances and buy the one that seemed best for their needs. If they were particularly industrious, thrifty, or enamored of the process, they*

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[14]See Edelman Trust Barometer 2021, available at https://www.edelman.com/trust/2021-trust-barometer, accessed August 31, 2021; Bart Nooteboom, "Uncertainty and the Economic Need for Trust," *Trust in Contemporary Society*, edited by Sasaki Masamichi (Brill, 2019), 60-74; and Mark Curtis, Kevin Quiring, Bill Theofilou, and Agneta Björnsjö, "Life Reimagined: Mapping the Motivations That Matter for Today's Consumers," Accenture, 2021, at https://www.accenture.com/us-en/insights/strategy/reimagined-consumer-expectations, accessed October 18, 2021.

Stephen M. R. Covey and Rebecca R. Merrill's extremely well-written book *The Speed of Trust: The One Thing That Changes Everything* (New York: Free Press, 2006) is based on this formula: "When trust goes up, speed will also go up and cost will go down. When trust goes down, speed will go down and cost will go up." In their taxonomy, trust is built (and can be rebuilt) on two things: competence and character. (Fundamentally, Covey and Merrill's idea of character is parallel to our concept of good intentions.) David Hutchens and Barry Rellaford wrote a short fable that succinctly illustrates the power of trust, based on the principles of Covey and Merrill's book: *A Slice of Trust* (Layton, UT: Gibbs Smith, 2011).

Also see David Maister, Charles H. Green, and Robert Galford, *The Trusted Advisor* (Touchstone, 2000); Amazon's description of Joel Peterson's *The 10 Laws of Trust: Building the Bonds That Make a Business Great* (New York: AMACOM, 2016) notes how JetBlue chairman Joel Peterson explores how a culture of trust gives companies an edge. Consider this: What does it feel like to work for a firm where leaders and colleagues trust one another? Freed from micromanagement and rivalry, every employee contributes his or her best. Risk taking and innovation become the norm. And, as Peterson notes, "When a company has a reputation for fair dealing, its costs drop: Trust cuts the time spent second-guessing and lawyering."

might call or visit two or three stores before making their purchase, dig out back issues of consumers' testing magazines, or consult a catalog or two to compare price and features. As more businesses went online, people suddenly had the ability to shop not only within their local area, but almost anywhere. Large and trusted online retailers were added to the shopping mix, giving consumers a few more options if they wished to pursue them. Between June 2004 and March 2005, however, as e-commerce began exploding worldwide, people who bought online suddenly became more prone to visiting 10 or more Web sites before returning to a favored location hours or days later to make a purchase. As of 2014, almost one-fifth of all online sales had actually moved to mobile devices like tablets and smartphones,[15] and in the same year 84 percent of shoppers used smartphones to compare prices and research, even while in a physical store.[16]

It has been said that information is like a toddler: it goes everywhere, gets into everything, and you can't always control it.[17] Someone should have told that to David Edmondson, former CEO of RadioShack. For consumers, easy access to information about vendors has become an advantage; for those like Edmondson, who had something to hide, it has meant devastation. When he joined RadioShack in 1994, Edmondson invented a couple of lines for his resume in the form of college degrees in theology and psychology from Pacific Coast Baptist College in California that he never earned. In February 2006, after just eight months at the top of his profession, he was forced to resign. Though the school had relocated to Oklahoma and renamed itself, a reporter from the Fort Worth Star-Telegram tracked it down and uncovered the discrepancies. Edmondson's career, built on the foundation of these lies, lay in pieces at his feet.[18,19]

Before the internet changed everything, and made it possible for anyone, anywhere to find out practically anything, it was easy to get away with shady stuff like this, but now dishonest corporate officers, military leaders, politicians, and CEOs can be found out easily. So can whole companies. As Seidman points out, by the time the dictionary listed *google* as a verb, you could look up anything on anybody, anytime. We are more interconnected, and our interconnectedness makes us morally interdependent. Our actions affect more people in ways they never have before.

[15]"E-Commerce Pulse Quarterly Report, Q1 2014," *Custora*, April 2014, as cited in Dov Seidman, *How*.
[16]"The New Digital Divide: Digital's Influence on In Store Sales," Deloitte, April 2014, as cited in Dov Seidman, *How*.
[17]Lev Grossman and Hannah Beech, "Google under the Gun," *Time,* February 5, 2006, as cited in Dov Seidman, *How*.
[18]Heather Landy, "RadioShack CEO Admits 'Misstatements,'" *Fort Worth Star-Telegram,* February 16, 2006, as cited in Dov Seidman, *How*.
[19]Partial reprint with permission of John Wiley & Sons from Dov Seidman, *HOW: Why How We Do Anything Means Everything* (Hoboken, NJ: John Wiley & Sons, 2011). Originally appeared in Don Peppers and Martha Rogers, *Managing Customer Relationships and Experiences* third edition, (Hoboken, NJ: John Wiley & Sons, 2016), pp. 96–97.

One of the hallmarks of any free-market economic system is that price and quality information are conveniently available to all customers.[20] Until recently, however, information about a company's service reputation, or about the overall customer experience at a firm, was not as conveniently available. Social media and mobile technology have revolutionized this, allowing customers quick and easy access, 24/7, to what other customers are saying about a brand or a business.[21] One key part of any company's overall service reputation has to do with whether it can be expected to act in the customer's interest. Is the firm really trustable?

Whatever a company does, good or bad, will be spread at internet speed:

- Everywhere ("online" is ubiquitous)
- Immediately (news travels fast)
- Permanently (not enough lawyers on the planet to take stuff off the internet)

Transparency will increase because of technological progress, and progress is inevitable. It cannot be avoided, averted, or slowed down. But what makes this particular aspect of technology—that is, transparency—unique is the degree to which it heightens and magnifies people's interconnectedness. We are all social by nature. We like being with others, telling stories, whispering rumors, playing games, laughing, entertaining, and being entertained. We like to share ideas, get feedback, discuss nuances, and sharpen our own thinking with other people's perspectives. We even look to others in order to know what our own true feelings should be. Being social is an essential ingredient of human nature. The term *antisocial* is an indictment, implying that someone is unfriendly, cold, or misanthropic. If you're antisocial, something's wrong with you.

As important as our social nature is, however, social media and other interactive technologies have injected it with steroids. Before our very eyes, we have been transformed into a dynamic and robust network of electronically interconnected people in a worldwide, 24/7 bazaar of creating and sharing, collaborating, publishing, critiquing,

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[20]A 2016 Forrester report showed that 67% of U.S. adults surveyed online trust brand or product recommendations from family and friends, 21% trust emails from companies or brands, 19% trust social media posts from companies or brands, and 14% trust text ads and website ads (Fatemeh Khatibloo with Eric G. Brown, Christopher McClean, Shar VanBoskirk, Kristopher Arcand, Alexander Spiliotes, and Tyler Thurston, "The Mechanics of Trust," Forrester Research, Inc., April 26, 2016, available at www.forrester.com). While most of us remember the Edelman Trust Barometer's famous 2006 finding that "a person like me" was the most trusted source of information (https://www.edelman.com/sites/g/files/aatuss191/files/2018-10/2006-Edelman-Trust-Barometer-Global-Results.pdf, accessed August 31, 2021), more recently the 2021 Edelman Trust Barometer, after the COVID-19 pandemic, has shown that business is now the only trusted institution (compared to government, NGOs, and media), as well as the only institution seen as both competent *and* ethical. It also showed trust in all news sources, including social media, at record lows. Edelman Trust Barometer 2021, available at https://www.edelman.com/trust/2021-trust-barometer, accessed August 31, 2021.

[21]John R. Patterson and Chip R. Bell point out that the average post is read by 45 people, and 62% of customers who hear about a bad experience on social media stop doing business with, or avoid doing business with, the offending company. See Patterson and Bell, *Wired and Dangerous: How Your Customers Have Changed and What to Do About It* (San Francisco, Berrett-Koehler, 2011), p. 50.

helping, learning, entertaining, competing, and having fun. The volume and speed of our interactions with others grow in lockstep with Moore's law,[22] which specifies that computers will get about a thousand times more powerful every 15 to 20 years. But this also means that every 15 to 20 years we will have the potential to interact a thousand times as much with others—by voice, phone, text, email, status update, video, and other means we don't even know about yet.[23] Sometimes, new media do more than just help us keep up with each other. Our appliances order detergent and printer ink when we are running low. Our car's "check engine" light talks to the dealership. And when our Ring doorbell alerts us to a raccoon on the front porch, who is keeping up with whom? The steady march of technological progress brings us steadily better devices, better online tools and platforms, and better mechanisms for managing. What it adds up to is *more* interactions that are faster, cheaper, and more convenient. At this rate we are destined to interact everywhere, all the time, with anyone anywhere.[24]

Think of this new form of higher-level trust as *trustability* As you recall from Chapter 3, *trustability* is proactive trustworthiness. To stay in business, companies will need to demonstrate honesty, transparency, and empathy—all the qualities anyone would associate with a true friend.

DO THINGS RIGHT, DO THE RIGHT THING, AND BE PROACTIVE

On the surface, the two primary components of trust—good intentions and competence—would seem to be two completely different and independent qualities. On the one hand, intention is a state of mind, and since nobody can read minds, the only way to get any indication of someone else's intention is by inferring it from their words and actions. We judge their intent by considering what we would intend ourselves, if we were to speak or act in a similar way.

Competence, on the other hand, is not a state of mind at all but a demonstrable talent or capability. A competent firm executes well, has reliable and disciplined people carrying out its policies, and doesn't make stupid mistakes. Proficiency and competence are directly observable. And they are an important part of the "customer experience"—how it feels to be a company's customer. Delivering a better, more ***frictionless*** customer experience is the reason companies connect their siloed databases in the first place. It's why companies send their people to seminars on mobile best practices, and increase efficiency so they can save customers time and help them find and get what they need without any roadblocks, at a fair price. While competence may seem to be more visible than good intentions, it is still a quality that has to be deliberately built over time. Companies don't just spring into existence fully capable of

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[22] Moore's law is named after Gordon Moore, a cofounder of Intel, who pointed out in 1965 that the number of transistors that could be fit onto a square inch of silicon doubled roughly every two years.

[23] As Professor Robert Wolcott says, "Today is the slowest pace we will experience the rest of our lives." Quoted from the World Marketing Summit, Tokyo, October 13, 2015.

[24] Mark Zuckerberg, founder of Facebook, has asserted that every 15 to 20 years we will interact a thousand times as much with others. This is sometimes referred to as *Zuckerberg's law*.

good service, high-quality production, and customer insight. One of the biggest learnings for many companies, when they begin a listening program to monitor problems involving their brand on Twitter, Facebook, and other social media platforms, is that just trying to identify who within a large corporation has actual responsibility for a problem can often be mind-numbingly difficult. To become competent requires some amount of deliberation and intent on the company's part. Without good intentions, it's doubtful that a firm would actually go to the trouble to build up enough competence to treat customers fairly, or do things right.[25] Or, turning the issue around, suppose you buy from a company that promises it will always respect your interest, but when dealing with their **customer service representatives** you find that they don't understand your problem, they can't answer the phone in less than five minutes, their right hand doesn't know what the left is doing, they can't remember your specifications from last time, or they treat every customer, including you, exactly the same. They screw up a lot, and even though they act nice and *mean* well, it's just too difficult to do business with them. There's so much friction in their customer experience that you can't rely on them. In this situation, you'd have to find yourself asking just how good their intentions could actually be, right? If they *really* intended to protect your interests, wouldn't they have made a little more effort?[26]

Has something like this happened to you? Imagine your streaming entertainment service was on the fritz one evening, and when you contacted the well-known company you got a recorded message saying there had been a disruption in the service, but that it would likely be restored sometime after midnight. The next day, you contacted the provider to be sure your bill that month reflected a credit for the previous day when the service was out. The service rep confirmed that the service had indeed been out in your area, and that your account would be credited, no problem. Out of curiosity, however, you asked the rep whether the company had already planned to give you the credit, since they knew you were one of the hundreds of households that experienced the outage. The rep's answer: "No, we only give refunds to those who call in to ask for them."

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[25]Some companies that have every intention of treating customers fairly still create hassles and waste a customer's time. First, they make a mistake. Then they make you wait on hold when you call, or wait days after you contact them. When they finally answer you, they make it your responsibility to set things up so they can fix the problem they caused. (This is usually where we say, "You want me to bring it in? That will take me about an hour. Since I'm not on your payroll, who will pay my hourly fee to do that work?" Why do companies think their customers' time is worth nothing?)

[26]Here's a great idea: "Becoming human-centric also creates new knowledge flows for the company that may not have existed in the past. For instance, if everyone at your company began receiving daily reports on the top social media opinions expressed about your company, its brands, and its executives, instead of just monthly market share or sales data, wouldn't this transparency profoundly affect decision making across various groups? Wouldn't it provide customer support with insights into how that function could be improved? Wouldn't such knowledge improve the planning, pricing, and promotion of your next product? Wouldn't it give your salespeople new ideas on new segments (think 'tribes') that they should be targeting?" For more on this, see Francois Gossieaux and Ed Moran, *The Hyper-Social Organization: Eclipse Your Competition by Leveraging Social Media* (New York: McGraw-Hill, 2010), Kindle edition, Loc. 1272–1276.

This streaming content provider—not unlike most other subscription-based businesses—is minimizing the cost of issuing refunds, not by denying them to people who are entitled, but simply by requiring people to request them first.

This method for handling refunds is less and less satisfactory to customers, who are used to having their needs met and their problems addressed in a more automated, easier, frictionless fashion. Proactive refunds are likely to become ever more common, as companies try to provide easier and more frictionless customer experiences, and as customers themselves continue to share these more and more frictionless customer experiences with their friends and colleagues.

Basic Principles of 21st-Century Trustability

If a business wants to be trustable, and to succeed in a more transparent, hyperinteractive world, then the company needs to live by these three basic principles:

1. **Do things right.** Be competent. Manage the functions, processes, and details right in order to make it easy for customers to do business with you. And pay attention to the customer's experience, not just the company's financial performance.
2. **Do the right thing.** Ensure that the way your organization makes money aligns with the needs and best interests of your customers. You can't be trustable if you're entirely focused on the short term. Customer relationships link short-term actions to long-term value.
3. **Be proactive.** Knowing that a customer's interest is not being well served but not doing anything about it is untrustable. Not knowing is incompetent.

Source: Adapted from Don Peppers and Martha Rogers, Ph.D., *Extreme Trust: Turning Proactive Honesty and Flawless Execution into Long-Term Profits* (New York: Portfolio/Penguin, 2016).

Ironic, isn't it, that some banks use their customer databases and analytics tools to craft highly sophisticated pictures of their customers' and prospects' value, profitability, and credit risk, and then bombard them with billions of credit card solicitations every year.[27] Why don't more of them do what Royal Bank of Canada (RBC) has done? RBC has used its superior insight to extend automatic overdraft protection (with no fee!) to low-risk customers (that is, *most* customers). That way, the customer gets a break—and so does the bank; instead of having to pay a service rep to handle a call from a reliable customer who demands the fee be rescinded, the bank chooses instead

[27]Bob Bryan, "Credit Card Companies Have Sent Out 3.2 Billion Pieces of Mail This Year, and That's Not Even Close to the Record," *Business Insider*, November 24, 2015, available at https://www.businessinsider.com/credit-card-companies-32-billion-pieces-of-mail-this-year-2015-11, accessed August 18, 2021.

to send a note explaining "this one's on us" and how to avoid overdrafts in the future, reducing RBC's costs in the process. Rather than incurring costs *and* resentment, and then netting no fee anyway, the bank saves the costs, builds goodwill, and *then* nets no fee. During the first 10 years after instituting this approach, RBC increased per-customer profitability by 13%.[28]

Many professional relationships are based on the concept of the trusted agent. Doctors, lawyers, psychologists, and financial planners must learn a lot about a customer before they can make their individualized recommendations; and their sense of professionalism compels them to make these recommendations in the best interests of their customers. This is, in fact, one of the hallmarks of any profession—that the client's interest will be paramount. The truth is, it could be argued that it's in a doctor's interest to keep their patients ill, so the doctor can continue treating and billing them. But true professionals don't act in their own self-interest; they act in the client's interest, as trusted agents.

Trust isn't just "nice"; it's a necessity for all companies wishing to enhance the value of their business. In Chapter 11, we'll look more closely at the cost of distrust and the financial returns of trust. For now, it's enough to know that as Richard Edelman said, "trust is the new brand equity."[29] According to a 2021 Edelman Trust Barometer Special Report, consumers are seven times more likely to buy from brands they trust.[30]

Edelman also found that, as COVID-19 deaths and mandates mounted, buying criteria changed globally. Before COVID-19, buying criteria focused on the customer's image, trendiness, and excitement. But after COVID-19, companies that offered value, customer safety, and care about people became more important.

Ironically, as people around the world lost faith in their governments and media, "business" emerged as the entity most likely to be seen as "more competent" and "more ethical." Although the pendulum always swings to and fro, businesses have the opportunity to build stronger relationships with customers looking for competence plus ethics. Edelman has called trust "the new brand equity." In fact, customers have realized that they would rather "trust" a brand they do business with than "love" the brand.[31]

> Customers have realized they would rather "trust" a brand than "love" a brand.

[28]Peppers and Rogers, *Extreme Trust*.

[29]Richard Edelman, "Trust, the New Brand Equity," Edelman.com, June 23, 2021, available at https://www.edelman.com/trust/2021-brand-trust/brand-equity, accessed August 31, 2021. Also see Blake Landau, "Winning True Customer Loyalty and Trust in a Recession: A Conversation with Expert Shaun Smith," Customer Contact Week Digital (March 23, 2009), available at https://www.customercontactweekdigital.com/customer-experience/interviews/winning-true-customer-loyalty-and-trust-in-a-reces, accessed August 18, 2021.

[30]"2021 Edelman Trust Barometer Special Report: Trust, the New Brand Equity," Edelman, https://www.edelman.com/sites/g/files/aatuss191/files/2021-07/2021_Edelman_Trust%20Barometer_Specl_Report%20Trust_The_New_Brand_Equity_1.pdf, p. 18, accessed October 18, 2021.

[31]Richard Edelman, "Trust, the New Brand Equity," Edelman.com, June 23, 2021, available at https://www.edelman.com/trust/2021-brand-trust/brand-equity, accessed October 30, 2021.

For example, consider the case of First Direct, a division of HSBC Bank. The company was named the United Kingdom's most trusted mortgage provider and most trusted current account provider.[32] First Direct has also been profitable every year since 1995, and, among its new customers, more than one in four come because of a referral.[33]

When General Robert McDermott took the helm at the USAA insurance company in 1968, he turned the stodgy, bureaucratic company into what was to become a virtual icon of great customer service and customer trust. To do so he instituted a large amount of reorganization, retraining, computer technology, and reengineering. In addition, he implemented a single, overriding company policy with respect to customer service, which he called his "Golden Rule of Customer Service." McDermott's policy, to be adhered to by all USAA employees, was: "Treat the customer the way you would want to be treated if you were the customer." And, today, the trusted agent mentality at USAA has earned it one of the most loyal and valuable customer bases in the financial services industry, now in its third generation. Owned today by Victory Capital, USAA remains dedicated to viability through dedication to its members.[34]

Conditions exist today that make it even more competitively important for enterprises to take on a role as trusted agent for their customers. In particular:

- ***Commoditization.*** Traditional marketers have always viewed customers through the lens of "Which product are we trying to sell?" Accordingly, in the old economy, a key driver of value was the "rent" producers of products could extract—derived from restricted information flows, brand "uniqueness," and other high-friction elements. Today, the internet and computer technology have dramatically reduced the friction that used to characterize the exchange of information. As a result, products are becoming more and more like interchangeable commodities, which thereby puts the squeeze on rents.
- ***Needs, not products.*** More relevant—and more rent producing—than specific products are the surrounding services. Customers are not looking for products as much as they are searching for experiences or solutions to problems. Consequently, value propositions are shifting. Value will increasingly be produced based on what companies know about individual customers and what they do to provide customized product/service bundles to meet that customer's needs or to solve that customer's problem.

[32]According to The Institute of Customer Service, "First Direct was the number one company in the UK for delivering high quality customer service" in 2021. First Direct company website, https://www1.firstdirect.com/press-releases/articles/top-brand-for-customer-service/, accessed March 25, 2021.

[33]"About First Direct: Key Facts and Figures," First Direct company website, https://www1.firstdirect.com/press-releases/about-first-direct/, accessed March 25, 2021.

[34]"USAA, Victory Capital Close Deal, Bringing Expanded Mutual Fund Options to Members," USAA, July 2019, available at https://communities.usaa.com/t5/USAA-News/USAA-Victory-Capital-close-deal-bringing-expanded-mutual-fund/ba-p/213287, accessed December 1, 2021.

To foster a trusted relationship, a customer-based enterprise ensures that it always has a customer's interest in mind. It would not hesitate, for instance, to sell a customer a competitor's product rather than send the customer away empty-handed to look for help at the competitor's door. The focus of every twentieth-century business was its product and inventory. In the 21st century, a company's products are, of course, important, but *a company can still exist without any products at all.* Now the company must have customers to thrive. A trusted agent is one that can be relied on to make the customer's interest paramount, to speak on the customer's behalf in all its dealings.

The focus of every twentieth-century business was its product and inventory. In the 21st century, a company's products are, of course, important, *but a company can still exist without any products at all*. Now the company must have customers to thrive.

The Man with the Folding Chair

A sales manager at Siemens AG often carried a folding chair into internal meetings with sales representatives. At first, the other participants in the meeting were puzzled. "Who are you expecting to join us?" someone asked. "Shouldn't we just get some more chairs brought in here?" others suggested.

"No," the manager replied, "This is my customer's chair. I brought it into the meeting so my customer can sit right here and listen to our discussion." The simple presence of the folding chair always changed the character of the meeting. It reminded everyone of the importance of the customers and caused everyone to ask, "What would our customer say?" and "How would our customer react?" It changed the very language and focus of the conversation.

The sales manager eventually became known as "Der Mann mit dem Klappstuhl," or "the man with the folding chair." The lesson he taught was powerful: Never fail to consider the customer's perspective in every decision.

Source: Adapted from Don Peppers & Martha Rogers, Ph.D., *Rules to Break & Laws to Follow: How Your Business Can Beat the Crisis of Short-Termism* (Hoboken, NJ: John Wiley & Sons, 2008), pp. 61–62.

The company with high trustability is confident that, in the long term, its knowledge of a customer's individual needs and preferences can be *monetized* at a higher value and with greater dependability than can a product or service differentiation. Such an organization is betting that customer relationships will give it a refuge from the assault of product and service commoditization. Instead of focusing on the profitability of a single transaction, the trusted agent focuses on the profitability of the long-term relationship with the customer. Wall Street calls it *loyalty equity,* a concept that is virtually synonymous with *customer equity* and ***relationship equity*** (see Chapters 1, 6, 12, and 14).

Relationships, to be effective, must be built on trust, but the problem is that most enterprises view their businesses and their enabling technologies through the "wrong end of the telescope." If an enterprise starts by asking how it can use interactivity, databases, social networking, innovation, and personalization to sell its customers more products, then failure is almost inevitable. This view of the issue is highly self-oriented and simply cannot build a significant level of customer trust. Without trust, customer relationships will not take root, and the company, in the end, will find it impossible to achieve its business goals. The right question to ask, instead, is: How can the enterprise use interactivity, databases, social networking, innovation, and personalization technologies to add value for its customers, by saving them time or money or by creating a better fitting or more appropriate offering?

The right question to ask is: How can the enterprise use interactivity, databases, social networking, innovation, and personalization technologies to add value for its customers, by saving them time or money or by creating a better fitting or more appropriate offering?

Again, what we've been talking about here is basic, old-fashioned trust—absolutely necessary for successful and sustainable relationships built on positive experiences. Now we must examine trust at a more modern and higher level, required by emerging technologies, social media and interconnectivity, and the resulting transparency. This new, higher level of trust—what we have been calling *Extreme Trust,* or *trustability*—means that companies increase financial value because they

- Do things right, and
- Do the right thing,
- Proactively.

RELATIONSHIPS REQUIRE INFORMATION, BUT INFORMATION COMES ONLY WITH TRUST

Customers will ultimately have to decide how much information they are willing to share about themselves with an enterprise. Those who are freer with their information may be able to receive more customized and personal service but will sacrifice a level of privacy. The future of a customer-strategy business world depends on gaining the customer's trust; relationships don't exist without it, partly and specifically because the relationship and the experiences that generate it depend on acting toward a customer in a way that is most relevant and valuable to *that* customer, which depends on the information from *that* specific customer. Furthermore, a customer who is willing to collaborate may have a higher value to a company, but willingness to collaborate will be possible only when a customer trusts a company to use their information fairly. Lose customer trust

> Without trust, customers will not give an enterprise the information it needs in order to serve that customer better.

and everything is lost. If a customer wasn't sure that their insurance company was not sharing their vital information with other companies, would they even think about filling out all those insurance forms? If a customer does not trust their bank, would they give it every single iota of financial information about their business to qualify for a loan? (Businesses give their patronage to more than one bank, so they won't be unduly dependent on any single institution, but some consumers give their business to more than one bank so that no single financial institution will have complete knowledge of their finances.)

Previously, we spoke about **trust platforms** such as Uber and Airbnb. One of the things that makes these companies work so well is a two-way rating system. After each Uber ride, the customer has an easy way to rate the driver, but the driver also rates the customer who just left the car. Smart customers know they shouldn't ride with drivers with low ratings, and they also try to keep their own ratings high by showing up at the meeting point on time, keeping the car clean, and being polite. That way, future drivers caught in high-demand situations will be far more likely to pick up better customers rather than the rude, late ones!

In handling customer information, mistakes sometimes do happen. In these cases, it is critical for the company to take prompt action to minimize the consequence of the error and to maximize the restoration of customer trust. An ***apology*** goes a long way in rebuilding the relationship, especially one that has three characteristics:

1. It must be truly sincere, must forthrightly acknowledge the wrongdoing, and must reiterate the importance that the company places on its trustworthiness.
2. It must accept responsibility for the mistake rather than attempting to make excuses or shift the blame to another party (e.g., the company's database management vendor).
3. It must articulate what the company has learned through the incident and how it is improving its processes and procedures to ensure that the mishap is not repeated.

When these steps are taken, most customers are willing to forgive temporary bouts of incompetence, provided that goodwill is demonstrated.

The late marketing guru Frederick Newell wrote that as marketers develop more and more information about the lives and lifestyles of customers, the privacy issue heats up around the world.

> *Privacy issues will have to be examined from fresh perspectives if we are to continue the delicate balance between the marketer's need for information and the consumer's desire to control that information. The marketing community, so anxious for a continuing flow of customer information, must work to keep the*

balance by sharing more positive stories of customer benefits, to balance the media focus on Big-Brotherism, and the legislators' zeal to "protect us" from ourselves.[35]

> Privacy issues will have to be examined from fresh perspectives if we are to continue the delicate balance between the marketer's need for information and the consumer's desire to control that information.
>
> —Frederick Newell

Once customers feel assured that their data are safe with the company, the next logical step is to make it comfortable for them to share more and more information. It is better to build a customer relationship gradually, one piece at a time, than to flood the relationship with massive requests for data. At every step of the collaboration, enterprises need to concentrate on gathering the information useful to them. To build the necessary trust for customers to share that information, enterprises often need to offer their customers something of value in return. Many offer direct, cash-oriented benefits such as discounts, coupons, or promotions. Not surprisingly, some of the most successful companies working on this kind of information exchange take steps to individualize the offer so that it has greater value to a particular customer.

Customers are also becoming comfortable using automatic personalization tools on the web. Although these tools are fine for customizing websites, they often fall short for nurturing enterprise–customer relationships. The enterprise must work harder to get to know the customer. A customer is more likely to stay loyal if she has taken the time to personalize a website herself *and the enterprise acts on the information given*. One of the primary goals of the enterprise focused on building customer value is to use the information it gathers about a customer to customize some aspect of its product or service to suit the customer's needs. The enterprise should begin to offer the customer things relevant to them, things that the customer could never find anywhere else, not from any generic offering that doesn't have information to use to meet his or her needs better. As a result, the customer will trust the company more. Once the flow of information begins between the customer and the enterprise, it is imperative for the enterprise to enable the customer to feel they control their information. The enterprise should enable the customer to use the information to save time and money and deliver value. All of this will fulfill the customer's expectations of trust and earn their lifetime loyalty, so long as the enterprise is a trustable partner. Using a customer's information to their advantage might involve reminding them when they are going to run out of a product they use regularly, or developing a related product or service they could use.

The irony of the ongoing privacy debate is that, provided the customer is doing business with a legitimate enterprise committed to responsible privacy protection, if the information flow to the enterprise is severed, the ultimate loser will be the consumer

[35]Frederick Newell, *The New Rules of Marketing* (New York: McGraw-Hill Professional Book Group, 1997).

himself. Precise product targeting can dramatically lower marketing costs and, subsequently, product prices. Although some consumers have said that they want customized offerings and other advantages enterprises can give them by tracking their personal data, it is essential to guarantee that the customized benefits will not jeopardize customer privacy. Customers need to know that the company will use their data in a limited way for services agreed upon in advance. Without such trust, customization is not a benefit.

What would it really mean for a business (or a government, or a nonprofit, or a university, or a hospital) to be *proactively trustworthy—or trustable*, rather than merely *trustworthy*? What would it mean to build Learning Relationships based on trust, and to develop customer value by improving customer experiences?

It isn't overly difficult to imagine how trustability would operate in any given business category. We only need to put ourselves in the customer's shoes. To drive it home for real, let's drill down to what it would mean for a particular business. Let's explore what trustability would mean for a mobile telephone carrier.

BEHIND THEIR CUSTOMERS' BACKS

When mobile phone carriers began proliferating in the late 1990s and early 2000s, they were not very proactive about protecting the interests of their customers. Operating before the Apple iPhone and its imitators became available, for instance, Verizon Wireless used to sell many of its smartphones with buttons that could easily result in a customer connecting to the internet unintentionally and generating a $2 data charge each time. After a consumer outcry and an FCC investigation, the company installed a landing page for users accessing the internet—so if you did push the connect button by mistake you could still cancel your connection before incurring a fee. But even after this change, many Verizon users continued to find mysterious data charges on their phone bills. And if a customer "never" used the internet from their mobile phone on account of the cost, how could such a user have incurred two or three internet charges, except by mistake?

> The company seemed to be intentionally charging customers for their mistakes.

According to the *New York Times*, the company seemed to be intentionally charging customers for mistakes. This, at least, was the allegation leveled by one of Verizon's own customer service reps in a communication with one of the newspaper's reporters. Verizon's phones had a feature that allowed users to *block* accidental internet access altogether but, at least according to this employee, the company had instructed them *not* to inform customers about this feature unless the customer specifically asked about it! And the company went to some effort to ensure that refunds were only grudgingly given, if at all, covering a maximum of a single month of erroneous charges.

Even if all these allegations were 100% true, Verizon hadn't actually done anything illegal. After all, you aren't really cheating a customer if you simply charge them what you say you're going to charge them when they themselves use their very own fingers to press a button and make it happen, even if it is a mistake on their part. Nor is it illegal to refrain from telling a customer how to avoid making such mistakes. So why was this employee so upset? Because *even though the company wasn't proactively deceiving customers, it wasn't proactively protecting their interests, either*. In other words, Verizon wasn't being *trustable*, in the sense we are talking about it here. It wasn't behaving in a proactively trustworthy way.[36]

Complexity—whether in pricing plans, product features, or warranty representations—presents a tempting opportunity to take advantage of customers. It might involve allowing customers to incur unintended data charges, or it might be failing to put a customer on the most beneficial or cost-efficient plan for their usage patterns. It might involve failing to warn a customer prior to a penalty kicking in for a late payment. Or it could involve simply failing to give a customer what they are due unless they ask, just like the example where you have to ask before you get a refund from your internet provider for service that went out temporarily.

Consider the many privacy policies and terms-of-service provisions that virtually every online merchant or mobile app now requires. Have you *ever* read *any* of these multipage service agreements from beginning to end? Any hands? Yet virtually all web services and app providers require them, and if you don't click "agree" at the end of the 20-page document full of legalese in fine print, you won't be able to access the service. That's why these agreements are frequently referred to as *click-wrap* because people get wrapped into a legally binding agreement just by clicking, but no one ever takes the time to read them. In one academic study of nearly 50,000 monthly visitors to 90 websites operated by online software companies, the scholars found that "only one or two of every 1,000 retail software shoppers access the license agreement and that most of those who do access it read no more than a small portion."[37] As Shoshanna Zuboff points out in her book *The Age of Surveillance Capitalism: The Fight for a Human Future at the New Frontier of Power*:

> Scholars point out that these digital documents are excessively long and complex in part to discourage users from actually reading the terms, safe in the knowledge that most courts have upheld the legitimacy of click-wrap agreements despite the obvious lack of meaningful consent . . . . Adding insult to injury, terms of service can be altered unilaterally by the firm at any time, without specific user knowledge or consent, and the terms typically implicate other companies (partners, suppliers, marketers, advertising intermediaries, etc.) without stating or accepting responsibility for their terms of service.[38]

[36]See David Pogue, "Is Verizon Wireless Making It Harder to Avoid Charges?" *New York Times*, June 17, 2010, available at https://www.nytimes.com/2010/06/17/technology/personaltech/17pogue-email.html, accessed August 18, 2021.
[37]Yannis Bakos, Florencia Marotta-Wurgler, and David R. Trossen, "Does Anyone Read the Fine Print? Consumer Attention to Standard-Form Contracts," *Journal of Legal Studies* 43, no. 1 (January 2014), available at https://www.journals.uchicago.edu/doi/10.1086/674424, accessed August 18, 2021.
[38]Shoshana Zuboff, *The Age of Surveillance Capitalism: The Fight for a Human Future at the New Frontier of Power* (PublicAffairs, 2019), pp. 48-49.

Moreover, as the **Internet of Things** continues to gain traction, not only will customers' online rights and obligations be governed by these intentionally obscure and cumbersome legal agreements, but people's connected products and devices will, too. As one University of London review found, when reviewing the Nest system of devices covering home security, webcams, thermostats, and other items, each one of which is covered by its own click-wrap agreement, in order to purchase just a single home thermostat a customer would need to review nearly a thousand such contracts![39]

HOW TRUSTABLE COMPANIES OPERATE

A genuinely trustable company will proactively act in its customers' interest, whether it means offering them the most appropriate calling plans based on their usage, or proactively refunding them for faulty or flawed service. Mobile companies in crowded retail markets around the world already do this, as they try to position themselves as more trustable in order to gain a competitive advantage. Vodafone Turkey, for instance, launched a "Customer Bill of Rights" program designed to do exactly that. The company assures its customers that it will always act in their interest, whether that involves proactively assigning a customer to the right calling plan or counseling a customer on how to spend less for messaging and roaming. Other mobile companies (as well as many other subscription-based businesses) have started sending emails or text messages to customers at bill-paying time, just to remind them of the upcoming payment deadline. A friend of ours reports having received one of these proactive service calls from AT&T and said: "Experiencing this was pretty nice. I personally feel that AT&T is looking out for me by doing this. They're building customer trust."[40]

More recently, another friend of ours (who was quite surprised and pleased) forwarded to us a message he had received from Verizon notifying him that he was due a small credit on account of his service having been interrupted briefly during the month. Companies that do this have become proactively trustworthy. Comcast does the same thing now—proactively providing a refund credit for any service outage they know about, even before the subscriber calls to ask for one. Proactive refunds like this, in fact, are becoming the norm for more and more companies. Jeff Bezos almost certainly had a role in beginning this trend. Commenting in his 2013 letter to Amazon shareholders, Bezos said that when customers have to call in to the company on account of some problem or other, the contact center rep they talk to consults Amazon's computer system to verify the customer's story. Yes indeed, the rep might see, the computer says that the Prime Video this customer ordered did in fact stream poorly, so the customer is due a refund, and the rep issues a refund. But, Bezos asked, if the computer already *knows* that a refund is due, why do we make the customer call in at all? And so he instituted a new policy at Amazon of issuing proactive refunds.

Mere trustworthiness, fine until now, will no longer be enough to compete with companies that have figured out how to be genuinely trustable. In Chapter 11, we'll

[39]Ibid., p. 7.
[40]Personal email message.

take this discussion a step further: *How much more would a customer be willing to pay to do business with a mobile carrier they considers to be trustable?*

RECOVERING LOST TRUST

On September 29, 1982, a 12-year-old Chicago-area girl died mysteriously, apparently having been poisoned with cyanide. Later that same day in Chicago a 27-year-old man, his younger brother, and his sister-in-law all died of cyanide poisoning, and within a few more days, cyanide poisoning took three more Chicago residents' lives. Trying to understand the pattern, police found that the only thing connecting these mysterious deaths was that each of the victims had apparently consumed a Tylenol pain reliever capsule just prior to their deaths. Tests quickly revealed cyanide present in the capsules, in bottles that had been tampered with after they had left the factory.[41] Johnson & Johnson immediately recalled all 31 million bottles of its Tylenol-brand pain reliever, across the entire country. In what has become an iconic demonstration of how to recover lost trust, the company didn't stop to weigh the monetary cost of its sudden recall against any likely future loss of life, nor did it hesitate to recall *every* bottle in the country even though the deaths all happened in Chicago. It made this $100 million decision in a matter of moments, with the result that Tylenol's share of the $1.2 billion market for over-the-counter analgesics fell from 37% to 7%.

> The company didn't stop to weigh the monetary cost of its sudden recall against any likely future loss of life.

Fortunately, when it comes to business, most of the crises that threaten to destroy trust do not involve untimely deaths caused by outside bad actors. Sometimes vandalism can come from inside the company, as happened when a couple of rogue employees at Domino's Pizza posted videos of themselves doing disgusting things to customers' pizzas before sending them out for delivery.[42] But cases of vandalism are rare. More often, customer trust will be lost because an enterprise overlooks some important precaution or it reaches clumsily for some business goal, and its own malfeasance becomes headline news.

Because of the many charges, fees, and penalties involved in today's retail banking services, banking is an ideal vehicle for making a profit off of customers when they aren't paying attention, which is one reason why survey after survey rates the financial services industry as one of the least trusted types of businesses by consumers. Wells Fargo was a proud, customer-oriented bank, descended from its 1852 founding by Henry Wells and

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[41]Howard Markel, "How the Tylenol Murders of 1982 Changed the Way We Consume Medication," PBS NewsHour, September 29, 2014, available at https://www.pbs.org/newshour/health/tylenol-murders-1982, accessed December 1, 2021.

[42]Stephanie Clifford, "Video Prank at Domino's Taints Brand," *New York Times*, April 15, 2009, available at https://www.nytimes.com/2009/04/16/business/media/16dominos.html, accessed December 1, 2021.

William G. Fargo, two of the original founders of American Express.[43] But in 2016 its customer-oriented reputation was ruined, in the wake of a massive scandal involving some 2 million fake accounts that customers had been signed up for without their knowledge or approval. The scandal resulted in fines of $185 million as well as an estimated $3 billion in additional penalties from civil and criminal suits, and caused the bank to fire its otherwise highly respected CEO.[44] Apparently, what caused the bank to establish so many new accounts for customers, without customers' knowledge, was a sales incentive program that rewarded employees for multi-account customers and penalized employees whose activities did not generate enough multi-account activity.

The most expeditious way to begin recovering customer trust, when it has been lost for any reason, is to take responsibility and apologize, directly and forcefully. Customers can forgive incompetence and mistakes after a sincere apology, and they are almost always willing to give companies the benefit of the doubt as long as their forbearance is not taken advantage of. But waffling of any sort in an apology—any excuses or explanations provided, or mitigating factors mentioned—will seriously compromise the effectiveness of the apology itself. So it is best never to use the word *but* in an apology. (That's true in real life, too.)

The most expeditious way to begin recovering customer trust, when it has been lost for any reason, is to take responsibility and apologize, directly and forcefully.

Good, ethical behavior in the future is the single most effective way to restore trust after it has been lost. A stated promise of better behavior will accelerate the growth of trust, but genuine actions must follow. And while trust lost through bad behavior or incompetence can generally be restored after a period of good behavior, when trust has been violated with both bad behavior and deceptive statements, it may never fully recover. Incompetence can be forgiven, in other words, but bad intentions indicate bad character—a fatal flaw. This is one of the biggest problems plaguing most large enterprises, because the first officials on the scene of a service disaster are often the PR folks, and no matter how good it is, spin is the opposite of straight talk.

Trustability Proof Points

Since actions speak louder than words in this sort of situation, to accelerate the recovery of lost trust, an enterprise should actively seek out actions designed to make

[43]"Wells Fargo," britannica.com, available at https://www.britannica.com/topic/Wells-Fargo-American-corporation, accessed December 1, 2021.

[44]Brian Tayan, "The Wells Fargo Cross-Selling Scandal," Harvard Law School Forum on Corporate Governance, February 6, 2019, available at https://corpgov.law.harvard.edu/2019/02/06/the-wells-fargo-cross-selling-scandal-2/ , accessed December 1, 2021; and Emily Flitter, "The Price of Wells Fargo's Fake Account Scandal Grows by $3 Billion," *New York Times*, February 21, 2020, available at https://www.nytimes.com/2020/02/21/business/wells-fargo-settlement.html, accessed December 1, 2021.

it clear to customers that it can be trusted to act in their interests. We call these actions proof points of trustability. What sorts of actions would characterize a truly trustable enterprise—an enterprise that is proactively trustworthy when it comes to protecting its customers' interests? Such proof points might include things like reminders that a subscription is about to automatically renew, or objective price and quality comparisons with competitors, or proactive refunds, or hosting customer reviews directly on the enterprise's own website.

After the scandal, this is one of the ways Wells Fargo sought to regain the trust of its own retail customers. On their revised mobile banking app, if an account holder looked at the transactions in their account, they would see the fees assessed against that account for the month. But right next to the charge for monthly fee was an invitation to click through for an explanation of how to avoid having to pay this fee in the future. In Exhibit 4.2, for example, are screenshots that show what an account holder saw as they drilled down by clicking on the invitation "How to avoid the monthly service fee."

This is a perfect example of a proof point at Wells Fargo, demonstrating that customers can trust it to act in their interest, even when it costs the business money to do so (as it would when customers figure out how to pay fewer fees). In the short term, obviously, the bank's profits would be higher if fewer customers knew how to avoid fees. But maximizing short-term profits didn't work out so well for the bank before, while convincing customers that they can trust the bank will pay off well in the long term.

Trust is the currency of all commerce. The single most powerful position in any customer's mind is that of trust. For that reason, earning trust almost always becomes one of the earliest goals in any effort to build a long-term relationship with a customer and to build shareholder value by growing customer equity.

> In our world gone mad, trust is, paradoxically, more important than ever.
>
> —Tom Peters

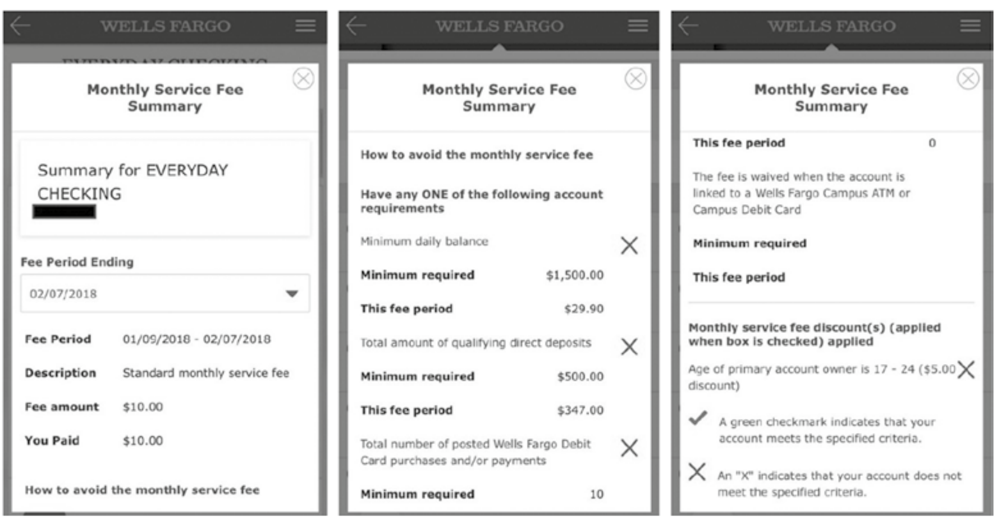

EXHIBIT 4.2 Wells Fargo fee explanation

Trust is the currency of all commerce.

Business expert Tom Peters points out: "In our world gone mad, trust is, paradoxically, more important than ever."[45] Let's face it: In a world of increasingly commodity-like products and services, a relationship founded on trust is the only genuinely sustainable competitive edge. Without trust, you're back to square one: *price competition*. The alternative is to build trusted Learning Relationships with customers, one customer at a time. And the way to do that is IDIC: identify, differentiate, interact, customize.

[45]Tom Peters, at www.tompeters.com.

Part I: Food for Thought

1. Understanding customers is not a new idea. Mass marketers have done it for years. But because they see everyone in a market as being alike—or at least everyone in a niche or a segment as being alike—they "understand" Customer A by asking 1,200 (or so) total strangers in a sample group from A's segment a few questions, then extrapolating the average results to the rest of the segment, including A. This is logical if all customers in a group are viewed as homogeneous. What will a company likely do differently in terms of understanding customers if it is able to see one customer at a time, remember what each customer tells the company, and treat different customers differently?
2. If retention is so much more profitable than acquisition, why have companies persisted for so long in spending more on getting new customers than keeping the ones they have? What would persuade them to change course?
3. How can we account for the upheaval in orientation from focusing on product profitability to focusing on customer profitability? If it's such a good idea, why didn't companies operate from the perspective of building customer value 50 years ago?
4. In the age of information (and connectivity), what will be happening to the four Ps, traditional advertising, and branding? What happens next?
5. Explain what the following statement means and whether or not you agree: "The new interactive technologies are not enough to cement a relationship, because companies need to change their behavior toward a customer and not just their communication."
6. One of the biggest obstacles to becoming more customer-centric for most companies has to do with the way a company measures success. Product-oriented companies measure success in terms of increasing product sales, from one financial period to the next. But customer-oriented companies also focus on keeping customers longer, and increasing their likelihood of purchasing in the future. Sales are easy to measure; just count them at the cash register. But how do we measure an existing customer's loyalty? Or their likelihood of purchasing another product?
7. Customers are the only source of a company's revenue. Why is this true?
8. Think back on your purchasing experiences in the past months. How have some of the organizations you have dealt with caused unnecessary friction? How would you advise them to remove the friction and make it easier to do more business? Think of it this way: Pick some business that you've bought from or dealt with in the past. Any business at all, in any country or city, online or offline. Describe some aspect of that company's customer experience that could have been improved. Keep in mind that this course is about treating different customers differently, so whatever you pick for improvement, it doesn't

have to be something that every single customer would want or need. Whether anyone else would want or need it, you should talk about something that YOU would like to be different, or better, or faster, or more relevant to you, relative to your value to the company. In other words: more reliable, valuable, relevant, or trustable. Of course, keep in mind that the change you'd like should make it possible for you to be a profitable customer.

9. How can Facebook restore lost trust?
10. Based on what we now know about the essence of relationships, is it possible for a customer to have a relationship with a commercial (or other) firm? Is it possible for a customer to have a relationship with a brand? Is it possible for a firm to have a relationship with a customer—especially a customer who is one of millions of customers? If you said no to any of these questions, what conditions would have to be met before a relationship would be possible?
11. James Barnes says an important ingredient to a good relationship is an emotional connection, but customer relationships have elsewhere been referred to as a bond of value or a bond of convenience. What do you think? Do customers have to love a product or company in order to have a relationship with that enterprise? Or is a perceived benefit—especially one that grows from a vested interest—enough? How would you approach a debate on this controversy?
12. Pick a brand that you will always buy. What happened specifically to create this loyalty from you? Is there anything that could dissolve your loyalty or make it even stronger?[46]
13. Imagine you operate a chain of flower shop/garden stores. The products in your stores include fertilizers, weed and bug killers, tools, and other gardening supplies, as well as your own fresh bouquets of flowers and potted plants. Your customers consist primarily of avid gardeners who rely on you for their supplies, but you also have a lot of customers who come in just for your fresh bouquets and potted plants, often asking you to deliver them as gifts to others.

    You want to set up Learning Relationships with as many of your customers as possible, so that they remain loyal to you. In a Learning Relationship, remember, the individual customer interacts to specify a product or service requirement the way they personally want it, and the company then customizes its behavior toward that customer, in some way designed to meet that individual customer's need. In such a relationship, the more any customer teaches a company about how he or she wants to be treated, the more loyal the customer is likely to be, because even if a competitor offers the same level of customization, the customer would first have to re-teach the competitor what it has already taught the original company.

    In 500 words or less, how would you propose setting up Learning Relationships with your various customers?
14. Think about the companies you do business with as a customer. Name an example of a company that identified and recognized you, one that differentiated

[46]This question was suggested by reviewer John Westman.

you by need or value, one that has made interaction easy and/or fun, and one that has changed something about the way it does business with you now, based on what it knows about you.

15. Do you agree or disagree that a relationship must always be characterized by some level of emotional involvement? Why?
16. In the past few years we have seen many examples of the breakdown between company governance and stakeholder interests. Do you think these corporate scandals might have played out differently if the corporations involved had built their businesses on the basis of becoming trusted agents for their customers? Is it really possible for companies to be trusted? What about governments? Political candidates and officeholders? Nonprofit organizations? What is the difference between the ones that are untrustable and those that are trustable?
17. With every interaction your business has with a customer, the customer might end up creating value for your business. A customer might create value simply by buying something right now, and that would be short-term value. Or, because of a customer's good (or bad) experience today, they might change their future intentions, becoming more (or less) likely to buy from you in the future. That would be long-term value.

    Explain why it is so important for marketers to understand the difference between the short-term value and long-term value created by customers, and specifically what this difference means when trying to determine whether the cost of a marketing initiative is justified or not.

PART II

Customer Experience and Relationships: Trust Is the Foundation and IDIC the Building Blocks

CHAPTER 5

IDIC Step 1: Identify Individual Customers

Be yourself; everyone else is already taken.

—Oscar Wilde

It should be intuitively obvious that before an enterprise can ***treat different customers differently***, it must first be able to tell its customers apart, one individual customer from another. To engage in a **mutually interactive** relationship with a customer, an enterprise must be able to **identify** the specific customer on the other end of the relationship. So it makes sense that identifying customers would be the very first step in the IDIC model. Such identification, however, doesn't require having a customer's name or driver's license number so long as the customer can be accurately identified by login credentials, or by mobile phone number, email address, membership number, or in any other reliable manner. To engage in an ongoing, individual relationship, the enterprise must be capable of knowing that *this particular individual* on the website right now is the same individual who came to the website yesterday, or who bought from the store last week, or who returned a product a month ago by mail. That level of identification, or **recognition**, is absolutely critical to treat the customer differently from other customers. In this chapter we address the issue of identification for consumers as well as for business customers, and we define the different elements of this task. We also address loyalty programs in the context of customer identification.

A senior brand executive at a large consumer packaged goods (CPG) company once commented to us that her brand's mission was to improve and strengthen the brand's relationship with its consumers. But, we respectfully replied, consumers do not have relationships with brands, so brands cannot have relationships with consumers. As explained in Chapter 4, a consumer may have affection and loyalty for a brand, or they may have disdain and contempt for it, but they do not have a relationship with a brand for the same reason that a fan of the singer Lady Gaga doesn't have a relationship with her. The fan might have Lady Gaga's pictures framed on the wall, and might go to all of Lady Gaga's concerts in their area, but unless Lady Gaga knows who *this fan* is, and would change her behavior to treat *this one person* differently from her other fans, this affection would not constitute a relationship.

Before technology made it cost efficient to distinguish customers, one from another, enterprises had to rely on **mass-marketing** techniques, providing the *same* messages and the *same* treatments to all the anonymous customers or potential customers in whatever market or segment it was trying to sell to. Populations, audiences, segments, and other collections of people do not engage in relationships, because only a thinking, conscious individual has the capacity to interact individually with another, remembering past interactions, and consciously choosing whether or how to change their own behaviors in response.

All enterprises use information about their customers to make smarter decisions. But for most traditional marketing decisions and actions, information is really needed only at the aggregate, or market, level. That is, any marketer needs to know the *average* demand for a particular product feature within a population of prospective customers, or the range of prices that they will find attractive. The enterprise then uses this information to plan its production and distribution as well as its marketing and sales activities.

But building relationships with customers necessarily involves making decisions based on customer-specific information in addition to information about the aggregate characteristics of the market population. Only then can the enterprise make different marketing, sales, distribution, and production decisions, and take different actions, with respect to different customers, to create better experiences and to increase customer value, even within the same market or niche population. In other words, only then can it *treat different customers differently*.

We can see this in action. A husband asks his wife if she saw the additional stories about gun control suggested on the *New York Times* website that morning. (They had each read the news on their own computers.) His wife answers with a laugh that those were the extra stories offered to *him;* she had seen suggestions for stories about stock market prospects in China. The items advertised were different, too, of course.

INDIVIDUAL INFORMATION REQUIRES CUSTOMER RECOGNITION

In the late 1990s the British utility company Scottish Power launched a December promotion to acknowledge its **most valuable customers** by mailing each of them a holiday greeting card; of those, the very most valuable customers also received a coffee mug. To the astonishment of its management, however, a large percentage of gifts and cards were returned to the company unopened in January. Apparently, many of the firm's "most valuable customers" were actually *lampposts*. Until that time, the company's customer database had been organized by meter readings, and some of these roadside lamppost meters controlled the lighting for 20 or more additional on-all-night lampposts, so they produced high-volume meter readings. But lampposts don't read holiday cards or drink coffee.[1]

[1]This story came to us in May 1999 via Alan Baikie, then a Peppers & Rogers Group consultant, based on his colleague Richard Hornby's conversation with Scottish Power, and it referred to the Christmas holiday in 1998.

The essence of managing customer relationships is *treating different customers differently;* therefore, the first requirement for any enterprise to engage in this type of competition is to distinguish one customer from another. It's not always easy, but it is always necessary.

Some enterprises will find it difficult simply to compile a complete and accurate list of all the uniquely individual customers they serve, though some businesses and industries are more naturally able to identify their customers than others. Consider the differences among these businesses, and consider the advantage that would accrue to a company that's able to identify individual customers and recognize each one at *every contact*:

- *Telecommunications companies* sell many of their services directly to end-user consumers. After all, to bill a customer for their calls and data usage in any given sales period, a phone company's computers must track that customer's calling activities—numbers connected to, time spent in each connection, day of week, and time of day. But even a cell phone company will likely make some sales to prepaid customers whose identities it can't actually learn because they buy their top-up cards in convenience stores or through distributors. Often prepaid customers want to maintain their anonymity on purpose. A telecom firm may also serve a number of corporate customers whose end users are not specifically identified. And some service providers offer friends and family deals that mean one name stands for half a dozen individual customers.
- *Retail banks* must know individual customer identities to keep track of each customer's banking activities and balances. Historically, banks have been organized along lines of business, with credit cards, checking accounts, and home equity loans processed and promoted in completely different divisions. As a result, information about whether a branch-banking customer is also a credit card customer has not always been readily available to either separate division. Unfortunately for banks, the numerous regulatory requirements historically needed to ensure liquidity and honest service in this industry have also provided banking executives with a ready-made excuse for not moving faster into the digital, technology-enabled future. According to George Westerman, a research scientist at the MIT Sloan Initiative on the Digital Economy, "one of the biggest problems the banking industry has is that they are too willing to say, 'the regulators won't let us do that.'"[2] But the notoriously stodgy and often uncoordinated services offered by banks, even in today's age of digital technology and ubiquitous interactivity, has also attracted a whole new coterie of competitors in the form of fintech companies, ranging from Apple Wallet and Google Pay to PayPal, Venmo, and Zest AI. These new services must still comply with applicable regulatory requirements, but they are free from the 200 years' worth of branch banking, physical checks, and 24-hour batch processing. Kabbage, a small business lending app referenced by Westerman, for example, doesn't require a borrower to provide extensive documentation to establish

[2]"How Retail Banks Use Personalization to Compete with Fintech Start-Ups," Treasure Data, April 19, 2021, at https://blog.treasuredata.com/blog/2021/02/23/how-retail-banks-use-personalization-to-compete-with-fintech-start-ups/, accessed May 14, 2021.

creditworthiness, the way a retail bank does. Rather, Kabbage simply asks for access to the borrower's business accounts, analyzes these accounts, and establishes a credit offering—in days, or even hours, rather than in weeks.[3]

- *Consumer packaged goods* companies sell their grocery and personal care products in supermarkets, drugstores, and other retail outlets. Although their true end customers are those who walk into the stores and buy these products, there is no technically simple way for packaged goods companies to learn these individuals' identities or track their buying histories, and the retailers they sell through aren't often inclined to help them, either. However, CPG companies could set up online clubs or they could offer useful online content for consumers, who would then identify themselves to the CPG firm. And that is in fact what such companies are doing. As one authority wrote, "Food companies are launching websites to support cooking and dieting. Cleaning companies are sponsoring organization challenges. Toilet paper companies are developing apps to help busy parents find the nearest bathroom—with user ratings—when they're out with the kids."[4] Moreover, the COVID-19 crisis, with all its stay-at-home orders and social distancing requirements, resulted in a dramatic ramp-up of direct-to-consumer (DTC) offerings by a variety of CPG companies. Unilever, for example, put its Ben & Jerry's ice cream products online, allowing fans to buy it directly (and identifying them individually in the process, of course). AB InBev, the Anheuser-Busch conglomerate, substantially increased its DTC businesses, particularly in Central and South America, and now enjoys direct connections with some 250 million consumers. Colgate launched a new DTC electric toothbrush; Nestle launched a DTC online shop for KitKat chocolate bars; and Ocean Spray began selling a line of water enhancers for dogs, Tally-Ho, using a direct to consumer approach.[5] So while CPG companies certainly don't have it as easy as retail stores or subscription businesses, identifying the individual consumers who buy their products does seem to be getting gradually easier.
- *Insurance companies* can nearly always tell you how many policies they have written, but many still cannot tell you how many customers they have or even how many households or businesses they serve. This is changing, of course, as more and more insurance companies recognize the need to align their offerings with customers' evolving **needs**.[6]

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[3]Ibid.
[4]Liz Alton, "Why CPG Brands Need Content Marketing to Create Lasting Product Demand," Sky Word, March 25, 2019, at https://www.skyword.com/contentstandard/why-cpg-brands-need-content-marketing-to-create-lasting-product-demand/, accessed May 14, 2021.
[5]Tom Treanor, "How CPG Companies Are Using DTC to Stay Competitive," *Forbes,* October 8, 2020, available at https://www.forbes.com/sites/forbescommunicationscouncil/2020/10/08/how-cpg-brands-are-using-dtc-to-stay-competitive/?sh=5474ceec4fca, accessed May 14, 2021.
[6]Bernhard Klein Wassink, "Are Your Insurance Solutions in Tune with New Consumer Needs?" Ernst and Young, February 16, 2021, https://www.ey.com/en_gl/insurance/are-your-insurance-solutions-in-tune-with-new-consumer-needs, accessed June 11, 2021; "2020 Global Insurance Outlook: The Drive for Transformation and Growth," Ernst and Young, pp. 16–17, https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/insurance/insurance-outlook-pdfs/ey-global-insurance-outlook-2020.pdf, accessed June 11, 2021.

- *A computer equipment company* selling systems to other companies in a business-to-business **(B2B)** environment may be able to identify the businesses it is selling to, but it is much more difficult for the firm to identify the *individual* players who actually participate in each organization's decision to buy, and then to repurchase. Yet within any business customer it is these players—decision makers, influencers, specifiers, approvers, contract authorities, purchasing agents, reviewers, end users—with whom the selling company should be developing relationships. Thus, some web-based selling and contact-management tools are now able to help keep this information in a way that's useful to the selling company.[7]
- *Carmakers*, as well as state and local governments, recorded, for decades, the current owner of each registered automobile by the vehicle identification number (VIN), visible through the front window of any car. However, even though the owner of each car can be determined this way, the cars belonging to each owner cannot, never mind whether an automobile is part of a corporate or government fleet, or even a family's garage. More recently, carmakers have created smartphone apps that allow customers to digitally access their owner's manual, dealership service options, and appointment reminders, and control remotely certain aspects of their car, in exchange for their contact information, car make and model, and permission to collect data from their device.[8]
- *Cable, streaming, and other media entertainment companies* often have unknown customer prospects use their websites. They are now faced with the same issue every online company faces: How does the company actively reengage a customer after they leave the site if it doesn't know who they are? Some companies are implementing customer data technology (such as **cookies**, see sidebar) to identify each website visitor, determine whether they are a hot prospect, and send a follow-up email specific to the interests of that individual customer.[9]

Identifying customers, therefore, is not usually very easy, and the degree of difficulty any company faces in identifying its own customers is largely a function of its

[7]"Align Brings Smiles to Millions with Salesforce" (case study), Salesforce company website, https://www.salesforce.com/customer-success-stories/align/, accessed June 11, 2021; Marco Nink and John H. Fleming, "B2B Companies: Do You Know Who Your Customer Is?" online *Gallup Business Journal*, November 11, 2014, available at http://www.gallup.com/businessjournal/179309/b2b-companies-know-customer.aspx, accessed June 11, 2021.

[8]Examples include the MyChevrolet app, Nissan Leaf app, and the My BMW app. See "Which Car Manufacturers Offer Connected Smartphone Apps?" Cartelligent, January 13, 2017, https://cartelligent.com/blog/which-car-manufacturers-offer-connected-smartphone-apps/, accessed June 11, 2021; and Eric Holtzclaw, "How to Collect Personal Data without Angering Your Customers," *Inc.*, August 22, 2013, available at https://www.inc.com/eric-v-holtzclaw/how-to-collect-personal-data-without-angering-your-customers.html, accessed April 18, 2021.

[9]Martha Rogers, Ph.D., Rashmi Vittal, and Tom Hoffman, "How an Omnichannel Consumer Identity Strategy Can Help Connect Marketers with Real People," webinar by 1to1 Media and Neustar, September 24, 2015, available at https://www.home.neustar/resources/webinar/omnichannel-consumer-identity-strategy-webinar, accessed June 11, 2021.

business model and its channel structure. But to engage any of its customers in relationships, an enterprise needs to know these customers' identities. Thus, it must first understand the limitations, make choices, and set priorities with respect to its need to identify individual customers. How many end-customer identities are actually known to the enterprise today? How accurate are these identities? How much duplication and overlap is there in the data? What proportion of all customer identities is known? Are there ways the enterprise could uncover a larger number of customer identities? If so, which customer identities does the enterprise want to access first?

With the explosion in customer touch points, slight variations in a customer's profile can easily result in fragmented data about that customer. Furthermore, the data is constantly in flux. According to Neustar, each year,

- 55 million Americans change phone carriers
- 45 million change phone numbers
- 35 million relocate
- 2.1 million legally change their names

Meanwhile, with rising privacy rules, publicly available information on individuals is declining, and therefore it's harder to use public data to create and maintain a customer's information file.[10]

Step 1: How Much Customer Identification Does a Company Already Have?

To assess more accurately how much customer-identifying information it already has, an enterprise should:

- *Take an inventory of all of the customer data already available in any kind of electronic format.* Customer identification information might be stored in several electronic places, such as the web server, the contact center database, or the cloud storage of the mobile app program.
- *Find customer-identifying information that is on file but not electronically compiled.* Data about customers that has been written down but not electronically recorded should be transferred to a computer database, if it is valuable, so that it will be accessible internally and protected from loss or unnecessary duplication. Compare the security and accessibility for you of your medical data at a doctor's office where there is one paper file versus one that uses online records.

Only after it assesses its current inventory of customer-identifying information should a company launch its own programs for gathering more. Programs designed to

[10]Devon DeBlasio, "How Sharp Is Your Customer Data? Marketers Need to Get Smarter," Neustar, June 29, 2018, https://www.home.neustar/blog/sharp-customer-data-marketers, accessed June 11, 2021.

collect customer-identifying information might include, for instance, the purchase of the data, if it is available, from various third-party database companies; the scheduling of an event to be attended by customers; or a contest, a loyalty program, or some other promotion that encourages customers to raise their hands.

The Real Objective of Loyalty Programs

Loyalty programs are a tactic by which an enterprise rewards its customers with points, discounts, merchandise, or other incentives, in return for the customer patronizing the enterprise on a repeated basis. Such loyalty programs can provide indispensable tools enabling companies to identify and track customers, one customer at a time, across different operating units or divisions, through different channels, and over long periods of time. By providing the customer with an incentive for purchasing that is linked to their previous purchases, the enterprise ensures that they have an interest in identifying themselves to the company and raising their hands whenever they deal with the company. The customer wants the incentive, and in order to get it, they must engage in activity that allows the enterprise to identify them as well as track and link their transactions, over time and across touch points.

Also known as a frequent-shopper or frequent-flyer program, loyalty programs are sometimes referred to as *frequency marketing*. It is not absolutely necessary for a loyalty program to be linked to a customer ID system. Top Value stamps and S&H Green Stamps programs were very popular in the 1950s and 1960s. As a consumer, you might choose to shop at grocery stores or gas stations that gave away Green Stamps. You'd pay your bill and get a receipt and your stamps in exchange. Then you would go home and paste the stamps into the right places on the pages of the little paperback book you had been given. Six books would get you a toaster; 4,300 books would buy a fishing boat. These giveaways were not used to identify customers; they involved no central customer database and maintained no records of individual purchase transactions. Although a trading stamps program is technically a loyalty program (customers are indeed rewarded for the frequency and volume of their purchases), such an unlinked program with no computer database of transaction information is practically useless when it comes to aiding a company in its effort to build customer relationships or improving **customer experience**, beyond the giveaway. It doesn't, in any way, treat different customers differently.

An unlinked program such as a trading stamps promotion simply awards prizes to customers and stops right there, with little or no effort put into changing the company's subsequent behavior or treatment of individual customers to reflect the needs or preferences revealed by the customer's own transactions. The problem is that while awards and prizes can generate **behavioral loyalty**, by themselves they amount to little more than bribes for customer transactions—really just a sophisticated form of price competition. The *faux loyalty* generated will have little impact on customer emotions, attitudes, or intentions, as evidenced by the fact that most consumers are members of several different loyalty programs for competitive firms simultaneously.

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The primary objective of a modern-day loyalty program should be to accumulate customer information by encouraging purchasers to identify themselves. For some companies—particularly those firms that find it difficult to identify and track customers who nevertheless engage in frequent or repeated transactions—loyalty programs can perform a vital part of the identification task, allowing a firm to link the interactions and transactions of a single customer from one event to the next. Frequent-shopper programs launched by grocery chains and other retail operators are excellent examples of this kind of loyalty program.

Thus the more effective loyalty program is one that *uses the information provided by a customer's rewarded behavior* to fashion more relevant, personalized, or satisfying services or offers for that individual customer, thereby earning more and more of the customer's **emotional loyalty** as well. In this kind of program, the discounts and prizes given to customers are, in effect, incentives to ensure that the company can accurately track customer transactions and interactions over time, allowing it to compile a useful profile of customer needs and to tailor future offers and experiences for that customer.

In other words, most organizations skip a key step. They base loyalty rewards on how much you buy, and that's all. Effective programs use the information about a customer generated by the process of collecting and consolidating data to serve that customer better. The reward is the excuse the customer has to give the company information, and the information is how the company builds true loyalty.

There is an important implication here with respect to how a program creates value for the enterprise. If goods and services are simply discounted with points or prizes, and that's the entire program, then it is a *parity strategy*. Once competitors match the points or the rewards, the only thing the sponsoring company will end up with is reduced profit margins. But if the points are given in exchange for shopping basket data or other information about a customer that can be used to deepen the relationship, then the information derived is an investment that can generate profits as the company uses the data to build a more loyal relationship with a customer.

As a matter of practice, many companies implement such programs with the sole intention of rewarding customers for giving them more of their patronage. The risk to the enterprise of doing this is that if the frequency program is a success, competitors will eventually offer customers the same or similar rewards structures for buying from them. Over time, the program will be reduced to nothing more than a sophisticated form of price competition, as in fact did happen to the S&H Green Stamps program when other stamp programs were introduced and consumers simply kept various stamps at home in separate cigar boxes.

To a customer, the incentive itself (e.g., free miles, free goods, prizes, discounts, upgrades, etc.) will often be the most immediate motive for participating. Then it is up to the enterprise to use the information to *treat each customer differently*. Airline frequent-flyer programs tier their customers into different levels—platinum, gold, silver, and so forth—and then provide special **benefits** to the highest tiers, from priority check-in lines to occasional upgrades. It is the information about an

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individual customer's ongoing purchases and needs that enables the enterprise to tailor its behavior or **customize** its product or service for that particular customer. The greater the level of customization, the more loyal customers can become.

It is not always so easy to figure out how to treat different customers differently, however, even when they can be individually identified and tracked. A grocery store's loyalty program can return a rich detail of information about the individual shopping habits of the store's customers, but what should the store then do with this information? Literally, of course, the store can't rearrange the merchandise to meet the needs of any particular customer entering the store. Nevertheless, it should be possible to use the information about the mix of products consumed by a single customer in such a way as to make highly customized offers to that customer, either by postal mail or through interactive technologies. Tesco, a United Kingdom–based supermarket chain, was one of the first to create a highly successful loyalty program that illustrates exactly what it means to make different offers to different customers (see also Chapter 10).

The largest grocery retailer in the United Kingdom, Tesco was the first major company to use a combination of technology and relationship strategy to execute a true loyalty program. Beginning in 1994, the Tesco Clubcard program used the information generated by its Clubcard membership to tailor each of its mailing pieces to each of its millions of Clubcard member households individually, through **mass-customized** printing capabilities.[a] Each mailing piece included personally relevant offers for its addressee and represented incremental income for Tesco, based on an estimated 25% response rate. If your pet was a cat, for instance, you did not get dog food offers.

During its relaunch in May 2009, Tesco's Clubcard loyalty program boasted 16 million active card holders in the United Kingdom,[b] and its members' purchases accounted for about 80% of all Tesco's in-store transactions at the time.

After implementing Clubcard, in-store product **turnover** increased more than 51% behind a mere 15% increase in floor space. The company credited its success with the fact that it was engaged in "rifle-shot" marketing to its customer base rather than the more traditional scattershot approach of the mass merchant. The Clubcard program allowed Tesco to link product information with each individual customer's past purchases. For example, based on its individual customer data, Tesco could send a Clubcard member a personalized letter with coupons aimed squarely at that particular customer's own shopping needs. This program generated an astonishingly *high* redemption rate of some 90%! Tesco **differentiated** more than 5,000 different needs segments among its customers and used that insight to send out highly customized offers. All members also received a mass-customized quarterly magazine.

Tesco originally defined eight primary life-state customer groups, with each edition's editorial content specifically written for its target group. Counting the multiplicity of third-party advertisements, Tesco's magazines were printed and distributed in literally hundreds of thousands of combinations.

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Now of course, web-based grocery delivery services such as Instacart, Amazon Fresh, and Shipt make it easier and easier for a regular customer to reorder online. In every individual case, the company remembers much of what works for the customer and is able to tailor suggestions to one customer at a time, going far beyond points rewards programs. In fact, these programs can now build loyalty without the giveaways. Amazon and other brick and/or click stores' most loyal and valuable customers pay the store for annual membership. Many enterprises have continued to develop this type of loyalty program with great success. A more recent approach is to enmesh the loyalty program in an improved customer experience, as Starbucks has done. In 2011, Starbucks was the first national retailer to incorporate mobile payment technology into its loyalty program—and in 2013 the program generated over 3 million transactions per week just in the United States.[c]

Starbucks then combined its loyalty program with a mobile app that has allowed ordering and payment from a mobile phone and pickup without waiting in line. Each purchase is automatically recorded in their loyalty program. The customer benefits from time saved, ease of purchase, and rewards points (toward a free item), while Starbucks benefits from information, including data about each customer's device and its usage, and customer's physical location. The company also, with customers' permission, gathers information about customers from other sources like **social media**. The company can then get a fuller picture of each customer's complete Starbucks experience and improve it in a way that works for both the company and the customer.[d]

Because the cost of the technology that manages loyalty programs has continued to decline, smaller and smaller companies are able to build deep relationships with customers, profitably, even if it's only a few customers and not millions. Zane's Cycles, based in Branford, Connecticut, began building relationships with customers by offering free annual basic bicycle maintenance in exchange for contact and user-preference information, which owner and president Chris Zane used to win a greater share of each cyclist's business. (See Chapter 13.)

Some enterprises charge customers a membership fee to belong to a loyalty program. Car rental companies, for example, have in the past had programs that charge customers a separate membership fee to guarantee preferential treatment at airports; these programs tracked the customer's individual transactions as well. Customers who are willing to invest money in a continuing **Learning Relationship** with an enterprise become committed to the **collaborative** solution of a problem. And any enterprise that collaborates with its customers is more likely to be able to ask the types of questions needed to achieve a higher share of a customer's business. It is easier for the enterprise to ask questions of a customer who has agreed to enter a relationship.

The bottom line on loyalty programs is this: Don't skip a step. Remember that most loyalty programs *are just a "me, too" way of reducing profit margin*. Once all the major players in a space offer one, it's just a bribe for doing business this time

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with a particular restaurant, store, airline, or product consumable. In contrast, the best-practice loyalty programs are the ones that offer a reward in exchange for ongoing customer information (e.g., shopping basket data, or preferred services and routes) and then *use that information* to serve a customer better than any other company can that does not have the information. That's how companies use loyalty programs correctly, by utilizing the data they collect to create the individual customer experience that generates customer loyalty.

[a]See Tesco PLC, available at https://www.tescoplc.com/ accessed June 11, 2021, for updated corporate information.
[b]"Tesco Clubcard Signs Up One Million Customers Since Relaunch," *Marketing Magazine,* https://www.campaignlive.co.uk/article/tesco-clubcard-signs-one-million-customers-relaunch/943397?src_site=marketingmagazine, accessed August 17, 2021.
[c]Jim Tierney, "Loyalty Program Triggers Starbucks' Record Q2," Loyalty360 Daily News, April 26, 2013, https://loyalty360.org/content-gallery/daily-news/loyalty-program-triggers-starbucks-record-q2, accessed August 17, 2021.
[d]See Starbucks' privacy policy for loyalty program at https://www.starbucks.com/terms/privacy-policy accessed April 18, 2021.

Step 2: Get Customers to Identify Themselves, and Make Sure to Identify Customers Accurately Through Any Channel

Sales contests and sponsored events are often designed for the specific purpose of gathering potential and established customer names and addresses. But to engage a customer in a genuine relationship, a company must also be able to *link* the customer to their own specific purchase and service transaction behavior. Analyzing past behavior is probably the single most useful method for modeling a customer's future value, as we'll see in Chapter 6, on customer value differentiation, and Chapter 12, on analytics. So although a onetime contest or promotion might help a company identify customers it did not previously know, linking the customer's identity to their actual transactions, and being able to recognize them at every touchpoint in the relationship is also important.

Loyalty programs, when they are executed strategically, suit both purposes, providing not only a mechanism to identify customers, but also a means to link customers, over time, with the specific transactions they undertake. Such programs have been used for years to strengthen relationships with individual customers, but it's important to recognize that a loyalty program is a tactic, not a strategy. It is an important enabling step for a broader relationship strategy because a loyalty program provides a company with a mechanism for identifying and tracking customers individually, but this will lead to a genuine relationship-management strategy only when the company actually uses the information it gets in this way to design different treatments for different customers.

WHAT DOES *IDENTIFY* MEAN?

Given that the purpose of identifying individual customers is to facilitate the development of relationships with them individually, we are using the word *identify* in its broadest possible form. What we are really saying is that an enterprise must undertake all of these identification activities:

Identification Activities

- *Define*. Decide what information will comprise each actual customer's identity: Is it a username, email address, mobile phone number, mobile app identity, account number? And how about for a business customer, would it be business name? End-user name? Contract number? Shipping address? Frequently used social media password?
- *Link*. Once a customer's identity is established, it must be used to link the customer to all their transactions and interactions with enterprise, at all points of contact, among all different operating units and divisions, across all product lines, and through time. It's certainly beneficial, for instance, to identify and greet a customer by name when they are personally recognized in a store, but a loyalty program or mobile app can be employed to link that shopper's identity to all their purchases, transactions, and interactions with the enterprise, in such a way that the enterprise knows it is the same shopper, every time. The goal is to see each customer as one complete customer, and not as a series of independent events, people, or contacts.
- *Integrate*. The customer's identity must not only be linked to all interactions and transactions; it must also be integrated into the information systems the enterprise uses to run its business. Frequent-flyer identities need to be integrated into the flight reservations data system. When a media company's cable television customer is also a mobile phone customer, the customer's identity should be integrated into the company's systems so that each division knows it is dealing with the same customer. When a customer spends time on an enterprise's website but then immediately makes a call to the contact center, if the agent answering the customer's call doesn't already know who the customer is and what they were just trying to do on the website, this represents is a technological failure on the enterprise's part in not integrating the customer's identity from the website to the contact center. (See the sidebar "Four Ways to Integrate the Online and Contact-Center Experience.")
- *Recognize*. The customer who returns to a different part of the organization needs to be recognized as the same customer, not a different one. In other words, the customer who visits the website today, goes into the store or the bank branch tomorrow, and calls the toll-free number next week needs to be recognized as the same customer, not three separate events or visitors.
- *Store*. Identifying information about individual customers must be linked, stored, and maintained in one or several electronic databases.
- *Update*. All customer data, including customer-identifying data, is subject to change and must be regularly verified, updated, improved, or revised.

- *Analyze*. Customer identities must serve as the key inputs for analyzing individual customer differences (see Chapter 12).
- *Make available*. The data on customer identities maintained in an enterprise's databases must be made available to the people and functions within the enterprise that need access to it. Especially in a service organization, making individual customer-identifying information available to frontline service personnel is critical. Computers help enterprises codify, aggregate, filter, and sort customer information for their own and their customers' benefit. Storing customer identification information in an accessible format is critical to the success of a customer-centered enterprise.
- *Secure and protect*. Because individual customer identities are both competitively sensitive and threatening to individual customer privacy, it is critical to secure this information to prevent its unauthorized use.

Four Ways to Integrate the Online and Contact-Center Experience

In the United States, more than half of inbound **customer service** calls today are preceded by an online session of some kind. And everyone has had the experience of going onto a company's website to try to get something done, not being able to figure it out, and then calling in. Then, when we do get someone on the phone, chances are they will have no idea what we just spent the last 15 or 30 minutes trying to do on the company's site. There are four simple, straightforward technologies (and we'll all keep an eye out for more) that can eradicate this problem, so that a customer's identity online can be integrated into identity when they call in:

1. **Proactive chat.** An easy way to give an online customer some human-to-human assistance while they're on a company's website is to open a chat window proactively, at the appropriate time. It has to be done carefully, because customers will likely be annoyed or simply tune out if they get a pop-up invitation to chat right out of the blue. The right kind of chat invitation is one based on a tested algorithm that considers factors such as how long a visitor has already been on the site, what pages they've viewed or re-viewed, and whether they've searched for particular terms unsuccessfully (i.e., null search results).
2. **Click-to-call.** An increasing number of online interactions take place on customers' own smartphones via a company's mobile app. If the customer must still call in to resolve something or to fix some problem, they shouldn't be required to make a separate phone call, but rather they should be able to click a button within the app that will generate a phone call, which will automatically integrate the caller's online identity with their call center identity.
3. **The "Call Me" button.** On many websites, if a customer can't figure things out, rather than just calling the toll-free number, they can click on a "Call Me" button, enter their phone number, and in a few seconds (or

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whenever they specify), someone from Amazon's contact center will call them. And of course this means that the rep who calls will already know exactly what the customer was doing on the website when they clicked the button, and they'll also happen to be skilled in handling that particular issue.

4. **The temporal phone number.** This is a mechanism for splitting the difference between proactive chat and a "Call Me" button. When a customer or prospect is on the website and wants to call in, they click the "Contact Us" button, and what pops up is a toll-free number that is actually a unique, one-time-use phone number just for them. It will only be valid for a few hours, and when they call that number the call center's technology can then know what web session the call is from, and so the company can integrate the caller's identity with the online customer's identity.

Technology is enabling enterprises to identify customers in ways never before imagined. Many businesspeople still hand out business cards, but computer contact databases and sophisticated customer information cloud-based **data warehousing** are far more important than physical cards for the same reason that public libraries long ago abandoned their card catalog systems: because card catalog systems cost much more than their electronic counterparts and are available for search only in the physical library building. Sophisticated electronic data systems allow library patrons to search a library's holdings from anywhere and help the library cut its own costs at the same time.

Integrated computer databases don't just reduce costs. More important, they also help identify patterns that aren't visible when the data is kept in filing systems or in separate data silos. The more the company integrates data from all corners of the enterprise, even including the extended enterprise, the richer in value the customer information becomes in planning and executing **customer-focused** strategies.

The end customer of an enterprise is the one who consumes the product or service it provides. That said, sometimes it is more of an indirect relationship, which makes it more difficult to tag the customer and link information to them. Sometimes, a product or service might be purchased by one customer and used by another member of the household or by the recipient of a gift. And as we discuss later, sometimes an end user will be an employee of a company while it is the company's purchasing department that actually buys the product. Regardless of these intermediary relationships, however, it is ultimately the end user who is at the top of the food chain and the end user whose relationship with the enterprise is most important, because this is the person whose needs will or won't be met by the product.

Customer Identification in a B2B Setting

A business-to-business (B2B) enterprise must identify customers just as much as business-to-consumer **(B2C)** enterprises, and many of the issues are the same, but there are some important differences that merit additional consideration. For instance, when selling to business customers, the B2B enterprise must consider who will be on the other side of the relationship. Will it be the purchasing manager or the executive who signs the purchase order? Will it be the financial vice president who approved the contract? Or will it be the production supervisor or line engineer who actually uses the product? The correct way for an enterprise to approach a B2B scenario is to think of each of these individuals as a part of the customer base. Each is important in his or her own way, and each one should be identified and tracked. The greatest challenge for many businesses that sell to other businesses is identifying the product's end users. Discovering who, within the corporate customer's organization, puts a product to work (i.e., who depends on the product to do her job) is often quite difficult. Some methods for identifying end users include:[11]

- If the product consumes any replenishable supplies (e.g., inks, drill bits, recording paper, chemicals), providing a convenient method for reordering these supplies is an obvious service for end users.
- If the product is complicated to use, requiring a detailed online instruction manual or perhaps different sets of application notes or even training, one way to secure end-user identities is to offer such instructions in a simplified format, tailored to all devices.
- If the product needs periodic maintenance or calibration or regular service for any reason, the enterprise can use these occasions to identify end users.

The single most important method for identifying the relationships within relationships at a business customer is to provide a service or a benefit that can only really be fully realized when the players themselves reveal their identities and participate actively in the relationship.

Customer Identification in a B2C Setting: Unify Omnichannel Marketing Programs

Can we identify—and recognize again and again—*millions* of customers? (See "Omnichannel: Myth versus Reality" in Chapter 8.) In the business-to-consumer (B2C) space, the technology-driven **customer relationship management (CRM)** movement has made it possible to conceive of the possibility of managing individual consumer relationships. But while managing relationships within the B2C space might be a relatively new idea, mass marketers have always understood that customer information is critical and that the possible ways of identifying customers are nearly limitless.

Certain technologies have made it possible to identify customers without their active involvement. Customers of ExxonMobil, the gasoline retailer, can download a mobile app

[11]Nink and Fleming, "B2B Companies"; Don Peppers, Martha Rogers, Ph.D., and Bob Dorf, *The One to One Fieldbook: The Complete Toolkit for Implementing a 1to1 Marketing Program* (New York: Doubleday, 1999).

that automatically identifies the customer at the pump, charges the customer's preferred method of payment for the transaction, and applies reward points for both fuel and convenience store purchases. The customer is identified with every transaction.

Of course, few would deny that the internet gave the biggest push to the customer relationship movement in the B2C arena. Not only did the World Wide Web provide tools to existing firms with which they could interact more effectively with their customers and identify an increasing number of them individually, but it also led to the creation of many new, internet-based businesses with extremely streamlined business models based on direct, one-to-one relationships with individual customers, online.

> The computer has brought about "three awesome powers": the power to *record*, the power to *find*, and the power to *compare*.
>
> —*Stan Rapp*

CUSTOMER DATA REVOLUTION

From its inception in the 1990s, Amazon has been less about finding customers for products and more about finding products for customers—millions of them. Clearly, in the **Information Age**, an enterprise can reach and communicate with individual customers one at a time, it can observe as customers talk to each other about the company, and it can follow strategies for its customer interactions that are based on relevant, customer-specific information stored in a customer database. The computer can now store millions of customer records—not just names and addresses, but age, gender, marital status and family configuration, buying habits, history, devices, and demographic and psychographic profiles. Individuals can be selected from this database by one, two, three, or more of their identifying characteristics. CRM expert Stan Rapp has said that the computer has brought about "three awesome powers": the power to *record*, the power to *find*, and the power to *compare*.[12]

For all its power, however, the truth is that when it comes to customer-oriented activities, the computer is an underutilized technology at most businesses—not because companies don't want to use it but because most customer data are simply not fit for use in an analytical database. The development of a database of customer information requires a **data model**—the tool required to bring data complexities under control. The data model defines the structure of the database and lays out a map for how information about customers will be organized and deployed.

What Data Do We Need When We Identify a Customer?

After it has mined its existing customer databases and developed a plan to gather new customer information, the enterprise then decides how to tag its customers' individual identities. Names are not always a sufficient customer identifier. More than one

[12]Stan Rapp, *The Great Marketing Turnaround* (Upper Saddle River, NJ: Prentice Hall, 1990).

customer might have the same name, or a customer might use several different varieties of the same name—middle initial, nickname, maiden name, and so forth. To use a customer database effectively, therefore, it is usually necessary to assign unique and reliable customer numbers or identifiers to each individual customer record. It could be the customer's email address, mobile phone number, a user name selected by the customer, or an internally generated identifier.

In addition to transaction details, other types of data generated from internal operations can make significant **contributions**. Information relating to billing and account status, customer service interactions, back orders, product shipment, product returns, claims history, and internal operating costs can all significantly affect an enterprise's understanding of its customers. Directly supplied data consists of data obtained directly from customers, prospects, or suspects. It is usually captured from lead-generation questionnaires, customer surveys, warranty registrations, customer service interactions, website responses, or other direct interactions with individuals.

Directly supplied data consists of three obvious types:

1. ***Behavioral data***, such as purchase and buying habits, clickstream data gleaned from the way a website visitor clicks through the firm's website, interactions with the company, chosen communication channels, language used, product consumption, and company share of wallet.
2. ***Attitudinal data***, reflecting attitudes about products, such as satisfaction levels, perceived competitive positioning, desired features, and unmet needs as well as lifestyles, brand preferences, social and personal values, opinions, and the like.
3. ***Descriptive data***, sometimes still referred to as demographic data includes details such as age, income, education level, marital status, household composition, gender, home ownership, livelihood, and so on (but see Chapter 7 about the limitations of understanding that come from demographic data.).

In categorizing data contained in a customer database, it's important to recognize that some data—*stable data,* such as birth date or gender—will need to be gathered only once. Once verified for accuracy, these data can survive in a database over long periods and many programs. Updates of stable data should be undertaken to correct errors, but, except for errors, stable data won't need much alteration. In contrast, there are other data—*adaptive data,* such as a person's intended purchases or even her feelings about a particular political candidate—that will need constant updating and cleansing. This is not a binary classification, of course. In reality, some data are *relatively* more stable or adaptive than other data. Part of the challenge comes from the fact that customers relate at different times to different parts of the organization: website (online marketing), bill paying (accounting), in-house (e.g., store management).

Why Is Identification Important?

Ultimately, of course, the central purpose of collecting customer information is to enable the development of closer, more profitable relationships with individual customers by creating consistently better experiences for each of them. In many cases, these relationships will be facilitated by the availability to the enterprise of information that will make the customer's next transaction simpler, faster, or cheaper. Remembering a customer's logistical information, for instance, will make reordering easier for them and therefore more likely. Remembering this type of information will also lead the customer to believe they are important to the company and that their patronage is valued.

Additionally, it's important to identify customers to reduce the waste in serving them. For example, one data cleansing company helped a Fortune 500 consumer electronics firm match unidentified callers in real time with existing customer data, including additional data that could be appended to the current interaction. Their efforts enabled 54% of unidentified callers to be identified in real time, saving $13.8 million in additional data work, and increasing customer satisfaction through better experiences.[13] Some companies are also now able to identify callers in the first few seconds of a call through voice or speech recognition.

In order to make any of this work, however, it is essential for the enterprise to establish a trusting relationship with each customer so each one will feel free to share information. A vocal privacy-protection movement—perhaps more active in Europe than in North America—has been energized by the increasingly important role individual information plays in ordinary commerce. In many instances, this is perceived as posing a threat to individual privacy. However, both practical experience and a number of academic studies have shown that the vast majority of consumers are not at all reluctant to share their individual information when there is a clear value proposition for doing so and when they trust the company. Therefore, if a company can demonstrate to the customer that individual information will be used to deliver tangible benefits (and provided the customer trusts the enterprise to hold the information reasonably confidential beyond that), then the customer is usually more than willing to allow use of the information. Trusting relationships or not, protecting customer privacy and ensuring the safety and security of customer-specific information are critical issues in the implementation of customer strategies and will be discussed in greater detail in Chapter 9.

First-Party, Second-Party, and Third-Party Data

In the always-connected online world, marketers have come to identify three different types of customer data based on how the data were obtained.

- ***First-party data*** is data that an enterprise obtains for itself about its own customers and prospects, based on their direct interactions with the company's website or mobile app, or at the contact center, or even at a retail location. For example, a car dealer gains first-party data when it tracks the activity of customers or prospects as they shop for cars on its own website. Such data can allow the dealer to show one customer more designs for the newest model,

[13]Rogers, Vittal, and Hoffman, "Omnichannel Identities."

while showing a different customer more options for slightly used cars. Similarly, they can provide views of sports cars to one person, and large sedans or vans to another, based on the customers' previous viewing habits on the website.

- ***Second-party data*** is another enterprise's first-party data. If the car dealership agrees to sell its first-party data to an insurance broker to so the broker can contact prospective car buyers about car insurance, the insurance broker would be using second-party data.
- ***Third-party data*** is usually collected in large volumes by specialized data harvesters who sell it to other businesses that might be interested in using it to discover potential new customers, or to enhance their own first-party and second-party data. Third-party data can be generated by fielding a massive number of consumer surveys and making inferences about customers based on their demographic, psychographic, or other profiles (as is done by Acxiom and Nielsen), or it can come from a company that pays to put third-party cookies on publishers' and social media companies' websites to track customer interactions (as is done by Lotame or OnAudience).[14]

Cookies and Privacy

When computer users navigate to a website, the computer server that hosts the site is able to track what an individual user has viewed or clicked on by using something called a cookie. A cookie is a small block of data, created by the computer server hosting a website that a user is viewing, and inserted by the server into the user's own computer browser. This block of data allows the server to recognize the user's browser so that the website itself can track the user's journey on the site, from page to page, over time. More than one cookie is often placed on a user's device during a session. Without cookies, a user would have to log in again every time they navigated from one page to another at a website, and the site would not be able to remember the products a user puts in their shopping cart. The site's owner would also be unable to prove to an advertiser that a user actually saw the banner ad they were paying for.

Cookies are what allow website owners to tailor their messages and offers to meet the different preferences and specifications of different users, but they can also be used to permit advertisers and others to track a user's journey through different websites following a session—over days, weeks, or months of future browsing behavior. If Company X hosts a website, it uses cookies to track its users' sessions,

[14]"How to Choose a 3rd-party Data Provider (Top Audience Data Providers in 2020)," OnAudience, available at https://www.onaudience.com/resources/third-party-data-providers/, accessed May 20, 2021, and "1st Party Data, 2nd Party Data, 3rd Party Data: What Does It All Mean?, Loatme, August 19, 2019, available at https://www.lotame.com/1st-party-2nd-party-3rd-party-data-what-does-it-all-mean/, accessed May 20, 2021. Note that Google will no longer allow use of third-party cookies as of 2022.

(*continued*)

and it will store a record of them in its own system. But if Company X sold Company Y the right to put up a banner ad on its website, then Company Y could also put its own cookie on the user's computer when the user views or clicks on their banner ad. When a cookie's domain name matches the website that placed it (owned by Company X), it's called a first-party cookie, and its use is tied directly to the website that placed the cookie. However, when the cookie is placed by someone else (say, the advertiser Company Y), that cookie's domain name is different from the host website, and it's called a third-party cookie. Because of increasing privacy concerns, many companies are phasing out the use of third-party cookies. The Safari and Firefox web browsers disallowed them in 2013, and Google has announced that its Chrome and Chrome for Android browsers, which are responsible for more than half of global web traffic, are scheduling 2023 as the end of allowing third-party cookies, [a] We talk more about privacy in Chapter 9.

[a] Emma Woollocott, "Google To Keep Third-Party Cookies a While Longer," *Forbes*, June 24, 2021, available at https://www.forbes.com/sites/emmawoollacott/2021/06/24/google-to-keep-third-party-cookies-a-while-longer/?sh=7bac1527453d, accessed July 5, 2021.

Integrating Data to Identify Customers

The process of identifying customers in order to engage them in relationships requires that relevant information be integrated into many different aspects of an enterprise's business activities. It used to be that customer data could be collected over a period of time, and the customer database could be updated with revised profile and analytic information in batches. On weekends, perhaps, or late at night, information collected since the last update should be used to update the customer database. Increasingly, however, companies rely on websites and call centers to interact with customers, and this places a much greater emphasis on ensuring real-time access to customer-identifying information.

Enterprises must be able to capture customer information and organize it, aggregate it, integrate it, and disseminate it to any individual or group, throughout the enterprise, in real time, and as technology continues to improve, it is enabling enterprises to accelerate the flow of customer information at the most strategically timed moment. As real-time interactivity continues to permeate all aspects of consumers' lives, we can expect them to demand more and more real-time service, which means enterprises will need real-time access to customer data.

In any service context, it is critical that an enterprise's customer-facing people have ready access to customer-identifying data as well as to the records attached to particular customer identities. Making valuable customer information available to frontline, customer-facing employees, whether they work on board a passenger airliner, behind the counter at a retail bank branch, or at the call center for an automobile manufacturer, is an increasingly important task at all B2C enterprises.

In the information technology world, customer identifying data would be called *master data*, which Gartner defines as "the consistent and uniform set of identifiers and extended **attributes** that describes the core entities of the enterprise including customers, prospects, citizens, suppliers, sites, hierarchies and chart of accounts."[15]

The identities of customers play a critical role in many customer-facing functions at an enterprise, including marketing and advertising, sales and sales enablement, customer service, and **customer care**. All these functions can be streamlined or automated with some application or another, and because of this, many enterprises have a considerable number of these different applications installed, such as CRM platforms, **sales force automation** applications, digital marketing programs, marketing automation platforms, customer success or customer support applications, and customer care platforms. But *customer data* is the master data that must enable each and every such application to function, and if the enterprise wants these various applications to be able to work together, then the functions have to be using the *same* identifying information for customers. If data about the most promising individual customer leads are to be successfully passed from the marketing automation platform to the sales enablement function, for instance, then both of these applications must agree on how to identify a customer.

In an increasingly automated world, the modern enterprise contains a network of marketing and sales applications and, as with most networks, it increases in value according to the network effect described in ***Metcalfe's Law***: the value of a network increases in proportion to the square of the number of members connected in the network (see Chapter 9).[16] For this reason, many enterprises with multiple customer-facing applications rely on a ***customer data platform (a CDP)*** to ensure that master data about customers is consistently presented and available to each and every application within the enterprise that might need it. According to the vendor-neutral CDP Institute, a CDP is "packaged software that creates a persistent, unified customer database that is accessible to other systems."[17] A CDP, in other words, is software that ensures an efficient and accurate mechanism for identifying customers, as and when those customer identities are required by other software within the enterprise. In this way, not only can conflicts and mistakes be minimized, but an enterprise's customers won't be required to provide the same information over and over, and security around customer identifying data can be enhanced, as well.

SaaS, the IoT, and Customer Relationships

SaaS stands for *software as a service*, a relatively new business model that has come into use on account of the increasing capabilities of **cloud computing technology**.

[15]Gartner, "Master Data Management (MDM)," available at https://www.gartner.com/en/information-technology/glossary/master-data-management-mdm#:~:text=Master%20data%20is%20the%20consistent,hierarchies%20and%20chart%20of%20accounts, accessed May 20, 2021.
[16]Dictionary.com, "Metcalfe's law," available at https://www.dictionary.com/browse/metcalfe-s-law, accessed December 3, 2021.
[17]Customer Data Platform Institute, "What Is a CDP?" available at https://www.cdpinstitute.org/learning-center/what-is-a-cdp/, accessed August 31, 2021.

Cloud technology has enabled enterprise software vendors to use their own servers to maintain their customers' applications, in such a way that a customer can enjoy the benefits of using the software without having the software installed on its own computers and servers.

Salesforce is probably the poster child for how the SaaS business model functions. It used to be, for instance, that if a business wanted an enterprise CRM application, it had to buy one from a large software vendor such as Oracle, Microsoft, or SAP. Such a system might have cost a large company upwards of a million dollars and required most of a year to install and integrate. But in 2009 Salesforce began offering its Service Cloud product, which allowed business customers to maintain their CRM application on Salesforce's servers, rather than their own, and their client's employees would then access the application remotely by connecting to it via Wi-Fi and broadband interactivity. Salesforce's new SaaS business model didn't require the time and expense of installation and integration. Instead, a Salesforce customer could now simply *subscribe* to the software application—for, say, $30,000 a month. And the customer could be up and running with the software in a couple of weeks.

But while the convenience and radically reduced expense of the SaaS business model generated an explosion in demand for such large enterprise software applications, it also presented a different kind of problem for the software vendor. On the one hand, consider a non-SaaS product: A customer spends a million dollars and most of a year to install and integrate an application on their own computer servers, so they are firmly committed to it. The vendor's profit is all in the sale itself, and any problems or difficulties a customer later has would be largely the customer's responsibility to handle. On the other hand, with SaaS, if a customer becomes unhappy with the software, or is attracted to a different vendor's application, they can simply stop paying the monthly fee and switch. So the SaaS vendor has a continuing interest in their business customer's satisfaction with the software product they're subscribing to.

Moreover, because cloud technology means that the customer's access and use of their software subscription place entirely on the vendor's own servers, the vendor can easily observe how, when, and how effectively any particular customer is actually using it. It can tell, for instance, if just 15% of a customer's sales reps use the software regularly, or whether and how quickly a customer is following up on generated leads. The vendor can provide regular feedback and coach the customer's people in how to get more use out of the software to ensure that the customer's business becomes more profitable and successful by using it, so that they will continue to subscribe to the software.

The SaaS business model has given rise to something often called the *subscription economy,* and to a whole new customer relationship discipline as it applies to business customers: the **customer success management** strategy, which we'll discuss in more detail in Chapters 10 and 13.

In the same way the SaaS business model promotes a subscription economy, with vendors interested in maintaining and continuing their successful relationships with the business customers they are selling to, a consumer-based revolution widely known as the ***Internet of Things*** (***IoT)*** is also promoting customer relationships. Attach a microchip and an RFID[18] tag to a product, or use a Bluetooth or Wi-Fi connection to enable your smartphone to control your speaker, or use the Tesla app to summon your car or to turn the heater on a few minutes before you get in on a cold winter day, and you are availing yourself of the IoT. Ubiquitous connectivity, it turns out, doesn't just mean connecting all the people in the world; it also means connecting all their things—and all the information that using them generates.

The IoT is closely related to cloud computing and the rise of the SaaS business model. As with SaaS, the more things consumers have connected to the network, the more consumers resemble subscribers to these products rather than simply purchasers of them. Buy a new printer, and it will likely come with its own app that allows it to signal the manufacturer when the ink is nearly empty, so a new package of cartridges can be delivered just in time. As a result, the printer manufacturer has an incentive to make sure you get the best use out of your printer so you continue to subscribe. And everybody in the **supply chain** has to earn your trust, since the manufacturer of the printer gets to determine how and when your money gets spent.

> Ubiquitous connectivity, it turns out, doesn't just mean connecting up all the people in the world; it also means connecting all their things—and all the information that using them generates.

The first task to accomplish in building a relationship with a customer is to *identify* them individually. This means an enterprise must have a method not only for tagging an individual customer with uniquely identifying information (name, account number, etc.), but also it must *recognize* each different customer at every point of contact and *remember* them, and *link* their data across all its product and service divisions, all its purchases and transactions, and through every communication and interaction channel, over time.

[18]RFID stands for radio-frequency identification.

CHAPTER 6

IDIC Step 2: Differentiate Customers by Value

The result of long-term relationships is better and better quality, and lower and lower costs.

—W. Edwards Deming

In this chapter, we explore the most fundamental ideas about the value that customers represent for an enterprise, including both a customer's **actual value** and **potential value**. We show how a firm can use insights about customer value to better allocate resources and prioritize sales, marketing, and service efforts. We consider whether and under what conditions a firm should consider "firing" very low-value or even negative-value customers.

All value created by a business comes from customers. Without a customer or client, at some level, no business can create any shareholder value at all, and this simple fact is inherent in the very nature of a business. By definition, a business exists to create and serve customers and, in so doing, to generate economic value for its stakeholders. But some customers will create more value for a business than others will, and understanding the differences among customers, in terms of the value they each will or could create, is critical to managing individual customer relationships.

Identifying each customer individually and linking the information about that customer to various business functions prepares the **customer-strategy enterprise** to engage each customer in a **mutual collaboration** that will grow stronger over time. The first step is to identify and **recognize** each customer at every touch point. As we saw in Chapter 5, when the identify task is properly executed, information about individual customers should allow a company to recognize each customer and see each one completely, as one customer, throughout the organization. Seeing customers individually will enable the company to compare them—to ***differentiate*** customers, one from another. By understanding that one customer is different from another, the enterprise reaches an important step in the development of an

interactive, customer-centric Learning Relationship with each customer.

The inability to see customers as being different does not mean the customers are the same in **needs** or value, only that the firm sees them that way. Understanding, analyzing, and profiting from individual customer differences are tasks that go to the very heart of what it means to be a customer-strategy or customer-centric enterprise—an enterprise that engages in customer-specific behaviors, in order to increase the overall value of its customer base.

> People are different. Customers are people. Therefore, customers are different. Our task, then, is to differentiate them.

Customers are different in two principal ways: Different customers have different *values to* the enterprise, and different customers have different *needs from* the enterprise. The entire value proposition between an enterprise and a customer can be captured in terms of the value the customer provides for the firm and the value the firm provides for the customer (i.e., what needs the firm can meet for the customer). All other customer differences, from demographics and psychographics, to behaviors, transactional histories, and attitudes, represent the tools and concepts marketers must use simply to get at these two most fundamental differences. Behaviors are in some instances the most observable, and thus the ability of a company to track differences in customer behaviors allows deeper understanding, and for that reason, we talk about differentiating customers by the value they have *to* the company, the needs they have *from* the company, and the behaviors they manifest that help us understand value and needs, as illustrated in Exhibit 6.1.

> The inability to see customers as being different does not mean the customers are the same in needs or value, only that the firm sees them that way.

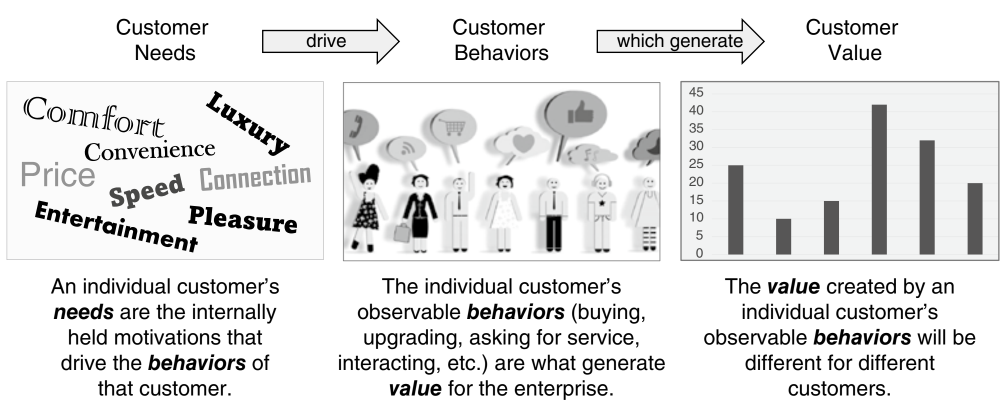

EXHIBIT 6.1

> The entire value proposition between an enterprise and a customer can be captured in terms of the value the customer provides for the firm and the value the firm provides for the customer.

Knowing which customers are most valuable and least valuable to the enterprise will enable a company to prioritize its competitive efforts, allocating relatively more time, effort, and resources to those customers likely to yield higher returns. It is not uncommon to hear marketers talk about ranking customers by value, usually from highest to lowest. In effect, an enterprise's financial objectives with respect to any single customer will be defined by the value the customer is currently creating for the enterprise (their actual value) as well as the potential value the customer *could* create for the enterprise, if the firm could present the exact right offerings at the right time as needed by the customer and thus change the customer's behavior in a way that works for both the customer and the enterprise. Of course, changing a customer's behavior (which is the basic objective of all marketing activity) can be accomplished only by appealing to the customer's own personal motives, or needs. While understanding a customer's value profile will determine a firm's financial objectives for that customer, the strategies and tactics required to achieve those objectives require an understanding of that customer's needs (see Chapter 7). It should be noted that a customer has value to the enterprise in two ways that matter to shareholders and decision makers, whether those are tracked and measured or not. First, a customer has current value, as measured by revenue minus cost to serve. Second, a customer has long-term value *in the present* that goes up or down based on that customer's experience with the company or brand, influence from the outside, and changes in a customer's individual needs.

In this chapter, we discuss the concept of customer **valuation,** including various ways a company might rank its customers by their individual values to the enterprise. In Chapter 7, we address the issue of customer needs. Importantly, we return again and again throughout the book to these two issues: the different *values* and *needs* of different individual customers.

CUSTOMER VALUE IS A FUTURE-ORIENTED VARIABLE

E-commerce firms, credit card companies, telecommunications firms, and other marketers with direct connections to their consumer customers often try to understand their marketing universe by doing a simple form of prioritization called *decile analysis*. Decile analysis is a process used to rank customers in order of their value to the company, then dividing this top-to-bottom list into 10 equal portions, or deciles, with each decile comprising 10% of the customers. In this way, the marketer can begin to analyze the differences between those customers who populate the most valuable one or two deciles and those who populate the less valuable deciles. A credit card company may find, for instance, that 65% of top-decile customers are married and have two cards on the same account while only 30% of other, less valuable customers have these characteristics. Or a web-based retailer may find that a majority of customers in the bottom three or four deciles have never before bought anything online from a mobile device while 85% of those in the top two deciles have.

It would not be unusual for a decile analysis to reveal that 50%, or even 95%, of a company's profit comes from the top one or two deciles of customers. Mail-order firms and other direct marketers are more likely than other marketers or retailers to have used decile analysis in the past, largely as a means for evaluating the productivity of their mailing campaigns, but this kind of customer ranking analysis will become increasingly important as more companies begin to adopt a **customer focus**.[1]

But just how does a company rank-order its customers by their value in the first place? What data would the credit card company use to analyze its customers individually, and then array them from top to bottom in terms of their value? What variables would go into the internet retailer's customer rankings? What do we mean when we talk about the value of a customer, anyway?

For our purposes, the value a customer represents to an enterprise should be thought of as the same type of value any other financial asset would represent. To say that some customers have more value for the enterprise than others is merely to acknowledge that some customers are more valuable, as assets, than others are. The primary objective of a customer-strategy enterprise should be to increase the value of its customer base, for the simple reason that customers are the source of all short-term revenue and all long-term value creation, by definition. In other words, a company should strive to increase the sum total of all its individual financial assets known as customers. But this is not as simple as it might sound because, in the same way any other financial asset should be valued, a customer's value to the enterprise is a function of the profit the customer will generate *in the future* for the enterprise.

Let's take a specific example. Suppose a company has two business customers. Customer A generated $1,000 per month in profit for the enterprise over the past two years, while Customer B generated $500 in monthly profit during the same period. Which customer is worth more to the enterprise?

Knowing only what we've been told so far, we can say it's *probable* that Customer A is worth more than Customer B, but this is not a certainty. If Customer A were to generate $1,000 in profit per month in all future months, while Customer B were to generate $500 per month in all future months, then certainly A is worth twice as much

[1] V. Kumar and Bharath Rajan, "Chapter 28: Customer Lifetime Value: What, How, and Why," in *The Routledge Companion to Strategic Marketing*, Bodo B. Schlegelmilch and Russell S. Winer, eds. (Taylor & Francis, 2020); Sarang Sunder, V. Kumar, and Yi Zhao, "Measuring the Lifetime Value of a Customer in the Consumer-Packaged Goods Industry," *Journal of Marketing Research* 53, no. 6 (2016): 901-21; V. Kumar and Werner Reinartz, "Creating Enduring Customer Value," *Journal of Marketing* 80, no. 6 (2016): 36-68; and Don Peppers and Martha Rogers, Ph.D., *The One to One Future* (New York: Doubleday, 1993).

to the enterprise as B. But what if we know that Customer A plans to merge its operations into another firm in three months and switch to a different supplier altogether, while Customer B plans to continue doing its regular volume with the company for the foreseeable future? In that case, our ranking of these two customers would be reversed, and we would consider B to be worth more than A. However, if what actually happens is that a competitor derails A's merger while B goes bankrupt and ceases all operations the following month, then even this reassessment would have been wrong.

The point is that by definition, a customer's value to an enterprise, as a financial asset, is a future-oriented variable, and only a fortune teller can know this future for certain. Therefore, a customer's value to a business today is a quantity that can truly be ascertained from the customer's actual behavior *in the future*. We mortals can analyze data points from past behavior, we can interview a customer to try to understand the customer's future opportunities and intent, and we can even conclude contractual agreements with customers to guarantee performance for the contract period, but the plain truth is that, without clairvoyant powers, we can't *know* what a customer's true value is until the future actually happens, even though we have better and better analytical tools to *predict* what will happen.

We can't *know* what a customer's true value is until the future actually happens, even though we have better and better analytical tools to *predict* what will happen.

However, until the future happens, we can affect its outcome—at least partially—by our own actions. Suppose we were to find a revenue stream for Customer B that allowed it to continue in business rather than going bankrupt. By our own deliberate action, in this case, we would have changed B's value to our firm as a financial asset.

To think about customer valuation, therefore, we need to use two different but related concepts:

1. *Actual value* is the customer's value, given what we currently know or predict about the customer's future behavior, with no different actions on our part.
2. *Potential value* is what the customer's value as an asset to the enterprise *could* represent if, through some conscious effort on our part, we could change the customer's future behavior in some way.

CUSTOMER LIFETIME VALUE

The actual value of a customer, as we define it, is equivalent to a quantity frequently termed customer **lifetime value (LTV).** Defined precisely, a customer's LTV is the ***net present value (NPV)*** of the expected future stream of financial **contributions** from the customer.[2] Every customer of an enterprise today will be responsible for some specific series of events in the future, each of which will have a financial impact on the enterprise—the purchase of a product, a blog post about the company, payment for a service, remittance of a subscription fee, a product rating on a retailing-commerce site, a product exchange or upgrade, a warranty claim, a help-line telephone call, the referral of another customer, and so forth. Each such event will take place at a particular

[2] It should be noted that a vigorous body of research and literature is constantly emerging in this important field, and the notes in this book should be supplemented with a review of the latest findings. Also see Peppers and Rogers, *Return on Customer* and *Rules to Break and Laws to Follow* as well as these seminal resources:

Berger, Paul, Naras Echambadi, Morris George, Donald R. Lehmann, Ross Rizley, and Rajkumar Venkatesan, "From Customer Lifetime Value to Shareholder Value: Theory, Empirical Evidence, and Issues for Future Research," *Journal of Service Research* 9, no. 2 (November 2006): 156–167.

Blattberg, Robert, Gary Getz, and Jacquelyn S. Thomas, *Customer Equity: Building and Managing Relationships as Valuable Assets* (Boston: Harvard Business School Press, 2001). Classic view focuses on measuring so that marketers can allocate resources wisely between acquisition and retention efforts.

Bolton, Ruth N., Katherine N. Lemon, and Peter C. Verhoef, "The Theoretical Underpinnings of Customer Asset Management: A Framework and Propositions for Future Research," *Journal of the Academy of Marketing Science* 32, no. 3 (2004): 271–292. Proposed CUSAMS— customer asset management of services—and claimed that CUSAMS enables service organizations to make a comprehensive assessment of the value of their customers, and to understand the influence of marketing instruments on them. Examines leading indicators of key customer behaviors reflecting the length, depth, and breadth of customer/service-organization relationship: duration, usage, and cross-buying.

Emmer, Marc and Kenneth A. Merchant, "Measuring Marketing Return on Investment." *Strategic Finance* 102, no. 1 (Jul 2020): 25-27.

Fader, Peter and Sarah Toms, *The Customer Centricity Playbook: Implement a Winning Strategy Driven by Customer Lifetime Value* (Philadelphia, PA: Wharton School Press, 2018).

Gross, Neil, "Commentary: Valuing 'Intangibles' Is a Tough Job, but It Has to Be Done," *BusinessWeek*, August 6, 2001, pp. 54–55. If companies can account for intangibles on a balance sheet when there's a merger or acquisition, why not all the time? There are worries that FASB (Financial Accounting Standards Board) will never buy it because any whiff of subjectivity leads to a label of "voodoo accounting."

Gupta, Sunil, and Donald R. Lehmann. *Managing Customers as Investments: The Strategic Value of Customers in the Long Run* (Philadelphia: Wharton School Publishing, 2005). Although its focus is still primarily on investment choices surrounding marketing decisions, it is the best discussion we've seen yet of ROMI (return on marketing investment.)

Gupta, Sunil, Donald R. Lehmann, and Jennifer Ames Stuart, "Valuing Customers," *Journal of Marketing Research* (February 2004): 7–18. This makes the case that much of the financial value of the firm depends on assets not listed on the balance sheet—for example, brands, customers, employees, and knowledge. It also demonstrates how valuing customers makes it feasible to value firms, including high-growth firms with negative earnings. Study examines Capital One, Ameritrade, E*TRADE, Amazon, and eBay.

Kumar, V., and Anita Pansari, "Aggregate and Individual Level Customer Lifetime Value," in *Handbook of Research on Customer Equity in Marketing*, eds. V. Kumar and Denish Shah, 44–75 (Cheltenham, UK: Elgar, 2015).

Kumar, V., and Werner Reinartz. "Customer Analytics Part I" and "Customer Analytics Part II" in *Customer Relationship Management: Concept, Strategy and Tools*, 3rd edition (Heidelberg: Springer, 2018).

time in the future and will have a financial impact that has a particular value at that time. The net present value (NPV) today of each of these future value-creating events can be derived by applying a discount rate to it to factor in the time value of money as well as the likelihood of the event. LTV is, in essence, the sum of the NPVs of all such future events attributed to a particular customer's actions. We'll be talking more about the short-term and long-term value each customer has today in Chapter 11.

One useful way to think about the different types of events and activities that different customers will be involved in is to visualize each customer as having a **trajectory** that carries the customer through time in a financial relationship with the enterprise. For example, a customer could begin their relationship at a particular starting point and spending level. At some point, the customer increases their spending, taking another product line from the company; later they also begin paying more for some added service. Still later they have a complaint, and it costs the company some expense to resolve it. This customer refers another customer to the company, and that

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Rust, Roland T., V. Kumar, and Rajkumar Venkatesan, "Will the Frog Change into a Prince? Predicting Future Customer Profitability," *International Journal of Research in Marketing* 28, no. 4 (December 2011): 281–294. Explores the limitations of using historic profitability to predict future profitability of customers. Offers new model that could help identify customers who, with the right marketing effort, could increase the most in value.

Rust, Roland T., Christine Moorman, and Gaurav Bhalla, "Rethinking Marketing," *Harvard Business Review* 88, no. 1 (January–February 2010): 94–101.

Ryals, Lynette, *Managing Customers Profitably* (Hoboken, NJ: John Wiley & Sons, 2008).

Schulze, Christian, Bernd Skiera, and Thorsten Wiesel, "Linking Customer and Financial Metrics to Shareholder Value: The Leverage Effect in Customer-Based Valuation," *Journal of Marketing* 76, no. 2 (March 2012): 17–32.

Stahl, Heinz K., Kurt Matzler, and Hans H. Hinterhuber, "Linking Customer Lifetime Value with Shareholder Value," *Industrial Marketing Management* 32, no. 4 (2003): 267–279. This emphasizes the increasing importance of ability to evaluate market strategies against ability to deliver shareholder value; therefore, acquisition and maintenance of customers must result in improved cash flows and shareholder value. It also argues that customers are assets and shareholder value increases by accelerating and enhancing cash flows, reducing cash flow volatility and vulnerability, and increasing residual value of the firm.

Thomas, Jacquelyn S., Werner Reinartz, and V. Kumar, "Getting the Most out of All Your Customers," *Harvard Business Review* 82, nos. 7–8 (July–August 2004): 116–123. It builds on the "Return on Marketing Investment" literature by asserting that profitability of customers matters more than their raw numbers or their loyalty.

Verhoef, Peter C. and Katherine N. Lemon, "Successful Customer Value Management: Key Lessons and Emerging Trends," *European Management Journal* 31, no. 1 (2013): 1. The authors shares six important lessons firms can use to maximize customer value, based on available research and best practices: (1) use CVM to improve business performance; (2) ensure that CVM is more customer-driven than IT driven; (3) adopt customer lifetime value as a core metric; (4) invest in strong analytical capabilities; (5) understand the key drivers of customer acquisition, customer retention, and customer expansion; and (6) manage channels to create customer value.

Woodruff, Robert B. "Customer Value: The Next Source of Competitive Advantage," *Journal of the Academy of Marketing Science* 25, no. 2 (1997): 139–153.

This sampling cannot serve as an exhaustive review of this important body of literature, since it is developing faster than a textbook or reference book can keep up with. Rather, this list serves as an introduction and basis for understanding and evaluating the ongoing work by others.

customer then begins their own trajectory, creating a whole additional **value stream**. Eventually, perhaps several years or decades later, the original customer leaves the franchise because their children grow up, or they decide to switch to another product altogether, or they get divorced, or retire, or die. At this point, their relationship with the enterprise comes to an end. (We could describe a business customer's trajectory in the same way. Although a business may have an indefinite future potential as a customer, each of the individual potential end users, purchasing agents, influencers, and so forth eventually will quit, get promoted or transferred or fired, retire, or die.)

Different customers will have different trajectories. In a way, the lifetime value of each customer amounts to the NPV of the financial contribution represented by that customer's trajectory through the customer base. From a customer's stream of positive contributions, including product and service purchases, an enterprise must deduct the expenses associated with that customer, including the cost of maintaining a relationship. For instance, relationships usually require some amount of individual communication, via phone, mail, email, or face-to-face meetings. These costs, along with any others that apply to a specific individual customer, will reduce the customer's LTV. It sometimes happens that the costs associated with a customer actually outweigh the customer's positive contributions altogether, in which case the customer's LTV is **below zero (BZ).**

Customer Contribution versus Customer Profit

We are using the term *contribution*, as opposed to *profit*, deliberately, because it's not really useful to assume that each customer's absolute profitability is calculable, or relevant, when you have to take fixed costs into consideration to make such a calculation. If you are a manufacturer with 100 customers, and it costs you $100,000 to build and then operate the small factory where you make your product for them, then before anybody pays you anything, they each cost you $1000. But if you lose one of them, the total cost of operating your business does not decline, and if you add a new one instead, the cost of operation may increase very little. If you add 10 new customers, there will be additional cost, but likely an even greater growth in income, if you're doing things the right way. So taking fixed costs into consideration, the value of a particular customer is equivalent to the marginal contribution of that customer, when they are added to the business in which the enterprise is already engaged.

Suppose we add up all the positive and negative cash flows an enterprise will generate over the next few years, and the total is $X. But then Customer A's trajectory of financial transactions is removed from the enterprise, and the positive and negative cash flows will only amount to a lesser total of $Y. The customer's marginal contribution is equal to X – Y. The NPV of those various contributions by Customer A is the customer's LTV. There are additional contributions a customer can make, not all of them monetary. For example, aside from the obvious **word of mouth (WOM)** or **social media** influence given by a customer, a nonprofit organization would consider the contribution of volunteer work or other forms of participation.

In practice, of course, it is not possible for an enterprise to know what any particular customer's future contributions will actually be, and if we want to be able to make current decisions based on this future-oriented number, then we will have to estimate it in some way. Traditionally, the most reliable predictor of a customer's future behavior has been thought to be that customer's past behavior. We are usually quite justified in making the commonsense assumption that a customer who has generated $1,000 of profit each month for the last two years will continue to generate that profit level for some period of time in the future, even though we simultaneously acknowledge that any number of forces can appear that will change this simplistic trend at any moment. (That's why so many of the researchers listed in footnote 2, and many others, are hard at work looking for alternative and more accurate ways to predict a customer's future value.) Various computational techniques can be used to model the probable trajectories of particular types of customers more precisely and to project these expected trajectories into the future. Some companies have customer databases that allow highly sophisticated modeling and analysis. Such analysis can sometimes be used to give an enterprise advance warning when a credit card customer, or a cell phone customer, or a website subscriber, is about to defect to a competitor. A whole class of statistical analysis tools, frequently termed ***predictive analytics***, is designed to help businesses sift through the historical records of certain types of customers, in order to model the likely behaviors of other, similar customers in the future.

According to the late CRM consultant Frederick Newell, LTV models have a number of uses. They can help an enterprise determine how much it can afford to spend to acquire a new customer or perhaps a certain type of new customer. They can help a firm decide just how much it would be worth to retain an existing customer. With a model that predicts higher values for certain types of customers, an enterprise can target its customer acquisition efforts in order to concentrate on attracting not just any warm body, but higher-value customers. And, of course, the LTV measurement represents a more economically correct way to evaluate marketing investments compared to simply counting immediate sales.[3]

Although sophisticated modeling and analytical methods help to quantify LTV, many variables cannot be easily quantified, such as the assistance a customer might give an enterprise in designing a new product, or the value derived from the customer's referral of another customer, or the customer's willingness to advocate for the product or company on a **social networking** website. Any model that attempts to calculate individual customer LTVs should employ some or all of these data, quantified and weighted appropriately:

- Repeat customer purchases
- Greater profit and/or lower cost (per sale) from repeat customers than from initial customers (converting prospects)
- Indirect benefits from customers, such as referrals
- Willingness to collaborate—the customer's level of comfort and trust with the company and participation in data exchange that results in the opportunity for better **customer experience** (sometimes called relationship strength)
- Willingness to refer—word of mouth—as well as social media sharing and rating

[3] See footnote 2 for a current overview of the topic.

- Customers' stated willingness to do business in the future rather than switch suppliers
- Customer records
- Transaction records (summary and detail)
- Products and product costs
- Cost to serve/support
- Marketing and transaction costs (including acquisition costs)
- Response rates to marketing/advertising efforts
- Company- or industry-specific information

The objective of LTV modeling is to use these and other data points to create a historically quantifiable representation of the customer and to compare that customer's history with other customers. Based on this analysis, the enterprise forecasts the customer's future trajectory with the enterprise, including how much they will spend, and over what period.

For our purposes, it is sufficient to know that:

- The actual value of a customer is the value of the customer as a financial asset, which is equivalent to the customer's lifetime value—the NPV of future cash flows associated with that customer. (This is the current value, assuming business as usual.)
- LTV is a quantity that no enterprise can ever calculate precisely, no matter how sophisticated its predictive analytics programs and statistical models are.
- Nevertheless, even though—as is the case with *many* of the widely accepted numbers calculated to report business performance—it can never be precisely known, LTV is a real financial number. Every enterprise has an interest in understanding it as accurately as possible and positively affecting its customers' LTVs to the extent possible, and—as we shall see in Chapter 12—holding members of the organization responsible for exactly that.

As difficult as LTV and actual value may be to model, *potential* value is an even more elusive quantity. It involves not only guesses about a customer's most likely future behavior but also about the customer's options for future behavior.

Even though—as is the case with *many* of the widely accepted numbers calculated to report business performance—it can never be precisely known, LTV is a real financial number. Every enterprise has an interest in understanding it as accurately as possible and positively affecting its customers' LTVs to the extent possible, and holding members of the organization responsible for exactly that.

Still, potential value isn't impossible to estimate, especially if the analysis begins with a set of customers who have already been assigned actual values or LTVs. Probably the most straightforward way to estimate a customer's potential value is to look at the range of LTVs for similar customers and then to make the arbitrary assumption that in an ideal world it should at least be possible to turn lower-LTV customers into higher-LTV customers. In the consumer business, this means examining the LTVs for customers who are perhaps at the same income level, or have the same family size, or live in the same neighborhoods. For business-to-business (**B2B**) customers, it would mean comparing the LTVs of corporate customers in the same vertical industries, with the same sales levels, or profit, or employment levels, and so forth.

The problem at many companies is that a customer's value to the firm is confused with the customer's current profitability. Often, measuring customer profitability at all, even in the short term, is an achievement for a firm. But when a customer's LTV is taken into account, the results will be more revealing, and estimating potential values will yield still more insight and drive better decisions and actions.

RECOGNIZING THE HIDDEN POTENTIAL VALUE IN CUSTOMERS

It is understandable that a firm's marketing analysts may be reluctant to forecast future behaviors for a customer when they haven't already observed and modeled those behaviors in the customer's transactional history. But consider the idea that today's customer might actually increase their patronage with a firm considerably, based solely on the fact that, as time goes on, the customer matures into an older and more productive person. Royal Bank of Canada (RBC)[4] was one of the first banks to look carefully and analytically at the youth segment as a promising group of retail banking customers when most banks were overlooking this segment due to their low current (actual) value. RBC recognized the high potential value of young college students, many of whom would become highly paid professionals in the future. The bank gained a competitive advantage by reaching out to and building loyalty in this segment early on, even though their current value was low. In a similar way, certain groups of customers who are in a temporary financial slump, or even in bankruptcy, could have the potential to be promising and high-value customers in the future. A bank that identifies such customers (differentiating them from other customers who are bankrupt now and likely to remain in financial distress for the long term) and reaches out to them at this difficult stage in their lives is certain to win these customers' loyalty and trust.

Taking into account the customer influence factor in modeling lifetime value is even more critical in some industries where a small number of customers exert a disproportionate share of influence on others' buying decisions, such as in the pharmaceuticals industry. The primary customers here, at least in most countries, are physicians, and some physicians almost always stand out for the amount of influence

[4] V. G. Narayanan and Lisa Brem, "Case Study: Customer Profitability and Customer Relationship Management at RBC Financial Group (abridged)," *Journal of Interactive Marketing* 16, no. 3 (Summer 2002): 76.

they have on the medical practices of other physicians. Identifying and trying to quantify the value of such ***key opinion leaders (KOLs)*** is a high priority for pharmaceutical companies.[5] KOLs are usually viewed by their peers as experts in specific therapeutic areas, and as such they exert immense influence over other doctors when it comes to the types of medications to be prescribed and the kinds of medical treatments to be administered in these therapeutic areas. Even though some KOLs may have low actual values themselves, in terms of the prescriptions they write in their own medical practice, their influence is disproportionately valuable. Many pharmaceutical companies try to identify KOLs or (even better) rising KOL stars who are showing signs of future success and influence. The companies then invite them to participate in medical education and other activities, hoping to build long-lasting relationships with them and to be favorably referenced by them in their future articles, presentations, or other content. And with the increasing volume and variety of digital data, there are a number of analytical firms that specialize in using **machine learning** and **artificial intelligence** to spot otherwise unknown but highly influential KOLs.[6]

One industry in which potential value can be an important differentiator is the airline business. Because of their widely used frequent-flyer programs, airlines usually have a fairly good handle on the transactional histories of their most frequent travelers who are, for the most part, business flyers. But even if a business traveler flies 75,000 miles a year on an airline, the airline has no way of knowing, from its own transactional records, whether that traveler is flying another 150,000 miles on competitive carriers, and thus has a large *potential* value. So, in trying to estimate the potential value of an airline customer, it is critical to look at external data sources when such sources are available, and perhaps to tap into accessible data from distributor partners, such as travel websites or credit card firms, in addition to simply *asking* the customer, when appropriate. Lifestyle changes can also create shifts in the potential value of a customer and should be taken into account. One airline, for example, identified and sent relevant offers to some currently low-value customers who moved to another country as expatriates, and these customers proved to have high potential value as evidenced by their future travels on holidays to their home country.

In addition to overlooking customers with high potential value, some companies make wrong and unprofitable investments in customers who seem to be high in value now but in fact have a low or sometimes negative potential value. In the retailer category, companies like Best Buy, Victoria's Secret, and Home Depot[7] have begun tracking

[5] "Key Opinion Leaders For Pharmaceutical Companies: How Do You Identify The Right Experts For Your Brand?," Axtria, available at https://insights.axtria.com/blog/key-opinion-leaders-for-pharmaceutical-companies-how-do-you-identify-the-right-experts-for-your-brand#:~:text=Pharmaceutical%20companies%20heavily%20rely%20on,is%20critical%20for%20brand%20adoption, accessed May 20, 2021.

[6] Andree Bates, "KOL Identification and Mapping: Can Big Data and AI Confer Stronger Results Than Traditional Approaches? Finding Those Who Matter Using Artificial Intelligence," Eularis, available at https://eularis.com/kol-identification-and-mapping-can-big-data-and-ai-confer-stronger-results-than-traditional-approaches-finding-those-who-matter-using-artificial-intelligence/ accessed May 21, 2021.

[7] Jennifer C. Kerr, Associated Press, "Retailers Tracking What Customers Return," USA Today, August 12, 2013, available at http://www.usatoday.com/story/money/business/2013/08/12/retailers-tracking-customers-returns/2642607/, accessed August 25, 2021.

customer returns for potential denial of repeat returners, preventing losses from this group who prove to be BZ customers over the long term.

Another company that avoided unnecessary investment in low-potential-value customers is Capital One Bank, which recognized its low-potential-value customers and adjusted its reactive retention strategy to deemphasize them. (After all, why should the company go out of its way to retain a low-value customer?) One variable that can reduce the potential value of a financial services customer is financial risk. Understanding the likelihood that a customer might need to be charged off in the future is an important function for any credit-granting institution. Capital One, while giving incentives and positive offers to its high-value customers so as to convince them not to close their accounts, encouraged the high-risk customers (i.e., low-potential-value customers) to close their accounts with the bank by advising these customers where they might be served better. This policy helped to minimize future financial losses to the bank, improving overall profitability and making sure that the bank's **most valuable customers (MVCs)** are not subsidizing its lowest-value customers. Certainly, this is more trustable behavior than expecting good customers to pay more than they might to cover the losses caused by bad customers.

The bank was making sure that its most valuable customers (MVCs) are not subsidizing its lowest-value customers. Certainly, this is more trustable behavior than expecting good customers to pay more than they might to cover the losses caused by bad customers.

Assessing customer value as a combination of current and potential value is no longer a choice if a firm wants to remain truly competitive. Estimating a customer's potential value is certainly more complex than simply trying to forecast actual value, or LTV, and requires a deeper look into factors such as needs, lifestyle phases, and behavioral trends. But making a genuine attempt to do so will likely prove quite beneficial.[8]

The Potential Value of Prospective Customers

It is an interesting fact that the very concept of **unrealized potential value** means that as long as there is some likelihood that a prospective customer will become a customer, then this prospect *already* represents an economic value to the enterprise. And what is that value?

Simply put, the economic value of a customer the enterprise doesn't even have (yet) can be equated to the actual value that this customer would represent if they

[8] Thanks to former Peppers & Rogers consultant Pelin Turunc for her contribution to this section.

(*continued*)

were to become a customer, multiplied by the probability that they will become a customer. Importantly, this means there are two distinct ways a business can improve the productivity of its customer acquisition efforts:

1. Concentrate on those prospects that will have the highest actual values if and when they become customers.
2. Work to increase the likelihood that a prospect will become a customer.

Growing Share of Customer

With respect to its relationship with a customer, the goal of any customer-strategy enterprise should be to positively alter the customer's financial trajectory, increasing the customer's overall value to the enterprise. The challenge, however, is to know how much the enterprise really can alter that trajectory—how much increase in the customer's value an enterprise can actually generate. (A new baby will go through 7,000 diapers between birth and toilet training. If your company sells disposable diapers, your goal will, of course, be to get as many of the diapers as possible to be your brand of diaper. But there's likely not anything you can do to get Mom and Dad to have a second infant!)

Unrealized potential value is a term used to denote the amount by which the enterprise could increase the value of a particular customer if it applied some effort to do so. It's a very straightforward concept because a customer's unrealized potential is simply that customer's growth potential. It represents the potential *additional* business a customer is capable of doing with the enterprise, much of which may never materialize. As an enterprise realizes more and more of a customer's *potential* value, however, it can be said to have a greater and greater share of that customer's business. (Indeed, if we divide a customer's actual value by the customer's potential value, the quotient should give us **share of customer**, or SOC.)

Increasing SOC[9] is an important goal for a customer-strategy enterprise and can be accomplished by increasing the amount of business a customer does, over and above what was otherwise expected (i.e., by applying a strategy to favorably affect the customer's trajectory). This is often referred to as *share of wallet*. For example, a bank might have a relationship with a customer who has a checking account, an auto loan,

[9] SOC refers to the percentage of total business conducted by a customer with a particular enterprise, in the product and service arena offered by that enterprise. For example, if a voter contributes a total of $1,000 in the 2024 presidential primaries to several candidates, the candidate who gets a $400 contribution would have a 40% SOC with that voter. If a Christmas shopper buys most of his presents at Best Buy, generating December purchases there of $800, as compared to a combined total of all other shopping of $400, then Best Buy would have an SOC of $800 of a total $1,200 in holiday shopping, or SOC = 67%. See Chapter 1 for a complete discussion of share of customer.

and a certificate of deposit.[10] The customer provides a regular profit to the bank each month, generated by transaction fees and the investment spread between the bank's own investment and borrowing rates, compared to the lending and savings rates it offers the customer. The net present value of this income stream over the customer's likely future tenure is the customer's LTV. This LTV amount is equivalent to the present value of the financial benefits the bank would lose in the future, if the customer were to defect to another financial services organization today.

But suppose that, in addition to the accounts the customer now maintains at the bank, they also have a home mortgage at a competitive institution. This loan represents unrealized potential value for the bank, while it represents actual value to the bank's competitor. The expected profit from that loan is one aspect of the customer's potential value to the bank, which may devise a strategy to win the customer's mortgage loan business away from its competitor.

Or suppose this customer owns a home computer and smartphone, but doesn't participate in the bank's online banking service. If they were to do more of their banking online, however, the cost of handling their transactions would decline, their likelihood of defection would decline, and their value to the bank would increase. Thus, the increased profit the bank could realize if the customer banked online represents another aspect of the customer's unrealized potential value to the bank.

Or perhaps another customer is a night student attempting to qualify for a more financially rewarding career. If the bank could help them achieve this objective, they would earn more money and do more banking, and their value to the bank would increase. All these possibilities represent real opportunities for a bank to capture some of a customer's unrealized potential value.

Assessing a Customer's Potential Value

In trying to assess a particular customer's potential value, some of the questions you want to answer include:

- How much of the customer's business currently goes to your competition but might be pried away with the right approach or relationship?
- How much more of a customer's business could you capture if you modify your treatment of them? If you improve their experience with you?
- How many more product lines might the customer buy from you? What other services or products could you sell the customer if you had the products available?

[10] Interestingly, NerdWallet suggested that certificates of deposit may still be one of the best alternatives to traditional savings accounts. See Chanelle Bessette, "5 Best Alternatives to Traditional Savings Accounts," *NerdWallet*, December 2, 2020, available at https://www.nerdwallet.com/article/banking/5-best-alternatives-to-traditional-savings-accounts, accessed April 23, 2021.

(*continued*)

- What additional value would you capture if you could prevent the customer's defection?
- The customer has needs you know about and cater to, but how can you identify the needs you don't yet know about?
- How much could you reduce the cost of serving this customer, while maintaining their satisfaction?
- How much could this customer be worth in terms of referrals, social sharing, and other nonmonetary contributions?
- How does this customer treat people in their social networks—and how much positive social influence do they have as a result? (Mere numbers don't necessarily indicate positive influence.) How might this translate into profitable word of mouth?

A firm's opportunity for organic growth is directly related to the unrealized potential values of its current and future customers. But that is just the firm's perspective. From the customer's perspective, potential value has to do with the customer's need. This is important: The outside limit of any customer's value is defined by the customer's need, not by your current product or service offering.

See also Don Peppers and Martha Rogers, Ph.D., *Return on Customer* (New York: Currency/Doubleday, 2005).

DIFFERENT CUSTOMERS HAVE DIFFERENT VALUES

The Pareto principle: 80% of any enterprise's business comes from just 20% of its customers.

Increasing a customer's value encompasses the central mission of an enterprise: to *get, keep,* and *grow* its customers. When it understands the value of individual customers relative to other customers, an enterprise can allocate its resources more effectively, because it is quite likely that a small proportion of its most valuable customers will account for a large proportion of the enterprise's profitability. This is an important principle of customer differentiation, and at its core is what is known as the Pareto principle, which asserts that 80% of any enterprise's business comes from just 20% of its customers.[11]

[11]"Pareto Principle," Investopedia, https://www.investopedia.com/terms/p/paretoprinciple.asp, accessed August 31, 2021, and elsewhere. Rajkumar Venkatesan, "Customer-Lifetime-Value-Based Resource Allocation," in *Handbook of Research on Customer Equity in Marketing*, eds. V. Kumar and Denish Shah (Cheltenham, UK: Elgar, 2015), pp. 283–305.

The Pareto principle implies that an e-commerce company ranking its customers into deciles by value is likely to find that the top two deciles of customers account for 80% of the business the company is doing. Obviously, the percentages can vary widely among different businesses, and one company might find that the top 20% of its customers do 95% of its business while another company finds that the top 20% of its customers do only 40% of its business. But in nearly every business, some customers are worth more than others. When the distribution of customer values is highly concentrated within just a small portion of the customer base, we say that the **value skew** of the customer base is steep.

> The outside limit of any customer's value is defined by the customer's need, not by your current product or service offering.

Pareto Principle and Power-Law Distributions

When it comes to analyzing how customer values are distributed, the 80–20 Pareto principle does not result in a normal distribution, like a bell curve. (See Exhibit 6.2.) The Pareto principle is a special case of what mathematicians call a power-law distribution or a log-normal distribution. The key to understanding how a power law differs from a bell curve is to recognize that power laws go on and on with the same kind of distribution. (For this reason, we say that power-law distributions are scale-free.)

For instance, if a company's customer lifetime values really are distributed according to the 80–20 Pareto principle, so that the top 20% of customers account for 80% of the total value, then the top 20% of *that* top 20% of customers will account for 80% of *that* 80% of value. In other words, just 4% of customers (20% of 20%) will account for some 64% of a company's total lifetime values (80% of 80%). Multiply it again and you'll find that fewer than 1% of customers will account for more than 50% of all customer lifetime value, and so forth.

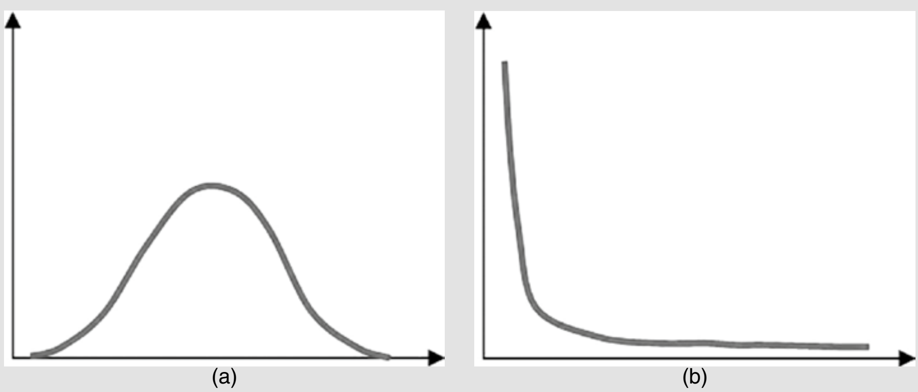

EXHIBIT 6.2 (a) Bell Curve or Normal Distribution and (b) Power-Law or Log-Normal Distribution

(*continued*)

It's important to remember that all such distributions are still inherently random, and no random distribution of discrete quantities (e.g., individual customer lifetime values) will ever conform precisely to a particular mathematical formula. But it's easy to be confused by the Pareto principle because it represents a power law, while many of the natural phenomena we observe in everyday life are distributed according to the more intuitively understandable bell curve. Human height, for instance, is distributed according to a bell curve, while wealth is distributed according to a power law. If you walk down a crowded city street and catalog the different heights of the people you encounter, chances are you'll occasionally see a person who is six-foot-six, or maybe even someone who is nearly seven feet tall, but the odds of finding someone much taller than seven-foot-six are vanishingly small. (You'll also see one or two adults who are under five feet tall and maybe, occasionally, someone shorter than four-foot-six.)

Wealth, however, has no natural upper limit and is distributed according to a power law. Let's suppose human height were distributed the same way personal wealth is distributed, with the average height of wealth being about 6 feet. If that were the case, then when you walked down the street you'd run into a few people in the five-to-seven–foot range, but most of the people you meet would actually be shorter than three feet tall, and the vast majority of *them* would be only a few inches high! Every block or so, however, you'd encounter a couple of people 20 feet tall, and you'd likely see a 100-foot-tall person or even a 500-foot-tall person once in a great while. The longer you walk, the more likely you'll see someone even taller than the last giant you encountered. If you happened to run into the few tallest people in the United States, say, Jeff Bezos, Bill Gates, and Warren Buffett, they would each tower over the city, their heads more than a mile in the sky. That would be a power-law distribution.

Power-law distributions characterize many kinds of measurable quantities that are based on networks, including the increasing proliferation of Internet-enabled social networks. As technology improves and continues to connect customers more and more closely together, power-law distributions can be expected to characterize things like the number of comments accumulated by different blogs, or the number of viewers of different YouTube videos, or the number of Twitter followers acquired by various users. As we will read in Chapter 8, this is an important and more or less universal characteristic of social networks.

While LTV is the variable an enterprise wants to know, sometimes a financial or statistical model is too difficult or costly to create. Instead, the enterprise may find some ***proxy variable*** to be nearly as useful. A proxy variable is a number, other than LTV, that can be used to rank customers in rough order of LTV, or as close to that order as possible, given the information and analytics available. A proxy variable should be easy to measure, but it obviously will not provide the same degree of accuracy when it comes to quantifying a customer's actual value or ranking customers relative to each other.

For instance, many direct marketers use a proxy variable called ***RFM*** (which stands for *recency, frequency,* and *monetary value*) to rank order their customers in terms of their value. The RFM model is based on individual customer purchase histories and incorporates three separate but quantified components:

1. *Recency:* Date of this customer's most recent transaction
2. *Frequency:* How often this customer has bought in the past
3. *Monetary value:* How much this customer has spent in the most recent specified period

An airline, by contrast, might use a customer's frequent-flyer mileage as a proxy variable to differentiate one customer's value from another's. The mileage total for the past year, or the past two years, or some other period, will be a good indicator of the customer's value, but it won't be entirely accurate. For instance, mileage by itself won't tell the airline whether the customer usually flies in first class or in coach, and it won't tell whether the customer always purchases the least expensive seat, frequently chooses to stay over on Saturdays, and takes advantage of other various pricing complexities and loopholes in order to obtain the lowest fare. And, as we noted before, it doesn't reveal anything about potential value based on share of customer.

A proxy variable is, in effect, a representation of a customer's value to the enterprise rather than a quantification of it. Nevertheless, proxy variables can be efficient tools for helping an enterprise rank its customers based on value, and with this ranking the company still can apply different strategies to different customers, based on their relative worth. Although more feasible all the time, sophisticated LTV models can be expensive and time consuming to create. If an enterprise is to explore and benefit from customer valuation principles, proxy variables that allow initial rank-ordering of customers by value are a good starting point.

The goal of value differentiation is not a *historical* understanding but a *predictive* plan of action. RFM and other, similar, history-based proxy-variable methods show that while differentiating among customers can be mathematically complicated, rank-ordering customers from top to bottom is still fundamentally a simple idea.

The goal of value differentiation is not a *historical* understanding, but a *predictive* plan of action.

CUSTOMER VALUE CATEGORIES

Every customer has an actual value and a potential value. By visualizing the customer base in terms of how customers are distributed across actual and potential values, managers can categorize customers into different value profiles, based on the type of financial goal the enterprise wants to achieve with each customer. For instance, one of a company's goals for a customer with a high unrealized potential value would be to

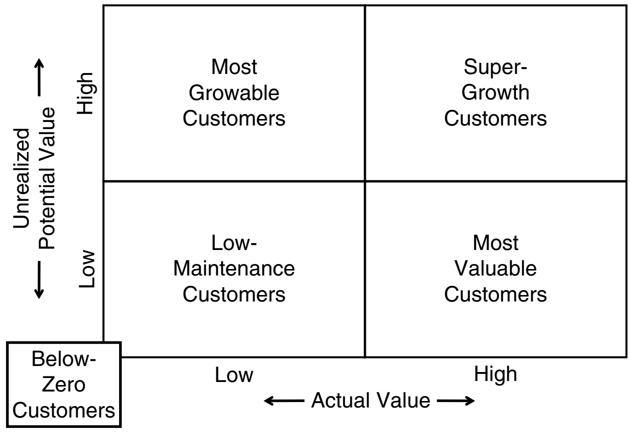

EXHIBIT 6.3 Customer Value Matrix

grow its share of customer (in order to realize some of this value), while one of the goals for a customer with low actual value and low potential value would be to minimize servicing costs. By thinking of individual customers in terms of each one's *actual value* (i.e., current LTV) and *unrealized potential values* (i.e., growth potential), a company could array its customers roughly as shown in Exhibit 6.3. (You'll find a more extensive discussion about managing experiences and values for these customers in Chapter 13.)

Five different categories of customers are shown on this diagram, and an enterprise should have different strategic goals for each one:

1. *Most valuable customers (MVCs).* In the lower-right quadrant of Exhibit 6.3, MVCs are the customers who have the highest actual value to the enterprise. This could be for any or all of a number of different reasons: They do the highest volume of business, yield the highest margins, stay more loyal, cost less to serve, and/or have the highest referral value. MVCs are also customers with whom the company probably has the greatest share of customer. These may or may not be the traditional heavy users of a product; the MVC may, for example, fly a lot less often but always pays full fare for first-class tickets. The primary financial objective an enterprise will have for its MVCs is retention, because these are the customers likely giving the company the bulk of its profitability to begin with. In the airline business, these are the platinum flyers in the frequent-flyer program. In order to retain these customers' patronage, an airline will give out bonus miles, offer special check-in lines, provide club **benefits**, and so forth. For a pharmaceutical company marketing prescription drugs to physicians, however, the most valuable customers may be those particular physicians who have the most influence over other physicians (key opinion leaders; see the section "Recognizing the Hidden Potential Value of Customers" earlier in this chapter.)
2. ***Most growable customers (MGCs).*** In the upper-left quadrant of Exhibit 6.3, MGCs are customers who have little actual value to the enterprise today but

significant growth potential. Here, of course, the enterprise's financial objective is to realize more of that potential value. As a practical matter, these customers are often large-volume or high-profit customers who simply patronize a different company. MGCs are often, in fact, the MVCs of the enterprise's competitors. So the company's objective will be to change the dynamics in some way so as to achieve a higher share of each of these customers' patronage. (Don't forget, however, that the reverse is also true: Your own MVCs are your competitors' MGCs.)

3. ***Low-maintenance customers.*** In the lower-left quadrant are customers who have little current value to the enterprise and little growth potential. But they are still worth something (i.e., they are still profitable, at some level), and there are probably a whole lot of them. The enterprise's financial objective for low-maintenance customers should be to streamline the services provided to them and to drive more and more interactions into more cost-efficient, automated channels. For a retail bank, for instance, these are the vast bulk of middle-market customers whose value will increase substantially if they can be convinced to use the bank's online services rather than taking the time and attention of tellers at the branch.
4. ***Super-growth customers.*** In the upper-right quadrant of Exhibit 6.3, many enterprises will have just a few customers who have substantial actual value *and also* a significant amount of untapped growth potential. This is more likely to be true for B2B firms than for consumer-marketing companies. If a company sells to corporate customers, it will likely have a few very large firms in its customer base that are giant, immense firms that already give the company a substantial amount of business. That is, they are likely already high-value customers, but they are so immense that they could still give the enterprise much more business. No matter what size B2B firm an enterprise is, if it sells to a Microsoft, Facebook, Toyota, Amazon, or some other corporate customer with a similarly large financial profile, chances are this customer is a super-growth customer. The business objective here is not just to retain the business already achieved but also to mine the account for more. There is one caveat, however: Sometimes super-growth customers, who obviously know that they represent immense opportunity for the companies they buy from, use their customer relationships to drive very hard bargains, squeezing margins down as they push volumes up. They can be merciless, because they know they are highly valuable to the firms they choose to buy from. (See the section "Dealing with Tough Customers" in this chapter.)
5. ***Below-zero customers (BZs).*** With very low or negative actual and potential values, BZs are customers who, no matter what effort a company makes, are still likely to generate less revenue than they cost to serve. No matter what the firm does, no matter what strategy it follows, a BZ customer is highly unlikely to ever show a positive net value to the enterprise. Nearly every company has at least a few of these customers. For a telecommunications company, a BZ might be a customer who moves often and leaves the last month or two unpaid at each address. For a retail bank, a BZ might be a customer who has little on deposit with the

bank, but tends to use the teller window often. (Some banks in the United States estimate that as many as 40% to 50% of their retail customers are, in fact, BZs.) For a B2B firm, there can be a razor-thin difference between a super-growth customer and a BZ, because some giant business clients can threaten to drive margins down so low that they no longer cover the cost of servicing the account. The enterprise's strategy for a BZ should be to create incentives either to convert the customer's trajectory into a breakeven or profitable one (e.g., by imposing service charges for services previously given away for free) or to encourage the BZ—very politely—to become someone else's unprofitable customer.

This categorization of customers by their value profiles is fairly arbitrary, because it presumes customers can be split into just a few tight groups, based on actual and potential value. But whether the enterprise uses the MVC-MGC-BZ typology or not, the enterprise should have different financial objectives for, and invest different levels of resources in, different customers. These decisions are based on a company's assessment of the amount of value each customer is or is not creating for the company already, and how much more value may or may not be possible. Understanding the value a particular customer represents is a necessary first step in a company's effort to **treat different customers differently**.

CUSTOMER REFERRAL VALUE

Obviously, some customers will refer new customers to an enterprise more frequently than others will, and this represents real value created by the referring customers. In most situations, a customer who comes into the enterprise's franchise because of another customer's referral is likely to be more satisfied with the service they receive, more loyal, and often significantly more valuable to the business than a customer who comes in through normal marketing or sales channels. This is only logical, because a friend's recommendation is a highly trusted vote of confidence. With social media and ratings systems, this referral value is now on steroids.

An enterprise should try to track customer referrals by individual customer, of course. For one thing, the enterprise needs to consider the fact of a referral in a customer's transactional records, because referred customers as well as referring customers may have different patterns of behavior and trajectories. In addition, the enterprise should probably thank the referring customer or provide other positive feedback that encourages additional referrals (although explicit monetary rewards are tricky here, as we will discuss soon).

The **Net Promoter Score (NPS),** a customer-satisfaction metric originated by the Bain consultant Frederick Reichheld and owned by Satmetrix (now part of NICE), is a compact single number designed to quantify the strength of a company's word-of-mouth reputation among existing customers.[12] Reichheld suggested that a business

[12] Fred Reichheld with Rob Markey, *The Ultimate Question 2.0: How Net Promoter Companies Thrive in a Customer-Driven World* (Boston: Harvard Business Review Press, 2011).

should survey its customers by asking *how willing they would be to recommend the business or product to a friend or colleague*, on a scale of 1 to 10. *Detractors* rate the likelihood anywhere from 1 to 6, while *promoters* rate it a 9 or 10. The NPS is calculated by subtracting the percentage of detractors from the percentage of promoters. With research from Bain and Satmetrix, Reichheld claimed that the resulting metric is positively **correlated** not only with customer loyalty but also with a company's growth prospects and its general financial performance. Reichheld also argued strongly that if a customer who is willing to refer another customer, the they must themselves be relatively more satisfied as well (and therefore more likely to remain loyal and valuable).[13] As a very simple number based on a single question, NPS doesn't offer a lot of diagnostic benefit—that is, by itself, it doesn't say much about why a customer is or is not willing to recommend, but it has to be admired for its simplicity and practicality as well as its intuitive logic. More recently, NPS has been expanded by its adopters to a transformative system for businesses rather than just a metric.[14]

Significantly, calculating NPS requires subtracting detractors from promoters, which is an excellent idea, because customer dissatisfaction has been found to be a much better predictor of defection than customer satisfaction is of loyalty. And most companies that do track their straight customer satisfaction scores don't bother trying to track dissatisfaction scores. This is a big mistake, because when customers talk about a company with other customers, it isn't always positive. And negative word of mouth can be an insidious, destructive force all by itself, with a real effect on the financial value of the firm. (More about this in Chapter 8, when we discuss social media.)

At least one study suggests that a customer's actual referral value—that is, the true financial value of a customer's referrals to an enterprise—is not well correlated with the value created by the customer's own spending. In other words, although a customer may refer others to a business, this doesn't necessarily mean that the customer herself spends much more than other customers. In a *Harvard Business Review* article, "How Valuable Is Word of Mouth?" Kumar, Petersen, and Leone developed a comprehensive model for calculating the value of referrals, taking into account the likelihood that a referred customer might have become a customer anyway, even without the referral. They then applied their model to a sample set of customers taken from two different actual firms—one telecom company and one financial services firm. What they found was that the value created by customer referrals is a very significant component of overall customer lifetime values. A decile analysis of customer spending

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[13] Reichheld with Markey, *The Ultimate Question 2.0*; Danny Pimentel Claro and Adriana Bruscato Bortoluzzo, "Profiling the Buzz Agent: Product Referral and the Study of Social Community and Brand Attachment," *BAR* (*Brazilian Administration Review*) 12, no. 2 (April/June 2015), available at https://www.scielo.br/j/bar/a/R5xVkVWPnSsqyGXbmxRfTzd/?lang=en, accessed August 30, 2021.

[14] In *The Ultimate Question 2.0*, Reichheld lays out the Net Promoter *System*, claiming that the Net Promoter Score, which he explains thoroughly in *2.0*, has been expanded by its adopters to a transformative system for businesses rather than just a metric. He gives many examples of standout companies that have high profitability and high Net Promoter ratings. Also see Nichole Elizabeth DeMere, "5 Interesting Ways Real Companies Use Net Promoter Score Results," HubSpot, https://blog.hubspot.com/service/net-promoter-score-results, accessed August 17, 2021.

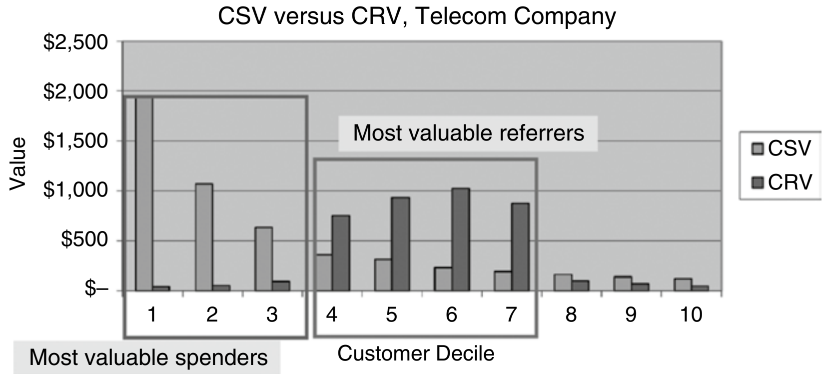

EXHIBIT 6.4 Decile Analysis of Customer Spending Values (CSVs) and Customer Referral Values (CRVs)

values (CSVs) and customer referral values (CRVs) for the telecom company's customers would look like Exhibit 6.4.[15]

What's interesting about the analysis shown in Exhibit 6.4 is that the highest CRVs are found among middling-level CSVs. That is, the company's most valuable customers, in terms of referrals, were not its highest spending-value customers at all, but neither were they its lowest spending-value customers. And while the study didn't suggest any actual reason for this phenomenon, it isn't hard to hypothesize an explanation. After all, when a potential customer is looking for information about a business they might want to buy from, what kind of friend, colleague, or expert do they seek out for their opinion? They don't necessarily seek out the opinion of a high-spending customer, but instead they want the opinion of someone who seems to have the most credible and authoritative *knowledge* with respect to the category, including not just this business but its competitors or alternatives, as well.

A very high-value social influencer—someone who constantly refers others to a business—is usually called a **customer advocate,** and many companies now work hard to find them and encourage them.[16]

Rewarding customers with monetary incentives for referring other customers can sometimes be helpful in encouraging more referrals. This is the basis for the classic direct marketing strategy colloquially known as member-get-a-member and is a common feature even today of many frequent-flyer programs, meal kit companies, and other product/service lines. Then there was the classic "Friends and Family" program

[15] Note: The authors defined customer lifetime values in terms of spending only, but we will call this "customer spending value," while in our definition of "lifetime value" customer referrals are already included.

[16] V. Kumar, J. Andrew Petersen, and Robert P. Leone, "How Valuable Is Word of Mouth?," *Harvard Business Review*, October 2007, available at https://hbr.org/2007/10/how-valuable-is-word-of-mouth#:~:text=Those%20with%20high%20lifetime%20values,measures%20we've%20labeled%20Misers, accessed May 21, 2021. Also see Mark Organ and Deena Zenyk, *The Messenger Is the Message: How to Mobilize Customers and Unleash the Power of Advocate Marketing* (Lioncrest, 2017).

launched by MCI, which was a remarkable success in the long-distance business in the 1990s. Name 10 friends or family members you make long-distance calls to, and if they become MCI customers, then everyone in your circle of friends and family will get a 10% discount off their calls to one another. Meal kit companies such as Hello Fresh and Home Chef that send ingredients and recipes direct to your door use this approach too; so do Tesla, Harry's subscription razors, and many others. But the very best and likely most valuable referrals will come without requiring any monetary incentive. If a customer is very happy with a company's product or service, then they are is much more likely to see referring their friend to the company as doing the friend a favor. If, however, a financial incentive is offered, then (the customer might think) how confident can the company be in the quality of its product?

> If a customer is very happy with a company's product or service, they is very likely to see referring their friend to the company as *doing the friend a favor*.

A highly successful online banking service in the United Kingdom, for instance, had a reputation for extremely good **customer service.** It had customer satisfaction levels far above its nearest bricks-and-mortar banking competitors, and the bank was proud of the fact that it had grown substantially in the past through customer recommendations. Citing Market & Opinion Research International, the firm's own website claimed it was "the UK's most recommended bank."[17]

However, after a few years in business, it had apparently begun to wear out its welcome among many of its most loyal customers. One customer, for instance, reported to the authors that while he used to recommend the bank to his friends regularly, he had stopped doing so. Why? Because lately the bank had been sending him repeated, irrelevant solicitations by mail. A 12-year customer of the bank, he "never borrows," but he and his wife were getting a near-weekly solicitation for mortgages or loans. "I still bank there. It's a good bank," he says. "But I used to recommend [this bank] all the time to friends and others. I just thought I was doing a good turn for my friends by recommending it to them. But now they're more like all the other banks out there—just trying to hustle me for more business. So I haven't recommended them recently to anyone. Also, I know several other customers who feel the same way."[18] And this may be one reason why this bank now pays its customers £25 for each new customer recommended to it. Put another way: The bank's current lower customer experience levels required it to pay a fee for recommendations it formerly got for free.

One large B2B company[19] performed a value analysis of its customer base and arrayed its customers by actual value and unrealized potential value, creating the scattergram shown in Exhibit 6.5. Each of the dots in the exhibit represents a different business customer. The customers in this graph who occupy the long spike out to the

[17] Customer interview, Peppers & Rogers Group.
[18] Customer interview, Peppers & Rogers Group.
[19] A client of Peppers & Rogers Group, identity not disclosed.

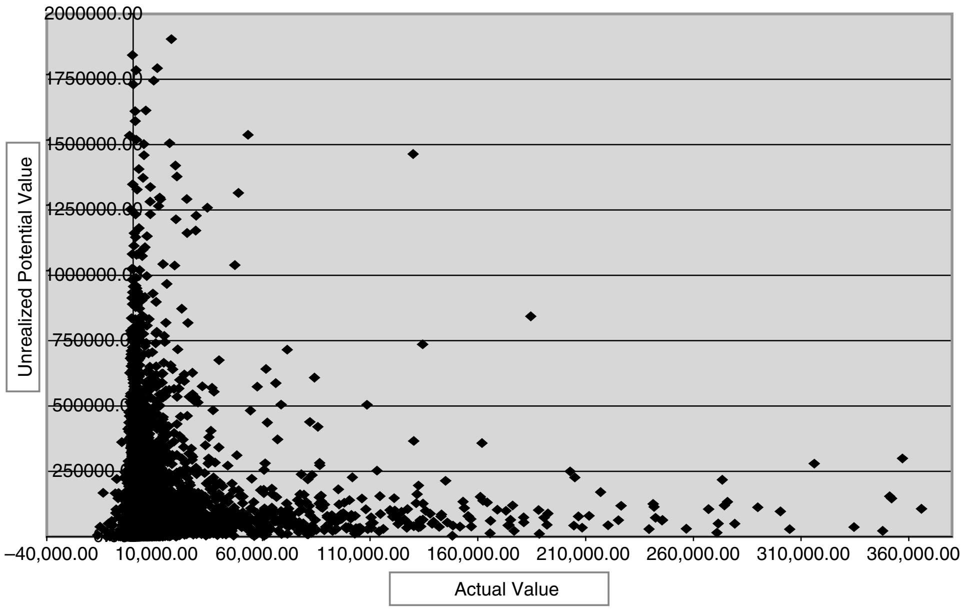

EXHIBIT 6.5 National Accounts' Actual versus Unrealized Potential Value

right represent this company's MVCs. Clearly, these are the customers giving the company the most business, and few of them have much unrealized potential value, because the company is getting the bulk of each one's patronage in its category. Down in the lower-left of the graph we can find a few customers who have less than zero actual value; these (of course) are this company's BZ customers.

The tall spike up the left-hand side of the scattergram represents this company's MGCs. These are the customers who don't give the firm much of their business right now but clearly have a great deal of business to give it, if they could be convinced to do so. You might note that the horizontal-vertical scales on this scattergram are not the same—that is, the vertical spike, if drawn to the same scale as the horizontal one, would soar up the page much farther than the illustration allows. And note: Most of the customers in this vertical spike are the company's *competitor's* MVCs.

Is It Fair to "Fire" Unprofitable Customers?

As a company gets better at predicting actual and strategic value, it will become clear that just as 20% or so of its customers will likely account for the lion's share of the firm's profitability, another relatively small group of customers is likely to account for the lion's share of service costs and transaction losses. It is not uncommon for a retail bank, for instance, to do a customer valuation analysis and learn that 110% of its profit comes from just the top 30% or so of its customers while the vast bulk of customers are either breakeven or unprofitable for the bank, when considered individually. Other businesses have similar problems, although retail banking is probably one of the most extreme examples.

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Because of traditional marketing's heavy emphasis on customer acquisition, for many companies, it would be anathema even to suggest it, but the plain truth is that, in many cases, a company would simply be more profitable if it were to *get rid* of some customers—provided, of course, that the customers it rids itself of are the ones who create losses without profit and who will likely continue to do so in the future.

Before leaping to the conclusion that this is unfair to customers, consider that it is the profitable customers—a company's best, most valuable customers—who are, in effect, subsidizing the unprofitable ones and probably without knowing it! So "firing" unprofitable customers is not at all a hostile activity but one designed to make the overall value proposition fairer for everybody. Nevertheless, there are some important ground rules to follow when reducing the number of BZ customers at a company:

- However a company defines the value of a customer, the analysis must apply the same way to everyone. The company engaging in careful customer value differentiation does not care about skin color, gender, religion, or political views. It cares only about each customer's actual and potential value, and it acts accordingly. This may disadvantage some customers who have long ago abandoned loyalty in favor of coupon clipping or other price shopping but will appropriately reward the customers who are keeping the business in business.
- Some companies, such as utilities or telecommunications firms (or banks, in some countries), have enjoyed monopoly or near-monopoly status in the past through regulatory directive. Even if they are no longer government-sanctioned monopolies, as the established incumbents these firms are likely to continue to have universal service mandates that require them to serve any and all customers. Such firms still may choose to define value or customer profitability in a more sophisticated way than simple revenue minus cost of service. The telephone company that is required by government mandate to provide basic service to Aunt Matilda in a rural area may not hope to make a profit on her, in the strictest financial sense, but rather than classifying her as a BZ customer, it might consider her part of the company's mission to serve the community, or simply part of the enterprise's fixed cost base. Moreover, accomplishing this mission probably will be related to the company's regulatory situation, and foreswearing such a customer might violate a legal requirement. For such a company, the real BZ customers would be those who move every few months and leave the final bill unpaid, requiring extra collection efforts; or who often cause mishaps with neighborhood lines; or who frequently change carriers or otherwise create excessive paperwork. For an e-commerce

> It's okay to stop spending money trying to get or keep a customer who generates a loss for the firm.

(*continued*)

company, it may be customers who abuse the company's return policy. These customers can be omitted from promotional mailing lists and other spending efforts. *It's okay to stop spending money trying to get or keep a customer who generates a loss for the firm.*

- Most important: Nothing about customer differentiation means treating anybody badly, ever. The enterprise that treats different customers differently will be required to maintain a consistently high floor of service that is the result of a fundamental recognition that customers are a 21st-century firm's most valuable asset, and—by definition—the firm's only source of revenue.

> Nothing about customer differentiation means treating anybody badly. Ever.

Dealing with Tough Customers

Sometimes, because of the structure of a B2B enterprise's own industry or its distribution network, or simply because of the type of market it has to deal with, it will have to cope with very powerful business customers—customers who have a great deal of negotiating leverage in their relationship with the vendors they buy from. Customers like these, while they may represent super-growth customers when considered in one light, are large enough that they can also demand and get highly favorable terms, in the form of lower prices, better service, priority delivery, and so forth. Occasionally, such customers are so powerful that they may all but require an enterprise to lose money just to serve them. But extremely large customers also have prestigious names and are difficult for any company to resist.

In retailing, the giant megastores and category killers, such as Amazon, Walmart, or some of the fast-food chains, are very tough customers, when it comes to the manufacturers and others whose products they sell. In the high-tech field, companies that manufacture components in mature markets, such as microchips, must sell to tough customers such as Lenovo and Hewlett-Packard. In the automotive category, almost all of the manufacturers are large, difficult to deal with, and obsessively concerned with price.

It's important for a company to keep its perspective when serving "oppressive but necessary customers."[a] In the first place, a firm can make rational decisions with respect to such relationships only if it understands its customers' actual and potential values across the entire enterprise. But in addition, management should keep in mind that it really is a power struggle, so the enterprise must somehow develop more power for itself in the relationship. (Ironically, given all our discussion about

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trust, a tough customer will very likely trust the enterprise, but it's the enterprise that will need to step carefully when dealing with this customer.) The goal, however, is to serve the customer's best interests, and the enterprise won't be able to do this if it has to give up on the relationship entirely because it has become too one-sided.

One former senior executive at Company X, a Fortune 100 technology firm, says, "[Company X] was always looked upon as the must-win account for every supplier—and we knew that well. So we routinely adopted very tough positions and made stringent demands." According to this executive, the company's "typical behavior" with respect to suppliers was to "work closely with that company, study them, and try to extract as much of the process and knowledge as possible, then fire the supplier and do it ourselves. Overall, being self-sufficient was always a key objective. A few companies managed to avoid this ultimate fate by continually innovating faster than we [at Company X] could absorb; so they maintained the ability to deliver new value each year."

This is the policy that many large and powerful buyers follow, especially in highly competitive environments or during periods of rapid and potentially **disruptive innovation.** The problem, when selling to such a customer, is that it will be very difficult to increase profitability or even to maintain it. It will be nearly impossible to establish any kind of loyalty or to protect margins—but that is, in fact, the purpose behind the customer's behavior in the first place. When dealing with suppliers, this kind of customer wants to use its power to hammer its costs down; and powerful firms have powerful hammers.

In 2020, Walmart suppliers were told that on-time and in-full (OTIF) shipments, across all categories, must be 98% complete instead of the traditional 70%. Suppliers who didn't meet new guidance would be fined 3% of the cost of goods. The memo sent shockwaves through the supplier community, particularly smaller companies that utilized less-than-truckload shipments, and suppliers who handled their own freight as well as those who utilized Walmart's logistics for moving goods.[b]

Sometimes an enterprise can deal effectively with tough customers by devising some service or offering that is **customized** to each customer's own needs, or that is available only because of the enterprise's own, larger breadth of experience or knowledge of the marketplace. In the commercial explosives business, Orica is a global company serving large mining companies and quarry operators.[c] Such customers use explosives to break rocks up into pieces of optimal size. An ineffective blast might leave the rock in chunks too large to be processed in an economically viable way. But as many as 20 different geological variables have to be considered when calibrating an explosive blast, and each customer's ability to experiment with these parameters is limited. Because of its size, and the many different mines and quarries Orica deals with, however, the company has collected a great deal of information from around the world, cataloging input parameters and blast results for a wide variety of geologies and situations. As a result, Orica has developed a sound understanding of blasting techniques and now offers to take charge of the entire

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blasting process for a customer, selling a service contract for broken rocks of a specific size. This service has two advantages for Orica's customers:

> First, they minimize the risk of poorly executed blasts. With an Orica contract, a customer, together with Orica, basically establishes a floor price for correctly broken-up rock—or broken rock of a certain size rather than simply buying an order of explosives. But second, many of a customer's fixed costs, such as equipment for drilling and employees to manage the process, now become variable costs, which makes it that much easier for the company to manage each separate blasting project for its own customers. What makes this service useful to customers is the fact that Orica is uniquely positioned to compile information on blast techniques and parameters in a wide variety of situations. Any single one of its customers would have a great deal of difficulty duplicating this expertise.

Four principal tactics can be used to improve and maintain the value of even the toughest customers, and each of these tactics involves increasing the enterprise's relative power, uniqueness, or indispensability in the relationship:

1. *Customization of services or products.* An enterprise can build high-end, customized services around the more commodity-like products or services it sells, which creates **switching costs** that increase a customer's willingness to remain loyal, rather than bidding out the contract at every opportunity. Ideally, the enterprise will lock the customer into a Learning Relationship, but most tough customers will be wary of allowing such relationships to develop. The strategy here is for the company to ensure that whatever high-end services are developed can be duplicated only by its competitors with great effort, even if they are instructed in advance (and they almost certainly will be by this tough customer!). This was Orica's strategy in offering broken rock of a certain size to customers rather than simply selling them explosives.
2. *Perpetual, cost-efficient innovation.* To the extent that an enterprise can stay ahead of its tough customer with innovative product or service ideas, it will always have something to sell. The organizational mission must center on being nimbler, more creative, and cost efficient—all at the same time. But the value such a firm is really bringing to the customer here is innovation, not the products themselves. Many tough customers will do their best to absorb a seller's innovation in order to do it themselves or perhaps even to disseminate it to the seller's own competitors, in order to maintain vigorous competition and low prices. In either case, the customers' motive is to regain their negotiating power in dealing with the seller. So perpetual innovation is just that—perpetual. If a company can keep

(*continued*)

the wheels spinning fast enough, and provided that it doesn't lose control of costs, it can safely deal with very tough buyers.

3. *Personal relationships* within the customer organization. In the end, businesses have no brains, and they make no decisions. Only the people within a business make decisions, and people are both rational but also emotional by nature. Therefore, the individuals within the enterprise need to have personal relationships with the individuals within the customer's organization. In the high-tech or automotive arena, this might mean developing relationships with the engineers within a customer's organization who are responsible for designing the company's components into the final product. In the retailing business, it could mean developing relationships with the regional merchandising managers who get promoted based on the success of the programs the enterprise helps organize for them.
4. *Direct appeals to end users.* A highly desirable brand or a completely unique product in heavy demand by the customer's own customers will pull a seller's products through the customer's own organization more easily. The classic "Intel Inside" advertising campaign was designed to create pull-through for Intel. When Bose offers Amazon an exclusive arrangement for particular configurations, or makes it possible for Amazon or Walmart to offer exclusive products with brand names such as Barbie or Transformers or Harry Potter, it is making itself indispensable to this very tough customer. Similarly, any sort of information system or added service that saves time or effort for the end user can also be expected to put pressure on a tough customer. Dell's web pages for **enterprise customers** not only save money for the customers but also give Dell a direct, one-to-one relationship with every executive who actually has a Dell computer on their desk.[d]

Management should never forget, however, that selling to a tough customer is a deliberate decision, and it's possible sometimes that this decision will be made for the wrong reason. There are almost always choices to be made when thinking about the types of customers to serve, but often companies focus on very large, highly visible, and strategic customers (i.e., tough customers), in the erroneous belief that simply because of their size they will be the most profitable. But, according to the former technology executive from Company X:

> *Overall, I don't think that we at [Company X] are all that different from most category-dominant companies. These guys know they're good and can get away with demanding just about anything. What many suppliers discover sooner or later is that despite the outward allure of serving a company*

(*continued*)

> *like ours, once you actually win the business, the long-term payoff can be too painful to harvest. It was not unusual for a supplier to fire us as a customer by politely declining to bid on the next program.*

[a] Thanks to Bob Langer, Tom Spitale, Vernon Tirey, Steve Skinner, and Lorenz Esguerra for their perspectives on the issues in this section on "tough customers." The term *oppressive-but-necessary customers* is from Tom Spitale.
[b] Kim Souza, "Walmart demands all suppliers comply with 98% on-time in-full shipment rule," TB&P, September 3, 2020, https://talkbusiness.net/2020/09/walmart-demands-all-suppliers-comply-with-98-on-time-in-full-shipment-rule/, accessed August 25, 2021.
[c] See http://www.oricaminingservices.com/GlobalHome.aspx accessed April 23, 2021. See also Jill Jusko, "How to Build a Better Supplier Partnership," *IndustryWeek*, May 12, 2011, available at https://www.industryweek.com/the-economy/article/21934785/how-to-build-a-better-supplier-partnership, accessed April 23, 2021; and the Executive Office of the President and the U.S. Department of Commerce, *Supply Chain Innovation: Strengthening America's Small Manufacturers, a White House report* (March 2015), available at https://obamawhitehouse.archives.gov/sites/default/files/docs/supply_chain_innovation_report_final.pdf accessed April 23, 2021.
[d] See Dell EMC Support Technologies at https://www.dell.com/support/home/en-us, accessed August 17, 2021.

Managing the Mix of Customers

One way to think about the process of managing customer relationships is that the enterprise is attempting to improve its situation not just by adding as many new customers as possible to the customer base but also by managing the mix of customers it deals with. It wants to add to the number of MVCs, create more profitability from its MGCs, and minimize the number of BZs. An enterprise in this situation could choose either to emphasize adding new customers to its customer base or (instead or in addition) to increase the values of the customers in its customer base. So imagine if an enterprise were to plot the distribution of its customer values on a chart, as in Exhibit 6.6, with actual values of customers shown across the bottom axis and the number of customers shown up the vertical axis.

Curve 1 on Exhibit 6.6 shows the enterprise's current mix of customers, with just a few BZs and MVCs at either end of the spectrum and the bulk of customers lying in between these two extremes. By applying a traditional customer-acquisition marketing strategy the enterprise will end up acquiring more and more customers, but these customers are likely to show a very similar mix of valuations as in its current customer base, as shown by Curve 2. Market share will likely improve, but the mix of customers will almost certainly remain the same. In fact, a customer acquisition strategy often results in a degraded **mix of customer values,** when an enterprise focuses on the number of customers acquired (as happens at many companies) without respect to their values, or by seeking customers attracted only by a price discount. Almost by definition, low-value customers are easier to acquire than high-value customers. If the

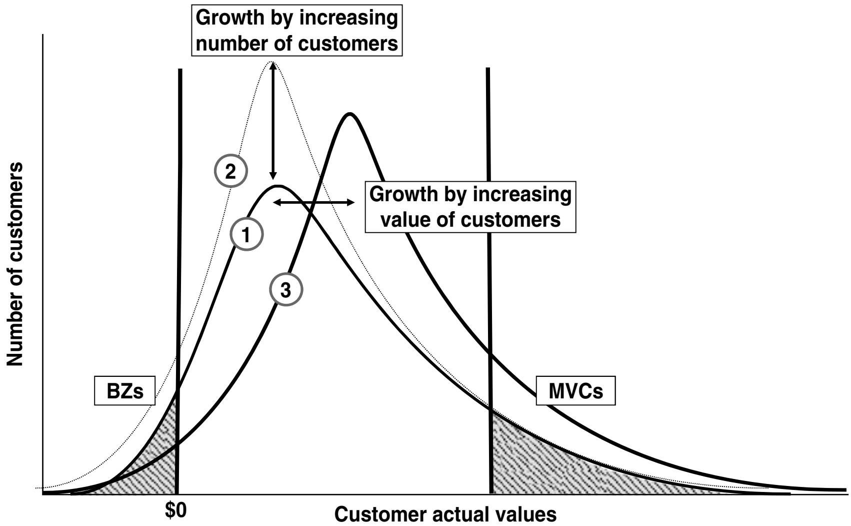

EXHIBIT 6.6 Managing the Mix of Customers

only variable being measured by the firm's management is the *number* of customers acquired, then average customer values will almost certainly decline rather than remain the same, as the company's customer-acquisition efforts ramp up.

If, however, the enterprise employs a customer-centric strategy, it will not be trying to acquire just *any* customers; instead, it will focus its customer acquisition efforts on acquiring higher-value customers. Moreover, it will focus a lot of its effort on improving the value of its existing customers (by keeping them longer and growing them bigger) and moving them up in value individually. The result of such a strategy is shown as Curve 3 in Exhibit 6.6. An enterprise that launches a successful CRM effort will end up shifting the customer mix itself, moving the entire customer base into a higher set of values, and reducing the number of BZs, while increasing the number of MVCs.

For over a decade, creating a valuable customer base has required understanding the distribution of customer relationship values and investing in acquisition, development, and retention accordingly.[20] Think of this as **customer value management.** By taking the time to understand the value profile of a customer relative to other customers, enterprises can begin to allocate resources intentionally to ensure that the most valuable customers remain loyal. The future of an enterprise,

[20] Peter C. Verhoef, Peter C. and Katherine N. Lemon, "Successful Customer Value Management: Key Lessons and Emerging Trends," *European Management Journal* 31, no. 1 (02, 2013): 1; Peter C. Verhoef and Katherine N. Lemon, "Successful Customer Value Management: Key Lessons and Emerging Trends," *European Management Journal* 31, no. 1 (February 2013): 1–15; Michael Lewis, "Customer Acquisitions Promotions and Customer Asset Value," *Journal of Marketing Research* 43 (May 2006): 195–203; and Roland T. Rust, Katherine N. Lemon, and Valarie Zeithaml, "Return on Marketing: Using Customer Equity to Focus Marketing Strategy," *Journal of Marketing* 68 (January 2004): 109–127.

therefore, depends on how effectively it acquires profitable new customers, develops the profitability of existing customers, and retains existing profitable relationships.[21] Customers will want to spend money with a business that serves them well, and that is nearly always a company that knows them well and uses that knowledge to build relationships in which customers perceive great value and benefit.[22]

Certainly one of the most important benefits of ranking customers by value is that the enterprise can more rationally allocate its resources and marketing efforts, focusing more on high-value and high-growth customers and less on low-value customers. Moreover, the enterprise will likely find it less attractive, as a marketing tactic, to acquire strangers as customers—some of whom will never be worth anything to the company.

Final Thoughts on Value Differentiation

Treating different customers differently requires an enterprise to know which customers to treat differently first, and the simple fact is that some customers are always more profitable for it than others. Knowing which customers are more valuable to it allows an enterprise to better allocate its own limited resources, and to prioritize its actions in a manner designed to ensure that the most customer-centric practices can actually be implemented cost-efficiently.

However, in precisely the same way that a stock's price is not based on the profits a company has already earned, but rather on what investors think the company is likely to earn in the future, the value that any customer represents to an enterprise today is not based on what the customer has already spent, but on what the customer is likely to spend in the future. And, as they are required to say in the investment business, "past performance is no guarantee of future results." The future patronage of any customer can't be known in the present, which means that customer valuations will always involve approximation and subjectivity. An enterprise with a **business model** that is based on a relatively straightforward mix of subscription revenue and retention rate (for instance, a mobile phone carrier, or a **SaaS** vendor) can make reasonably useful calculations with respect to its customers' lifetime values. And a business with a large number of customers whose individual transactions and digital interactions are analyzed in a detailed way can often use predictive analytics to calculate the likely future patronage levels of particular types of customers, in the same way that Amazon or Netflix can recommend purchases to a customer based on what other, similar types of customers have purchased in the past. Nevertheless, even companies that have none of these advantages can still use their judgment to make estimates of the lifetime values of the different types of customers they serve, or they can select

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[21] Peter Fader, *Customer Centricity: Focus on the Right Customers for Strategic Advantage* (Philadelphia: Wharton School Press, reprinted 2020).

[22] "When Seeking a Digital Advantage, Is Consumer Trust a Missing Piece of the Puzzle?" Ernst & Young, December 21, 2020, available at https://www.ey.com/en_us/alumni/when-seeking-a-digital-advantage-is-consumer-trust-the-missing-piece-of-the-puzzle, accessed August 31, 2021.

proxy variables to serve as substitutes, allowing them at least to rank their customers by value.

But most importantly, as this chapter has shown, by relying on a taxonomy of customer types based on their different value profiles, including both actual values and unrealized potential values, the enterprise can create a useful model for setting different objectives for different customers—whether an effort should be made to grow a customer into a bigger customer, or to retain the customer longer, or to reduce the costs of serving the customer.

When it comes to treating different customers differently, however, determining the appropriate financial objective for a customer based on the customer's value profile is just the beginning. To achieve whatever financial objective has been set, the enterprise must alter the customer's future behavior in some way; by changing its own behavior to the customer, it may get the customer to do something the customer otherwise would not have done.

But of course this is the purpose of all marketing, is it not? The only reason any business would spend anything at all for marketing is because it hopes to get its customers to do something they would not otherwise have done, in the absence of the marketing. To behave differently. To become more valuable to the firm. And the secret to changing a customer's behavior is to address the customer's own needs—to better satisfy a customer's wants, preferences, or desires. To become more valuable to the customer. But guess what? As different as customers are in terms of their value *to* the business, they are even more different in terms of what they need *from* the business.

In the next chapter we will explore how the enterprise can differentiate based on their individual needs.

CHAPTER 7

IDIC Step 2: Differentiate Customers by Needs

Strive not to be a success, but rather to be of value.

—Albert Einstein

All value for a business is created by customers, but the reason any single customer creates value for a business is that a customer sees the business as a way to meet that particular customer's own individual **needs.** While it's important to recognize that different customers will create different amounts of value for the enterprise (i.e., some customers are worth more than other customers, a subject we explored in Chapter 6), it's even more important to understand how customers differ in terms of their individual needs, and this is the topic we will tackle in this chapter. Individual customer valuation methods are fairly well established as an important steppingstone for managing the **customer-strategy enterprise.** Academics and business professionals alike spend much time and energy testing the effectiveness of alternative methods and models. But **differentiating** customers based on their needs is in some ways a more challenging goal, not so widely practiced by companies in a formal way—not even by those professing to take a **customer-centric** approach to business. At its heart, ***needs differentiation*** of customers involves using feedback from an identifiable, individual customer to predict that customer's needs better than any competitor can who doesn't have that feedback. In addition to categorizing customers by their value profiles (see Chapter 6), it is vital to categorize customers based on their individually expressed needs when they are similar. This is the only practical way to set up criteria for **treating different customers differently**.

Having a good knowledge of customers' value is certainly important, but to use customer-centric tools and customer strategies to increase a customer's value, the business must be able to see things from the customer's perspective, with the realization that there are many different types of customers whose perspective must be individually understood. Value differentiation by itself will not give a company this perspective. Think about it: Except for very frequent flyers, customers don't usually know or care what their value is to a business. Customers simply want to have their problem solved, and every customer has their own slightly different idea on how the process should be handled, even if more than one customer wants a problem solved a particular way. The key to building a customer's value is understanding how *this* customer wants it solved. So one key to building profitable relationships is developing an understanding of how customers are different in terms of their needs and how (and to what extent) such needs-based differences relate to different customer values, both actual and potential. What behavior changes on the customer's part can be accomplished by meeting those needs? What are the triggers that will allow the firm to actualize some of that customer's **unrealized potential value?**

In this chapter, we consider the different needs of different customers and the role that customer needs to play in an enterprise's relationship-building effort. In most situations, it makes sense to differentiate customers first by their value and then by their needs. In this way, the relationship-building process, which can be expensive, will begin with the company's higher-value customers, for whom the investment is more likely to be worthwhile. (An important exception to this general rule, however, applies to treating different customers differently on the internet through mobile and other devices. On the web, the incremental costs of automated **interaction** are near zero, so it makes little difference whether an enterprise differentiates just its top customers by their needs or all its customers.)

> In the view of some, differentiating by value first, then needs, may appear to focus first on the company's needs, then those of the customers; but another way to look at this order of strategic imperatives is to think about how a company that used to treat every customer's needs as equally important will now focus more on the needs of those customers who **contribute** the most to the success of the firm and therefore will put the needs of some customers ahead of the needs of other customers, thus allocating resources best for the **most valuable customers**.

DIFFERENTIATING CUSTOMERS BY NEED: DEFINITIONS AND EXAMPLES

Before going too much further, let's pause to define the important terms relevant to this discussion.

Needs

When we refer to customer needs, we are using the term in its most generic sense. That is, what a customer needs from an enterprise is, by our definition, what they want, what they prefer, or what they would like. In this sense, we do not distinguish a customer's needs from their wants. For that matter, we do not distinguish needs from preferences, wishes, desires, or whims. Each of these terms might imply some nuance of need—perhaps the intensity of the need or the permanence of it—but to simplify our discussion, we will refer to them all as needs.

It is what a customer needs from an enterprise that is the driving force behind the customer's behavior. Needs represent the *why* (and often, the *how*) behind a customer's actions. *How* customers want to buy may be as important as *why* they want to buy. The presumption has been that frequent purchasers use the product differently from irregular purchasers, but it may be that they alternatively or additionally like the available channel better. For that matter, it may be that they like the communications channel better. The point is that needs are not just about product usage but about an ***expanded need set*** (which we discuss fully in Chapter 10) or the combination of product, cross-buy product and service opportunities, delivery channels, communication style and channels, invoicing methods, and so on.

In a relationship, what the enterprise most wants is to influence customer behavior in a way that is financially beneficial to the enterprise; therefore, understanding the customer's basic need is critical. It could be said that while the amount the customer pays the enterprise is a component of the customer's value to the enterprise, the need that the enterprise satisfies represents the enterprise's value to the customer. Needs and value are, essentially, both sides of the value proposition between enterprise and customer—what the customer can do for the enterprise and what the enterprise can do for the customer.

It could be said that while the amount the customer pays the enterprise is a component of the customer's value to the enterprise, the need that the enterprise satisfies represents the enterprise's value to the customer.

Customers

Now that we have defined both customer value and customer needs, we should pause for a reminder of the definition of *customer* before continuing with our discussion. In Chapter 1, we defined what we mean by customer. On the surface, the definition should be obvious. A customer is one who "gives their custom" to a store or business; someone who patronizes a business is the business's *customer*. However, the overwhelming majority of enterprises serve multiple types of customers, and these different types of customers have different characteristics in terms of their value and their individual needs.

A brand-name clothing manufacturer, for instance, has two sets of customers: the end-user consumers who wear the clothes and the retailers that buy the clothes from the manufacturer and sell them to consumers. As a customer base, clothing consumers do not have as steep a **value skew** as, say, a hotel's customer base, even though some consumers might buy new clothes every week. (In other words, the discrepancy in value between the most valuable consumers and the average will generally be smaller for a particular clothing merchant.) But all consumers of the clothing manufacturer do want different combinations of sizes, colors, and styles. So even though clothing consumers may not be highly differentiated in terms of their value, they are highly differentiated in terms of their needs. Retailer customers also have very different needs: Some need more help with marketing, with advertising co-op dollars, or with displays. Different retailers will have different requirements for invoice or address format and timing or for shipping and delivery. They may need different palletization or precoded price tags. Interestingly, retailers will also vary widely in their values to the clothing manufacturer, with much more value skew than consumers will show. Some large department store chains will sell hundreds of times more stock than can a local mom-and-pop clothing shop. And some online retailers have stocking and timing issues that are quite different from retailers who sell mostly through in-store displays. Thus, retailer customers display high levels of differentiation in terms of both their needs and their value.

For the clothing manufacturer, if the enterprise expresses an interest in improving its relationships with its customers, the question to answer is: Which customers? And this is, in fact, the type of structure in which most enterprises operate. They won't all sell products to retailers, but the vast majority of businesses do have distribution partners of some kind—online and bricks-and-mortar retailers, dealers, brokers, representatives, value-added resellers, and so forth. Moreover, a business that sells to other businesses, whether these business customers are a part of a distribution chain or not, really is selling to the *people* within those businesses, people of varying levels of influence and authority. Putting in place a relationship program involving business customers will necessarily entail dealing with purchasing agents, approvers, influencers, decision makers, and possibly end users within the business customer's organization, and each of these people will have quite different motivations in choosing to buy.

The logical first step for any enterprise embarking on a relationship-building program, therefore, is to decide which sets of customers to focus on. A relationship-building strategy aimed at end-user consumers can (and, in most cases, should) involve some or all of the intermediaries in the value chain in some way. However, it is a perfectly legitimate goal to seek stronger and deeper relationships with a particular set of intermediaries. The basic objective of relationship building with any set of customers is to increase the **value of the customer base**; thus, it's important to understand from the beginning exactly which customer base is going to be measured and evaluated. Then, when focusing on that customer base, the enterprise must be able to map out its customers in terms of their different values and needs.

It is easy to confuse a customer's needs with a product's **benefits.** Companies create products and services with benefits that are specifically designed to satisfy customer needs, *but the benefits themselves are not equivalent to needs.* In traditional marketing discipline, a product's benefits are the advantages that customers get from using the product, based on its features and **attributes.** But features, attributes, and benefits are all based on the product rather than on the customer. Needs, in contrast, are based on the customer, not the product. Two different customers might use the same product, based on the same features and attributes, *to satisfy very different needs.*

When it focuses on the customer's need, the enterprise will find it easier to increase its **share of customer,** because ultimately it will seek to solve a greater and greater portion of the customer's problem—that is, to meet a larger and larger share of the customer's need. And because the customer's need is not directly related to the product, meeting the need might, in fact, lead an enterprise to develop or procure other products and services for the customer that are totally unrelated to the original product but closely related to the customer's need.

Demographic data, and even age, can lead our understanding of what makes customers tick quite far astray. One recent study disproves assumptions about the similarity of members of demographically defined cohorts and proposes a new system for audience profiling based on shared values. Nobody acts their age anymore, gender roles have changed dramatically, and income doesn't **correlate** to behavior as it might have in the past.

It is easy to confuse a customer's needs with a product's benefits. Companies create products and services with benefits that are specifically designed to satisfy customer needs, *but the benefits themselves are not equivalent to needs*. Two different customers might use the same product, based on the same features and attributes, *to satisfy very different needs*.[1]

Demographics Do Not Reveal Needs

Nearly fifty years ago, a groundbreaking marketing article asked: "Are Grace Slick and Tricia Nixon Cox the same person?" Grace Slick, lead singer for the rock group Jefferson Starship, and Tricia Nixon Cox, the preppy daughter of Richard Nixon who married Dwight Eisenhower's grandson, were demographically indistinguishable. They were both urban, working women, college graduates, age 25 to 35, at similar income levels, household of three, including one child.

What made this question startling in the early 1970s was that it undermined the validity of the traditional demographic tools that marketers had been using for decades to segment consumers into distinct, identifiable groups. With demographic statistics, mass marketers thought they could distinguish a quiz show's audience from, say, a news program's. Then marketers could compare these audiences with the demographics of soap buyers, tire purchasers, or beer drinkers. The more effectively a marketer could define their own customers and target prospects, differentiating this group from all the other consumers who were not the target, the more efficiently they could get their message across in a world of limited television channels, radio stations, magazines, and newspapers. They could buy media that would reach a higher proportion of their own target audience.

But demographics could not explain the distinctly nondemographic differences between Grace Slick and Tricia Nixon Cox. So as computer capabilities and speeds grew, marketers began to collect additional information to distinguish consumers, not just by their age and gender, but also by their attitudes toward themselves, their families and society, their beliefs, their values, their behaviors, and their lifestyles.

[1] A large body of academic research, as well as trade articles and professional work, has been published on the topics of benefits, attributes, and needs as well as the findings about the different reasons two customers with the same transaction history are motivated to buy the same products.

(*continued*)

There are dozens of similar examples today of pairs of people who are demonstrably alike demographically, but have very different lifestyles and needs. Think about Ilhan Omar and Nicki Minaj—both immigrants who came to the United States from other countries, both born in 1982, both women of color, both professional working mothers. But Ilhan Omar was elected to the US House of Representatives from Minnesota's 5th district in 2019, while Nicki Minaj is known as the Queen of Rap.

Source: Excerpted and updated from Don Peppers and Martha Rogers, Ph.D., *The One to One Future* (1993), in reference to John O'Toole, "Are Grace Slick and Tricia Nixon Cox the Same Person?" *Journal of Advertising* 2 (1973): 32–34.

David Allison, founder and CEO of Valuegraphics, surveyed almost a half-million people from 180 countries around the world (with the interviews conducted in 152 languages). Researchers used algorithmic survey-targeting techniques to construct a random stratified statistically representative sample of the population of all regions of the globe. The surveys measured responses to a list of 40 core personal values derived from the World Values Index, the Bhutan Gross Domestic Happiness Index, and other established social science tools used by the scientific community. An additional 380 contextualizing questions were included, about wants, needs, and expectations, for a total of 420 metrics.

As shown in Exhibit 7.1, no demographically defined segment produced constituent agreement of more than 17%, with an average of 8%.

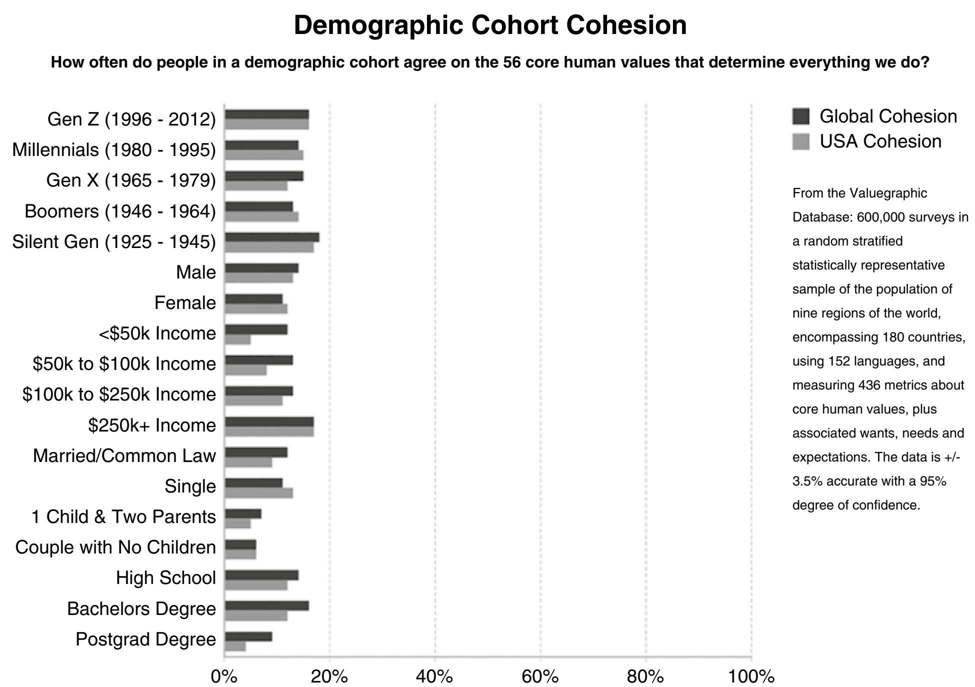

EXHIBIT 7.1
Source: Valuegraphics Database, 2021.

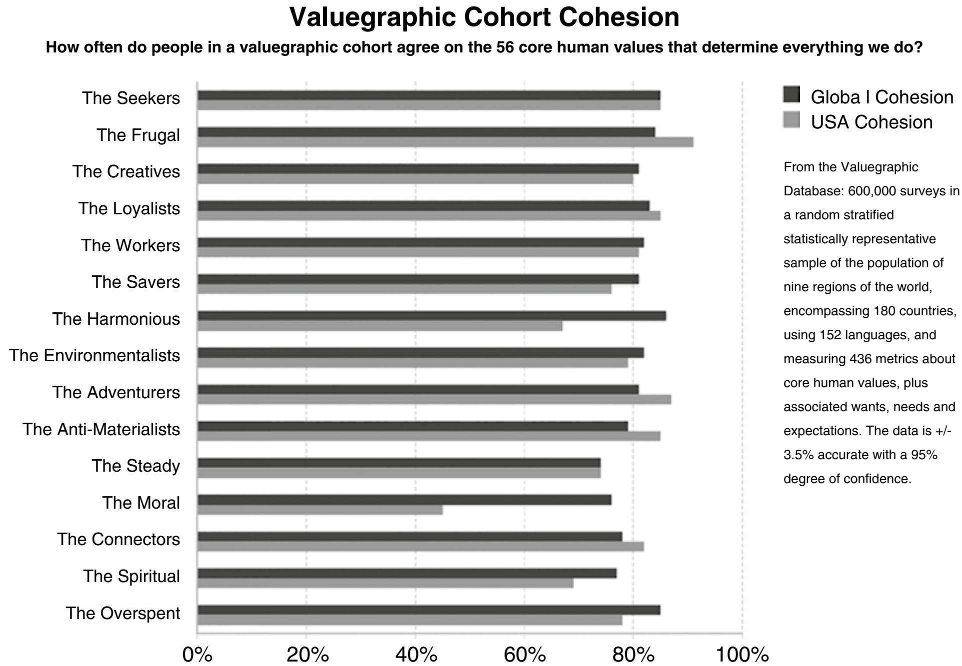

EXHIBIT 7.2
Source: Valuegraphics Database, 2021.

In Exhibit 7.2, we see the results in the same study of looking at the level of agreement among members of groups defined by shared values, "chosen as a profiling system because of a foundational tenant of sociology: Values determine behavior."[2] Exhibit 7.2 shows the 10 values-based cohorts that have the highest levels of agreement, ranging from 76% to 89%.[3]

Some Examples of Needs Differentiation

Consider a company that manufactures interlocking toy blocks for children, such as Lego or Mega Bloks. Three 10-year-old boys or girls might buy the same set of building blocks for a spaceship toy, at the same store on the same day and at the same price, but for three completely different reasons:

1. The first child (let's call him the *constructor*) might take great pleasure in putting the blocks together just the way they are shown in the very complicated diagram. Once that's done, once the spaceship toy has been constructed, he's

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[2] "New Research Casts Doubt on Demographic Profiling," press release, Valuegraphics, 2021.
[3] David Allison, *We Are All the Same Age Now: Valuegraphics and the End of Demographic Stereotypes* (Lioncrest, 2018).

had his fun. He might leave it together in his room for a couple of weeks but then tear it apart just to have the pleasure of putting it together again.

2. The second child (let's call her the *role player*) is eager to put the spaceship together so she can act out the part of the spaceship commander, or maybe the enemy alien, or maybe both.
3. The third child (let's call him the *creator*) might not enjoy putting together anything that someone else has already diagrammed. Instead, he prefers to use the pieces to assemble something quite different based on his own imagination.

The point is that if the toymaker just knew which child was which, it could sell a wide range of additional products and services to each different child, with the objective of meeting that specific child's different needs.

- For the constructor, the toymaker could sell extra diagrams for additional interesting things the child could construct from the same set of blocks, or maybe additional things that could be made with this set of blocks and one or two other, similar sets. The constructor might even be interested in an inventory-control app for all the different blocks he has.
- For the role player, the toymaker could sell story books, videos, and costumes. A toy lightsaber, astronaut helmet, or ray gun would juice up any role.
- And for the creator, the toymaker could offer interesting blocks or extra pieces in unusual colors or shapes, or perhaps supplemental sets of parts that haven't been planned into any diagrams at all.

This is only a hypothetical example, of course, and we could easily come up with several additional types of customers, based on the needs they are satisfying with these construction blocks. For instance, there might be some girls who want the spaceship set of blocks because they are really interested in rockets, outer space, and other things astronautical. Or there might be some boys who want the set because they are collectors of these kinds of building-block toys, and they want to add this to a large set of other, similar toys. Or there might be others who like to use this kind of toy to invite friends over to join them in working on the assembly. Any single child might, in fact, have any combination of these needs that they wish to satisfy, either at different times or in combination.

Clearly, the features, attributes, and benefits of the toymaker's various products represent a product-centric view of each customer's experience, but the *needs* that an individual customer has for the product represent the customer-centric view. Only by knowing *what a customer needs a product's features and attributes to do for them* can the enterprise truly understand the **customer experience**, not from the perspective of the product that was sold, but from the perspective of the customer that bought it. The point is that by taking each different customer's own individual perspective—by seeking to understand each different customer's *needs*—the enterprise can more effectively meet those needs, treating different customers differently in such a manner as to become more valuable to each customer in a different way.

Similar **needs-based differentiation** of customers can be accomplished for other products and services. Consider, for instance, a commercial real estate broker and the broker's various property-buying clients, who have at least three distinguishing types of needs:

- One type of customer, which we could call the buy-and-hold investor, is interested in obtaining a property that represents good value. Patient and careful, they will be concerned about keeping transaction costs to a minimum.
- Another type of customer, which we might call an active deal maker, is rarely interested in long-term investing because they focus on flipping properties relatively quickly. What a deal maker truly needs from their real estate broker would be immediate availability, speed of service, and agility.
- Still a third type, which we could call an operator, is in the business of putting together real estate properties and investments as a way to create new opportunities for growth. For instance, this customer might want to own a property that would soon increase in value because it lies just outside a new shopping mall being built. An operator would be looking for synergies between and among properties, and they won't be overly worried about transaction costs.

Or consider an airline's different customers. Even though they're all on the same plane going from one place to another at the same exact time, they may have very different needs from the airline:

- Customer A is a business traveler, flying on their company's expense account. Not overly concerned with price, as long as it's within budget, this customer needs the best schedule (Monday afternoon departure only, after the last meeting) and wants flawless reliability—on-time arrival, ease of check-in, good baggage handling.
- Customer B is a nonbusiness flyer visiting their mother as they do two or three times a year. This customer is price-sensitive, and willing to fly into nearby airports or switch itineraries (or airlines) for a better fare.
- Customer C is insecure and unsure about travel in general, and about flying in particular. Needing reassurance and a bit of hand-holding, they're more likely to deal with a travel agency and leave the planning to them.
- Customer D is a luxury and comfort seeker. They want access to a club lounge at the airport and to have extra legroom onboard, preferring the fold-down seats of business class for any lengthy overseas trip, which they will upgrade to with their own miles if a client isn't already paying.
- Customer E cares about price, but mostly wants to save time, and depends on mobile apps for decision making and bookings.

Or consider a florist's business. A few years ago, one client of Peppers & Rogers Group was a large direct-marketing florist. After a relatively extensive market research survey the florist's retail customers were categorized into five different needs-based groups, each with an appropriate name:

1. *Well-meaning but overwhelmed* usually remember occasions and are punctual but would like advice on personalized gifts to save them time and trouble.
2. *Big-hearted benefactors* remember occasions and are mostly punctual, but prone to be impulsive and indulgent. Less burdened and time-constrained, they most need creative ideas.
3. *Slow but sentimental* customers often forget or get late with their gifts, but they value sentiment before price, and what they need are reminders about upcoming occasions.
4. *Last-minute and lavish* customers often forget or get late, but they are impulsive and indulgent, as well as time-constrained and burdened. They need both reminders and good counsel.
5. *Practical and self-sufficient* customers sometimes forget, but they are practical, personal, and less burdened. They usually don't need much help.

We could go on. A truck tire retail and repair shop (or a chain of them) will sell to big fleet owners, who would value speed and efficiency, as well as to mom-and-pop truck drivers who want friendliness and deals, and to specialty vehicle operators such as tank trucks and flatbeds, which would need more specialized servicing. Or an agrochemical company selling to farm operators might differentiate its customers by the fact that some value learning more and always having the latest technology, while others value conservative farming principles, others need to see a solid ROI, and still others are highly loyal to their local dealers.

The point is, *by taking the customer's own perspective, the customer's point of view*—by concentrating on understanding each different customer's needs beyond any demographic measurements—the enterprise will more easily be able to influence customer behavior by meeting their needs better, and changing the future behavior of a customer by becoming more valuable to them is the key to realizing additional value from that customer.

Scenario: Financial Services

A well-known retail brokerage and investment management company trains its financial advisors (FAs) to recognize that an investing client's needs are deeper, more personal, and more unique than most of the client's stated investment goals and aspirations. Putting one's money at risk is a deeply personal commitment, fraught with risk, tension, and unvoiced emotions. Clearly, more than security and financial planning are involved, and it's important for the FA to probe for a client's actual life goals and psychological framework, so that these factors can help drive the actual experience delivered to each client. Rather than the mechanics and details of a trade or some other transaction, in other words, the focus of an FA's efforts ought to be turned to understanding the client's individual psychology, and what that psychology says about the client's real *needs*.

(*continued*)

As an example, the company suggests, consider three different retail investors, Mr. A, Ms. B, and Dr. C, each of whom comes to the FA with an idea for buying a thousand shares of Merck (MRK), representing an investment of more than $75,000. But, the company asks, *why* does each investor want to consider this transaction? This is what the FA should seek to better understand first, because each client will have their own needs, which are what will likely drive future requests and transactions. In discussing the transaction with each investor, the FA learns that they all have different reasons for wanting to do this transaction:

- Mr. A said he's simply looking for long-term growth stocks in highly capitalized firms, and MRK fits this criterion.
- Ms. B says she expects MRK to have a nice gain in the near term once the FDA approves a particularly interesting new drug.
- Dr. C, a medical professional, admits she doesn't really know much about investing, but she does know the pharma field, and thinks MRK is a safe and solid investment.

So far so good, but in addition to facilitating the immediate transaction that each investor is requesting, by probing even further (perhaps in a series of conversations, over time), it's possible that an FA might learn even more about each different investor's personal *needs*, so as to better serve that investor in future discussions and transactions. In doing so, for instance, the FA may find out that:

- Mr. A's desire for a highly capitalized firm actually was driven by his basic aversion to risk, and a desire to save carefully for the future—preservation over appreciation, in other words. He'll more likely be drawn to future investments and transactions that satisfy this need—his *actual* need.
- Ms. B's identification of a near-term market opportunity is a classic indicator of the fact that she's more confident in her own financial judgment and less risk averse when acting on it. One thing she really needs from the FA, in addition to advice and suggestions, is flawless, speedy execution.
- Dr. C's admission that she's not particularly knowledgeable about investments suggests that she would indeed benefit from the FA taking a more proactive and assertive role, educating and counseling her with respect to additional investments and transactions to meet her goals.

Importantly, the investment company says, an FA should record in the CRM platform their observations and insights with respect to each different client for future reference, so that each can be appropriately treated in all future interactions. Only in this manner can the firm treat different customers differently, based on their deepest, individual needs.

UNDERSTANDING CUSTOMER BEHAVIORS AND NEEDS

Understanding the differences in customer behaviors, and the needs underlying these behaviors, is critical for all stages in a company: from product development to financial consolidation, from production planning to strategic planning or marketing budgeting. All decisions and activities made by customers in order to evaluate, purchase, use, and dispose of any goods or services offered by a company are subject to being captured in the transactional record and are subject to behavioral analysis. A customer's need is what they want, prefer, or wish, while their behavior is what they do or how they act in order to satisfy this need. In other words, needs are the *why* of a customer's actions, and behaviors are the *what*. Behaviors can be observed directly, and from behaviors an enterprise can often infer things about a customer's needs. This hierarchy or logical ordering in these two notions, that customer needs drive customer behaviors, is a critical pillar for the relationship-marketing practitioner.

All companies want to understand why and how customers make their buying decisions. Factors that affect this process are analytically assessed and examined, then reexamined. Clearly segmenting customers by their needs and behaviors will allow an enterprise to **identify** and describe different categories of customers and ensure that its marketing efforts are effective for each of these groups.

Needs May Not Be Rational, but Everybody Has Them

In his classic book *Predictably Irrational*,[a] Dan Ariely makes the case that humans are irrational in what they want and what they do but—oddly enough—in completely predictable ways. Some of the research he cites draws from lab work on rats and other animals. In one of the most telling studies, mice were offered a food pellet instantly if they pressed a green button. If, instead, they pressed a purple button, they could get *10* pellets, but they had to wait 10 whole seconds, which must seem like forever in mouse time. If they pressed the purple button, and—while they were waiting for the big reward—had a chance to press the green button, they could not stop themselves and just had to press the green button—even after they figured out that pressing the green button stopped the delivery of the 10 pellets from the purple button. They learned that if they could not (and therefore did not) press the green button, but they had already pressed the purple button, they did in fact get their 10 pellets after a delay.

What did they do about this situation? Enter the red button, which, makes it impossible to press the green button. So the mice learned to press the purple button, then immediately press the red button, then press the green button all they wanted, but since pressing the red button had turned off the green button, the mice still got to collect the big win of 10 pellets.[b]

And this is just lab mice, managing to balance their own short- and long-term goals. Can companies do as well? And can we understand that the same customer wrestles with multiple kinds of needs at the same time?

This customer needs thing: It's complicated.

(*continued*)

[a] Dan Ariely, *Predictably Irrational: The Hidden Forces That Shape Our Decisions* (New York: HarperCollins, 2008). See also Dan Ariely, *Amazing Decisions: The Illustrated Guide to Improving Business Deals and Family Meals* (New York: Hill and Wang, 2019), *Dollars and Sense: How We Misthink Money and How to Spend Smarter* (New York: Harper, 2018), *Payoff: The Hidden Logic That Shapes Our Motivations* (New York: Ted Books/Simon & Schuster, 2016), and *The Upside of Irrationality: The Unexpected Benefits of Defying Logic at Work and Home* (New York; HarperCollins, 2011).
[b] Paraphrased from a story told by Dan Ariely in a keynote address to the Duke University Fuqua School of Business Marketing Club annual conference, January 27, 2010.

The Difference Between Customer Behaviors and Needs

Companies now have comprehensive systems and processes to capture and store customer data covering almost every aspect of a customer's relationship with a firm. Descriptive characteristics such as gender, age and income, along with behavioral and transactional data such as interactions, purchases, payments, and service requests—all this information can be captured and stored by the enterprise. The information companies store which describes their individual customers is usually referred to in terms of customer profiles.

But enterprises are not comprised of mind readers, and, just as it will never be possible for any human being or AI tool to calculate a customer's precise value by predicting their exact future behavior, it will never be possible to know a customer's precise personal needs that drive that behavior. The customer's needs are based on the customer's own life and emotions, memories, thoughts, and beliefs.

However, the customer's actual *behaviors* are observable. And in the same way that it's possible for a customer-oriented enterprise to make reasonable quantitative estimates of a customer's value based on their most likely future behaviors, the enterprise can work backward from a customer's observable behaviors in order to make inferences about the most likely needs that drove those behaviors.

By *observable behaviors* we mean all sorts of actions taken by a customer. At its very simplest, a customer behavior relevant to an enterprise could mean the answer that the customer gave on a survey from the enterprise, a product specification provided by the customer, or a complaint made. When a customer answers a "**Golden Question**" (see Chapter 8) they have provided **behavioral data**, and all this data can help an enterprise better understand the customer's needs. But clicking Item A rather than Item B on the enterprise's website is also an observable behavior, as is abandoning an online shopping cart, or commenting about the enterprise on Facebook or LinkedIn or Reddit. Every single activity undertaken by a customer to evaluate, purchase, use, and/or dispose of any good or service offered by a company is subject to being observed and captured in a transactional record—a data record that can be used by a customer-centric marketer to deduce the particular needs that underlie this behavior or collection of behaviors.

But the *need* that drives a customer's observable behavior (i.e., whatever motivated the customer to engage in that behavior)—that need comes from within the customer. So when we talk about a customer's *need* we're talking about what the customer wants, prefers, or wishes. By contrast, customer behavior consists of what a person does *in order to satisfy this internally felt need*. As we said, behaviors are the *what* of a customer's actions, but needs are the *why* behind those observable behaviors. To put it another way, behaviors are *a customer's footprints on the company*.

This logical ordering of events (i.e., that needs come first and drive observable behaviors) is a critical pillar for the customer-centric competitor. To compete successfully in the customer-centric dimension it is essential to deduce and understand as much as possible about the *why* behind the *what* of each individual customer and how that customer makes their buying decisions.

Behaviors are the customers' footprints on a company.

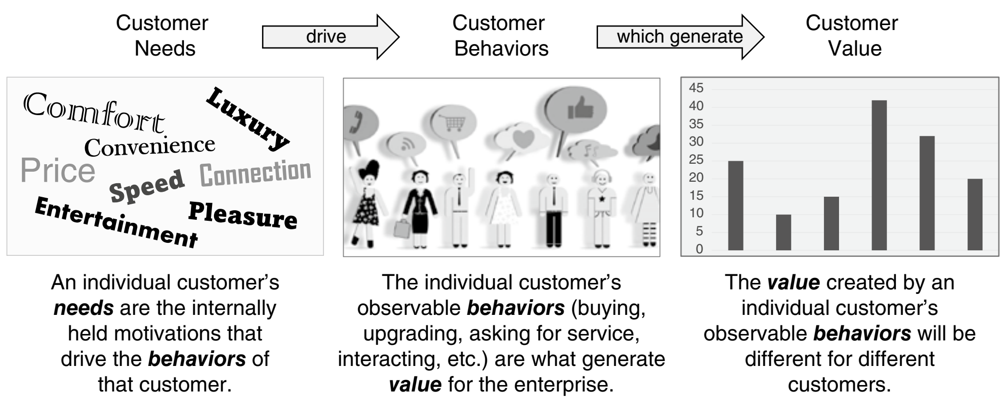

EXHIBIT 7.3 Needs Drive Behaviors

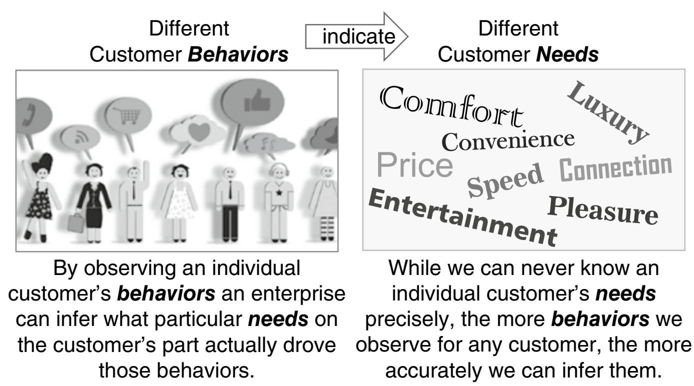

EXHIBIT 7.4 Behaviors Indicate Needs

WHY DOESN'T EVERY COMPANY ALREADY DIFFERENTIATE ITS CUSTOMERS BY NEEDS?

It is reasonable to ask, if the logic outlined is so compelling, why toy manufacturers and other firms aren't already attempting to differentiate customers by needs. Many firms that have traditionally sold through retailers still believe that the hurdles to doing so are sizable. For example, most toy manufacturers sell their products through retailers and have little or no direct contact with the end users of their products. In order to make contact with consumers, a manufacturer would either have to launch a program in cooperation with its retailing partners or figure out how to go around those retailers altogether—a course of action likely to arouse considerable resentment among the retailers themselves. So the majority of a manufacturer's end-user consumers are destined to remain unknown to the enterprise. Moreover, even if it had its customers' identities, the manufacturer still would have to find some means of interacting with the customers individually and of processing their feedback, in order to learn their genuine needs. Then it would have to be able to translate those needs into different actions, requiring a mechanism for actually offering and delivering different products and services to different consumers. Nevertheless, some companies, such as Lego, still sell through storefront and online retailers, but also sell directly to consumers through a website. Lego, for instance, offers free shipping every day at https://www.lego.com/en-us/. Its website is highly interactive, keeping track of what a particular kid likes to do there, using their login and password. Users also receive a subscription magazine, allowing Lego to log an address, all in addition to their store website, which offers some exclusive parts and sets you can't get elsewhere.

Doing all this sets up a direct competitive relationship with the very retailers that most product manufacturers still depend on for a large percentage of sales. And real resources are required to take these steps to build direct relationships. These obstacles make it very difficult for toy manufacturers simply to leap into a relationship-building program with toy consumers at the very end of the value chain. That said, the manufacturer does not have to launch such a program for all consumers at once. Rather, it could start by identifying its most avid fans, its highest-volume, most valuable customers. It could, for instance, do some **content marketing**, infusing its website with interesting or useful content that is purposefully designed to attract such customers to the site so they could be identified, and where their needs could be at least partially inferred from the types of content they consume most. Perhaps the enterprise could also devise a strategy for treating each of those highly valuable customers to individually different products and services, in a way that wouldn't undermine retailer relationships. A website designed to attract and entertain such consumers could play this kind of role, and the toymaker could take advantage of **social networking** connectivity as well. Although the toy manufacturer would still encourage other shoppers to buy its products in stores, perhaps it could begin to offer more specialized sets and pieces directly to catalog and web purchasers. If it had a system for doing this, launching a program designed to make different types of offers to different types of end-user consumers—based on their individual needs—would be much simpler and would, for practical reasons, start that process with customers of highest **actual value** and also highest **potential value**.

Indeed, the primary reason so many firms are now attempting to engage their customers in relationships is that the new tools of interactivity and information technology make it possible. And of course the onset of the COVID-19 pandemic, with all the remote work and online collaboration activities that it spawned, dramatically accelerated many firms' plans for improving their digital technologies, as well as showcasing the many tools available to the modern enterprise, when it comes to communicating with their individual end-user customers, one customer at a time, and shipping products directly to them. Video meeting platforms, online collaboration tools, marketing and **customer analytics** applications, digital marketing programs, **customer data platforms**, **sales force automation** applications—these tools and others are making this type of activity ever more cost efficient and practical for an enterprise. But in terms of generating increased patronage from the customer, the hot button is understanding each individual customer's *need*.

Content Marketing

It used to be there was a distinct boundary between the interests of customers and the interests of the marketers that sold to them. It was a very simple equation: The customer wanted to pay the lowest possible price, while the marketer wanted to charge the highest possible price. Everything else about marketing strategy was a detail.

But that was then and this is now. In our electronically transparent world, interactivity and **social media** have forever changed the way companies must approach the sales and marketing task. Customers now have immediate access to the tools and information required to make much more informed decisions, and no company will survive long without aligning its own interests with the interests of the customers it is trying to sell to.

In his book *Non-Obvious: How to Think Different, Curate Ideas, and Predict the Future*, Rohit Bhargava points out that the clout and power of the marketing function within companies is clearly growing. One widely cited statistic, for instance, is that CMOs will soon be spending more on technology than CIOs. However, he says, marketers themselves seem to be shying away from the "marketing" moniker more and more. Bhargava calls this a trend, and he labels it the "Reluctant Marketer Trend."[4]

Even with the power that information technology now places directly on their keyboards, the fact is that marketers have become reluctant to do the kinds of selling and promotion activities they used to do, for the simple reason that customers now see through these devices.

Instead, one of the most effective and increasingly important tools for today's marketer is content marketing. Why? Because by dispensing more objective information for the benefit of customers a marketer can earn the customer's trust. Whether you're a consumer marketing firm trying to promote your brand or a **B2B** company selling your product or service to large **enterprise customers**, putting

[4] Rohit Bhargava, *Non-Obvious: How to Think Different, Curate Ideas, and Predict the Future* (Ideapress, 2015).

(*continued*)

out customer-oriented content will improve your standing with current and potential customers for the simple reason that you are giving them value without asking for something in return.

By speaking to the actual self-interest of customers (rather than trying to overcome that self-interest with ever more compelling sales messages and offers), today's marketer can develop a level of trust and engagement with a customer that was never possible before, even as the boundary between editorial and promotion blurs.

If you want your content marketing effort to be truly effective, however, then you need to approach it from the customer's point of view. Your content needs to be oriented around the customer's own need, so that the customer gets real value from your content. Here are some suggestions:

1. Your content should be as objectively brand-neutral as possible. You want your customers to see you as an authority on the problem they're trying to solve or the need they're trying to meet. You're not telling them the best thing to buy; you're telling them the best way to solve their problem.
2. Make your content "snackable." Produce it in bite sizes that can easily be consumed without a lot of effort. The more **frictionless** it is to digest your content, the more your customers are likely to rely on it.
3. Use research to figure out what topics and issues are of most interest to your customers. You can acquire some insight into these topics by using Google's keyword analysis tools, or by scanning "most popular article" lists.
4. Pay attention to the headlines you use. Don't expect most customers to give you more than a glance, so make that glance as effective as possible.
5. And finally, be sure to curate and repurpose others' content as well. Don't steal credit for anything, but by citing and summarizing others' content and points of view (yes, even your competitors' content, if they produce any), you will appear bigger than any mere contender. You will be speaking as an authority.

CATEGORIZING CUSTOMERS BY THEIR NEEDS

The fact that different customers represent different levels of value for an enterprise, one of the topics we tackled in the previous chapter, means that an enterprise can prioritize its customer strategies based on those customers already creating the most value, or with the unrealized potential to create the most value. But the effort to realize that value creation necessarily means that the enterprise must change the customer's behavior. It must change the customer's otherwise expected future behavior, inducing a customer to do something that in the absence of the enterprise's effort the customer would not do. The enterprise needs more value from the customer, but the only way to make this happen is to focus on what it is that the *customer* needs.

In the end, behavior change on the part of the customer is what customer-based strategies are all about. We hope the customer will buy from an additional product line, or take the financing package as well as the product, or to interact on the less expensive website rather than through the call center, and so forth.

This is why understanding customer needs is so critical to success. The customer is master of their own behavior, and that behavior will change only if our strategy and offer can appeal persuasively to their very own needs—not what we want their needs to be, or some average of needs for a bunch of different customers. Being able to see the situation from the *customer's point of view* is key to any successful customer-based strategy.

But here's the thing: In order to take action based on different customers and their different needs, we must categorize our customers into different groups based on these needs. Clearly, for most enterprises serving thousands, or millions, of customers, it would be too costly to treat every single customer with a custom-designed set of product features or services. Instead, by using information technology the **customer-focused** enterprise categorizes customers into finer and finer groups, based on what is known about each customer, and then match each group with an appropriately mass-customized product-and-service offering. (More about **mass customization** and the actual mechanics of the process in Chapter 10.)

One big problem is the complexity of describing and categorizing customers by their needs. Customer values are easy, by comparison, because while it may be difficult to forecast the future value-creating behaviors of a customer, there is still just a single dimension of value—the dimension of dollars and cents (or pounds and pence, or yen, or pesos). But there are as many dimensions and nuances to customer needs as there are analysts to imagine them. For consumers, there are deeply held beliefs, psychological predispositions, life stages, moods, ambitions, and the like. For business customers, there are business strategy differences, financial reporting horizons, collegial or hierarchical decision-making styles, and other corporate differences—not to mention the individual motivations of the players within the customer organizations, including decision makers, approvers, specifiers, reviewers, and others involved in shaping the company's behavior.

Marketing has always relied on appealing to different customers in different ways. Market segmentation is a highly developed, sophisticated discipline, but it is based primarily on products and the appeal of product benefits rather than on customers and their broader set of needs, which must be considered in a holistic fashion for each individual customer. To address customers as *different types of customers,* rather than as mere recipients of a product's different benefits, the customer-based enterprise must think beyond

> The effort an enterprise makes to categorize its customers by their needs is central to its efforts to *treat different customers differently* in such a way as to create the most value possible from each customer.

market segmentation per se. Rather than grouping customers into *segments* based on the product's appeal, the customer-based enterprise places customers into *portfolios* based primarily on type of need.

A **market segment** is made up of customers who have a similar attribute, while a **customer portfolio** is made up of customers who have similar needs (and by "needs" we are referring to *all* the things the customer might need from the enterprise). A customer can easily be a member of multiple segments (i.e., the segment of male customers, and the segment of middle-class customers, and the segment of unmarried customers), but he should be a member of one and only one customer portfolio, because it is the portfolio that will determine how the enterprise treats that customer, when it strives to *treat different customers differently*. If a customer were a member of two different portfolios, he would be treated as if he were two different customers.

> A market segment is made up of customers who have a similar attribute, while a customer portfolio is made up of customers who have similar needs.

In Chapter 13, we will further discuss customer management, including the grouping of customers into portfolios so that the enterprise can actively manage how it treats each customer across all its business units and divisions. There is a continuing role for traditional market segmentation, even in a highly evolved customer-strategy enterprise, because understanding how a product's benefits match up with the attributes of different customers continues to be an important marketing activity. But as the enterprise gains greater and greater insight into the actual motivations of particular categories of customers, it will find that managing relationships cannot be accomplished in segment categories, because *any single customer can easily be found in more than one segment*. Instead, when they take the customer's perspective, the managers at a customer-strategy enterprise will learn that they must meet the complex, *multiple needs* of each customer, as an individual. And doing this will require categorizing customers according to their own, broader needs rather than according to how they react to the product's individually considered attributes and benefits. *Each customer can appear in only one portfolio*.

> A single customer can be found in more than one market segment but in only one customer portfolio.

The effort an enterprise makes to categorize its customers by their needs is central to its efforts to *treat different customers differently* in such a way as to create the most value possible from each customer.

Understanding different customers' different needs is critical to any serious relationship-building program. Some of the characteristics of customer needs should be given careful consideration:

- *Customer needs can be situational in nature.* Not only will two different consumers often buy the same product to satisfy different needs, but a customer's needs might change from event to event, and it's important to recognize when this occurs. An airline might think it has two customer types—business travelers and leisure travelers—but in reality this typology refers to events, not customers. Even the most frequent business traveler will occasionally be traveling for leisure, perhaps with a spouse or family instead of the usual solo travel, and in that event she will need different services from the airline than she needs when she travels on business.
- *Customer needs are dynamic and can change over time.* People are changeable creatures; our lives evolve from one stage to another, we move from place to place, we change our minds. Moreover, certain types of people change their minds more often than others, tending to be less predictable. That said, the fact that a certain type of customer is not predictable is a customer characteristic itself, which can be used to help guide an enterprise's treatment of that customer. Marriage, new babies, and retirement typically lead to profound changes in needs for most people.
- *Customers have different intensities of needs and different need profiles.* Even when two customers have a similar need, one customer will have that need intensely while the other may feel the need but less intensely and perhaps in a different profile, combined with other needs. One homemaker is committed to running a very green kitchen, while another wants to take care of the environment where it makes sense but also needs to save time as much as possible and may use paper plates so they don't have to spend so much time washing dishes.
- *Customer needs often correlate with customer value.* Although it is not always true, more often than not a high-value customer is likely to have certain types of needs in common with other high-value customers. Similarly, a **below-zero customer's** needs are more likely than not to be similar to other below-zero customers' needs. A business that can correlate customer value with customer needs is generally in a good situation, because by satisfying certain types of needs, it can do a more efficient job of winning the long-term loyalty of higher-value customers.
- *The most fundamental human needs are psychological.* When dealing with human beings as customers (as opposed to companies or organizations), understanding the psychological differences among people can provide useful guidance for treating different customers differently.
- *Some needs are uniquely individual, while some needs are shared by other customers.* When the florist reminds a customer that their mother's birthday is coming up, the message may prompt the customer to purchase flowers, but the date itself represents a uniquely personal need. However, when Netflix correctly recommends a video that Customer A will like, or when Google correctly anticipates Customer A's search terms even before they are fully typed into the search window, these sorts of actions are made possible by the fact that many other customers have chosen videos in the past that are similar to the ones Customer A has chosen in the past, or have searched for similar

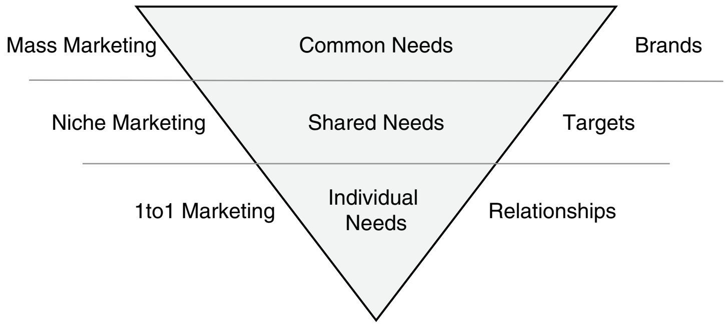

EXHIBIT 7.5

terms as Customer A is now searching for, and these other customers have already shown a tendency to prefer the recommended video now being suggested, or the search terms now being anticipated. This is an aspect of something we call **community knowledge**, which allows an enterprise's treatment of an individual customer to be informed not just by its knowledge about that customer, but about many other customers who have similarities with that customer. The computational process for sifting through large numbers of customers to find such commonalities is called **collaborative filtering** (more about these concepts in a moment), but the collaborative filtering algorithm only works because different customers often do share some needs with other customers (see Exhibit 7.5).

- *There is no single best way to differentiate customers by their needs*. As difficult as it is to predict and quantify a customer's value to the enterprise, at least the final result will be measured in economic terms. Value ranking, in other words, is done in one dimension: the financial dimension.[5] But when an enterprise sets out to differentiate its customers by their needs, it is embarking on a creative expedition, with no fixed dimension of reference. There are as many ways to differentiate customers by their needs as there are creative ways to understand the deepest human motivations. The value of any particular type of needs-based differentiation is to be found solely in its usefulness for affecting the different behaviors of different customers.

[5] Even customer recommendations, while technically nonfinancial, have potential financial implications. And the financial dimension is not limited to for-profits: For nonprofit organizations, the financial dimension might include maximizing funds from outside sources or maintaining fiscal stability. See "Drivers for Non-Profits' Success: Volunteer Engagement and Financial Sustainability Practices through the Resource Dependence Theory," *Economies* 8, no. 4 (2020): 101, doi:http://dx.doi.org/10.3390/economies8040101; and April Burbank, "Nonprofits Have Customers Too," *Forbes*, June 28, 2012, available at http://www.forbes.com/sites/ashoka/2012/06/28/nonprofits-have-customers-too-2/, accessed August 25, 2021. For nonprofits, customer, member, donor, volunteer value may include proxies for financial value such as willingness to participate, compliance rates, voting record, donations of time and volunteerism, and so forth.

- *Even in B2B settings, a firm's customers are not really other companies, each with a clearly defined, homogeneous set of needs*. Instead, customers are a combination of purchasing agents, who need low prices; end users, who need benefits and attributes; the managers of the end users, who need those end users to be productive; and so on.

COMMUNITY KNOWLEDGE

In the competition for a customer, the successful enterprise will usually be the one with the largest scope of knowledge about an individual customer's needs, if they use it, but this kind of information can come to the enterprise in a number of different ways. It may come by simply observing the customer's behaviors, by the items on the company's website a customer clicks on, or from a direct interaction between the enterprise and the customer, in which the customer *specifies* the kind of product or service she needs. Or perhaps the customer will provide a *satisfaction rating* of some type, with respect to some product or service she has already bought (an additional customer behavior that can be observed).

> In the competition for a customer, the successful enterprise will usually be the one with the largest scope of knowledge about an individual customer's needs, if they use it.

Alternatively, insight into an individual customer's individual needs could come from the fact that the enterprise enjoys relationships with other customers who have exhibited highly similar behaviors in the past, showing interest in the same products, services, or information as this customer has shown. If so, then the needs revealed by the members of this community of customers will also provide insight into the needs of the individual customer, someone who is like them in terms of their own past behaviors. This represents community knowledge for the enterprise, knowledge that can often provide interesting and *predictive* insights into individual customers and their needs today.

Collaborative filtering is the term applied to the algorithms and software that make it possible for an enterprise to realize the benefits of community knowledge, and these calculations, in turn, are only possible because of the accumulation of insight into the individual needs, tastes and preferences of vast numbers of other customers. By sorting through this data it is possible to find customers who have expressed similar tastes and preferences through the specific products and services they have purchased in the past, or (even more effective) by the ratings that they've given to specific products and services in the past. Sorting through customers for similarities is essentially a matching task, and collaborative filtering algorithms that operate on data sets of hundreds of thousands (or tens of millions) of customers, now allow an enterprise to serve up products or services to a particular *individual* customer based on what other customers with similar tastes have preferred, with respect to a particular product or service.

These concepts—community knowledge and collaborative filtering—are tools that can help not just data-driven companies like Netflix or Google to better understand the preferences and needs of their individual consumers, but also B2B companies trying to better understand how the needs of this purchasing agent at a client company may have certain similarities to the needs of other clients' purchasing agents. After all, the community knowledge idea has a direct lineage from one of the most time-honored values of any B2B business seeking to establish better, more long-lasting relationships with its customers.

Community knowledge is what a B2B enterprise brings to a business customer when the enterprise counsels and educates a customer on what *other* businesses with similar needs are doing (in the aggregate, of course, never individually). The executives at a B2B customer will already be highly knowledgeable about their own business category, but they aren't likely to know as much about the business category of the B2B enterprise they are relying on to provide some product or service. Consider an agrichemical enterprise, for instance, selling to farm operator customers. Any given farm operator customer will know the farming business extremely well, including the science of cultivation, crop rotation, turning soil over the right way for different crops, and the best tools for facilitating a harvest. But with respect to the proper use of a particular chemical to protect a crop from a particular insect or infection, the agrichemical company's expertise will be superior. And it will be an expertise composed not just of knowledge about the properties of the chemical or product being sold, but also the community knowledge about the proper way its own customers (i.e., other farm operators) have found to apply it, and which techniques have proven the most helpful, with this particular soil type and climate conditions.

So a B2B enterprise can bring insight to a business customer based on its many dealings with a large number of that customer's own competitors. Tapping into the community knowledge made available through interacting with other, similar customers, in other words, can yield immense benefits to many businesses, but especially to those businesses that have:

- *Cost-efficient, interactive connections with customers as a matter of routine,* such as online businesses, banks and financial institutions, retail stores, and B2B marketers, all of which communicate and interact with their customers directly and on a regular basis
- *Customers who are highly differentiated by their needs,* including **B2C** businesses that sell things like books, fashion, automobiles, groceries, and health care, and almost all non-commodity B2B businesses

The modern B2B enterprise operates in the same interactive, data-infused, anything-as-a-service world that every other enterprise operates in, and an increasingly successful strategy, when it comes to the goal of maintaining and strengthening its business-customer relationships, is to challenge the customer to think differently, or to adopt new perspectives. The B2B enterprise that can always bring an innovative idea, or that can make a business customer's leaders raise their eyebrows in surprise, is more likely to maintain that customer's loyalty and to gain increased business from it. And often the most direct route to challenging a business customer's thinking is to begin with community knowledge.

Pharmaceutical Industry Example

Consider, for example, the pharmaceutical (pharma) category. Traditionally, pharma companies didn't engage in much relationship building with end-user consumers (i.e., the patients for whom their drugs are prescribed). Rather, they always considered their primary customers to be the prescribing physicians and other health care providers, along with pharmacies, employers, medical insurance organizations, and the government bodies charged with overseeing the health care industry. Although pharma companies operate differently in different countries, depending on convention and regulatory regime, they need to deal with the same technological disruptions and innovations that are moving so many other companies and industries toward more customer-centric practices, including needs-based differentiation of patients, whenever that will improve each patient's experience.

Taking a more patient-centered approach to the business, of course, has moral overtones and trust implications as well. Who wouldn't want to work for a company whose mission is to improve everyone's health, rather than simply making as much money as possible from their patented drugs? According to Gitte Aabo, CEO of Leo Pharma, a Denmark-based company, "We strongly believe that when we focus on people, the business will follow. And that means for us as a company that there are cases where we know that we can actually meet an unmet need for the patients, but we are unable to make the business case. If we are able to meet the unmet need even though we can't make the business case, we will do it anyway."[6] Their patient-centered values seem to have paid off; even after COVID-19 severely tested the healthcare industry, Leo Pharma's revenue and R&D pipelines have remained resilient.[7]

But as difficult as it may be to make a strong business case for patient-centered policies, declaring patient health itself to be the company's mission is likely to dramatically improve Leo's ability to hire and retain highly motivated employees. Kimberly Stoddart, Vice President of Human Resources and Communications at Leo Pharma Canada, suggests, "When we are looking to hire new people, we show the video to candidates. We can tell immediately whether the concept motivates them, and to what extent, which we then explore. If it doesn't, they're not for us."[8]

One U.S. pharmaceutical company, for instance, sells medicines for diabetes, a disease that can only be kept in check through constant vigilance. As is the case with many such diseases, *compliance* is a constant problem. Patients often simply fail to keep up their prescribed medical treatments, or they fail to monitor their own condition

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[6] Eyeforpharma, "Overcoming Barriers to Patient Centricity at LEO Pharma," YouTube video, January 5, 2016, available at https://www.youtube.com/watch?v=Psa6q2obH-U, accessed August 31, 2021.

[7] "2020 Annual Report," LEO Pharma, available at https://www.leo-pharma.com/our-annual-reporting, accessed October 25, 2021.

[8] Eyeforpharma, "Patient-Centred Culture by Design," white paper, January 7, 2016, p. 14, available at https://www.ashfieldhealthcare.com/wp-content/uploads/2016/01/Patient-Centred-Culture-WhitePaper.pdf, accessed August 30, 2021.

properly. Patients are all different, however, and while some are less vigilant, others are highly engaged in managing their disease, and still others have caregivers who watch out for them.

Knowing that different patients will need different types of support and assistance, this pharma enterprise undertook to design a more patient-centered website by treating different patients differently. The company began by conducting a research survey of patients, and they found that a patient's attitude toward keeping the disease in check will tend to drive what the patient actually needed from the company's website and mobile app. Newly diagnosed patients for the most part simply want any and all information related to their condition, combing through the content in order to find the information most relevant to their own problems. However, as patients come to grips with their illness, their attitudes evolve. The pharma company's research led it to group its diabetes patients into three different categories, which the company called:

1. *Individualists*. Rely on themselves to make educated decisions about how to manage their disease. The website will steer individualists toward online clinical support. A patient can **opt into** a **customized** electronic newsletter or take advantage of a number of online health-tracking tools and apps.
2. *Abdicators*. These patients' attitude toward the disease is more one of resignation and detachment. An abdicator is a patient who has decided that they will "just have to live with the conditions of the disease," so they end up depending on the help given by a significant other—perhaps a spouse, a parent, or an adult child. In addition to patient resources, the site will direct abdicator patients to various caregiver resources, and provide planning information related to nutrition and meals.
3. *Connectors*. This type of patient welcomes as much information and support as they can get from others to help them make educated decisions about how to manage their disease. They value the opinions of other patients with similar conditions, so the site directs connectors to online chat rooms and electronic bulletin boards, where they can meet and converse with other patients. There is an "e-buddy" feature that pairs a patient with someone similar to themselves, not just for information but for support and consolation.

Any of the company's website visitors or mobile app users, of course, might choose to employ any of the site's features on any given visit, even a feature that might not have been indicated by the patient's categorization as an individualist, an abdicator, or a connector. And it's almost a certainty that each feature will overlap the different needs of different types of customers. It's important to remember, however, that while one customer's needs often overlap with another's, every customer is still a unique individual with their own unique psychologies and motivations.

So while the pharma company's categorization of these unique and different customers into three specific needs-based groups might give us the illusion that the members of any given group are all the same, they are not. Moreover, even a slight difference in the research survey might have resulted in different categorizations, or more of them, or fewer of them. We must categorize customers, however, not just to make sense of their differences, but also to take the actions required to treat different customers differently in a cost-efficient way. In a sense, the needs-based categories of customers we create, in order to better understand them, are analogous to the various modules that a mass-customizing company will combine, in order to configure different products for different customers (or different web pages, or different marketing messages).

Gary Adamson, who once served as president of Medimetrix/Unison Marketing in Denver, Colorado, said the power of health care integration lies in creating the ability to do things differently for each customer, not to do more of the same for all customers.[9] One of Medimetrix's clients, Community Hospitals in Indianapolis, Indiana, for example, implemented Patient-Focused Medicine, a **customer relationship management (CRM)** initiative aimed at four constituent groups: patients, physicians, employees, and payers. The hospital found that most medical practitioners customize the "care *for* you" component of health care by individually diagnosing and treating medical disorders. But Community also individualized the "care *about* you" component—the part that makes most patients at most hospitals feel like one in a herd of cattle.

The real opportunity lies in building a **Learning Relationship** between the health care provider and the customer. A drugstore, for example, might know a customer buys the same over-the-counter remedy every month. But if the same drugstore detects that the customer is suddenly buying the product every week, it could personalize its service by asking them whether they are having a health problem and how it could assist them with personal information or other types of medication. Already, the pharmacy is the last resort for many patients to help spot possible drug interactions for medications (both prescription and over the counter) prescribed by a variety of different physicians. Using information to serve the customer better helps the drugstore create a long-lasting bond with this customer.

USING NEEDS DIFFERENTIATION TO BUILD CUSTOMER VALUE

The scenarios of the toy manufacturer and the pharmaceutical company show how each had to be aware of its respective individual customer's needs so it could act on them. Once a particular customer's needs are known, the company is better able to put itself in the place of the customer and can offer the experience that is best for that customer. Both the toy company and the pharma company get information about their customer's different needs primarily by interacting. Therefore, an open dialogue between the customer and the enterprise is critical for needs differentiation. Moreover, customer needs are complex and intricate enough that the more a customer interacts with an enterprise, the more learning an enterprise will gain about the particular

[9] Don Peppers, Martha Rogers, Ph.D., and Bob Dorf, *The One to One Fieldbook* (New York: Doubleday, 1999).

preferences, desires, wants, and whims of that customer. Provided that the enterprise has the capability required to act on this more and more detailed **customer insight**, by treating the customer differently, it will be able to create a rich and enduring Learning Relationship.

A successful Learning Relationship with a customer is founded on changes in the enterprise's behavior toward the customer based on the use of more in-depth knowledge about that particular customer. Knowing the individual customer's needs is essential to nurturing the Learning Relationship. As the firm learns more about a customer, it compiles a gold mine of data that should, within the bounds of privacy protection, be made available to all those at the enterprise who interact with the customer. Kraft, for example, empowers its salespeople with the data they need to make intelligent recommendations to a retailer. (The retailer is Kraft's most direct customer, and the retailer sells Kraft products to end-user consumers, who can also be considered Kraft's customers.) Kraft has assembled a centralized information system that integrates data from three internal database sources. One database contains information about the individual stores that track purchases of consumers by category and price. Another database contains consumer demographics and buying-habit information at food stores nationwide. A third database, purchased from an outside vendor, has geodemographic data aligned by zip code.

But truly to get to know a consumer through interactions directly with them, enterprises must do more than gather and analyze aggregated quantitative information. Accumulating information is only a first step in creating the knowledge needed to pursue a customer-centered strategy successfully. Information is the raw material that is transformed into knowledge through its organization, analysis, and understanding. This knowledge then must be applied and managed in ways that best support investment decisions and resource deployment.

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Customer knowledge management is the effective leverage of information and experience in the acquisition, development, and retention of a profitable customer. Gathering superior customer knowledge without codifying and leveraging it across the enterprise results in missed opportunities.

Final Thoughts on Needs Differentiation

Customers are all different, and they are different in two fundamental ways: They have different values to the enterprise, and they need different things from the

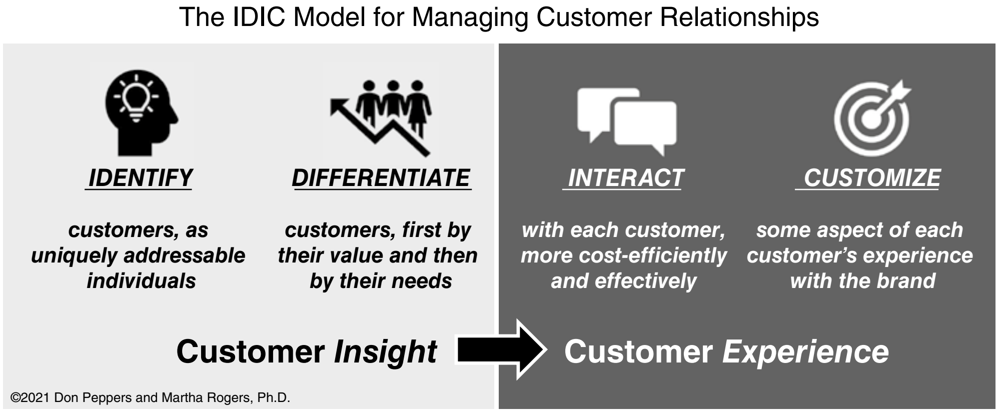

EXHIBIT 7.6

enterprise. Importantly, a customer's value and needs represent a complete description of both the give and take sides of the value proposition. All other descriptions of customer differences (e.g., income, age, demographics, psychographics, likelihood to leave, favorite color, etc.) are simply metrics designed to provide clues about the customer's likely value to the enterprise and their likely needs from the enterprise. And all value propositions involve two parties, so we could easily define this value proposition in the reverse manner, by looking at it from the perspective of the customer rather than the enterprise. To the customer, the enterprises they deal with and buy from are all different in two ways: their value to the customer, and what they need from the customer.

We talked about value differentiation before needs differentiation for one good reason: As a rule of thumb, an organization should differentiate current and future customers first by value, in order to know where to invest the most resources. Then, it should differentiate them by need, to know what is best to do for those most valuable and highest potential customers.

We have now discussed the necessity of knowing who the customer is (identifying) and knowing how the customer is different individually (differentiating). Identify and differentiate are the first two steps in the **Identify-Differentiate-Interact-Customize (IDIC) methodology** for developing and managing customer relationships, and they can largely be accomplished by an enterprise with little or no participation by the customer. That is, a customer won't necessarily know about or be involved in whatever process the enterprise uses to identify them as a customer, nor will they likely even be aware of the enterprise's effort to rank them by their value, or to categorize them by their needs, as a customer. As we mentioned earlier, we can think of these first two steps in the IDIC methodology as the customer insight phase of relationship management. Students of CRM software applications would call these first two steps ***analytical CRM***.

In addition to simply observing customer behaviors and making inferences, this sort of customer-specific information is also obtained by directly *interacting* with the customer. However, this third step of IDIC, the interact step, requires the customer's participation. Because interaction and customization can only really take place with the customer's direct involvement, these latter two steps in the IDIC model could be thought of as managing the "customer experience," based on insights developed in the first two steps. In the world of CRM software, these latter two steps would be referred to as ***operational CRM***.

> We can think of these first two steps in the IDIC methodology—identify and differentiate—as the customer insight phase of relationship management. Students of CRM software applications would call these first two steps *analytical CRM*.

Interacting with customers, the third step in the IDIC methodology, is our next point of discussion.

CHAPTER 8

IDIC Step 3: Interact to Learn and Collaborate

We live in a technological universe in which we are always communicating. And yet we have sacrificed conversation for mere connection.

—Sherry Turkle

So far, we have discussed the ways an enterprise can **identify** and **differentiate** customers. But while each of these tasks is purely analytical and can thus be accomplished by simple observation with no participation on the customer's part at all, the quality of the analysis and **customer insight** generated can still be greatly enhanced by including data and feedback that comes through **interacting** directly with the customer himself. Interacting with customers, the subject of this chapter, represents the third step in our **identify-differentiate-interact-customize (IDIC) methodology**. And importantly, as we shall soon learn, the information and insight that an enterprise acquires directly from a customer, by interacting with that customer, can convey a distinct and significant competitive advantage. It enables the enterprise not only to serve that individual customer better, based on the insight gained through the interaction, but to serve them better than any competitor possibly could, unless the customer has also gone to the trouble of conveying the same information to the competitor via a separate interaction.

Managing **customer experiences** and individual customer relationships is a challenging, ongoing process that evolves as the customer and the enterprise deepen their awareness of and involvement with each other. To reach this new plateau of intimacy, the enterprise must get as close to the customer as it can.[1] It must be able to understand the customer in ways that no competitor does. The only viable method of getting to know an individual, to understand them, and to get information about them is to interact with them—one to one.

[1]See the seminal book by Tom Peters and Robert Waterman, Jr., *In Search of Excellence: Lessons from America's Best-Run Companies* (New York: Harper Business Essentials, 2004, 1982).

In Chapter 2, we began to define customer experience and a relationship. We listed several important characteristics in our definition of the term *relationship*, but one of the most fundamental of these characteristics is interaction. A relationship, by its very definition, is characterized by two-way communication between the two parties in the relationship.

> The main reason for interaction is to get more information directly from a customer in order to serve them better in a way no competitor can who doesn't have the information.

Interacting with customers acquires a new importance for a **customer-strategy enterprise**—an enterprise aimed at creating and cultivating relationships with individual customers. The enterprise is no longer merely talking to a customer during a transaction and then waiting (or hoping) the customer will return again to buy. For the customer-strategy enterprise, interacting *with* individual customers becomes a **mutually** beneficial experience. The enterprise learns about the customer so it can understand their value to the enterprise and their individual **needs**. But in a relationship the customer learns, too—about becoming a more proficient consumer or purchasing agent for a business. The interaction, in essence, is now a ***collaboration*** in which the enterprise and the customer work together to make this transaction, and each successive one, more beneficial for each of them. The focus shifts from a one-way message or a onetime sale to a continuous, **iterative** process, which *de facto* moves both customer and enterprise from a transactional approach to a relationship-based approach. The goal of the process is to be more and more satisfying for the customer, as the enterprise's **Learning Relationship** with that customer improves. The result of this collaboration, if it is to be successful, is that both the customer and the enterprise will benefit and want to continue to work together. This is no longer about *generating messages* about your organization. This is about *generating feedback,* creating a collaborative feedback loop with individual customers by treating each of them in a way that they have specified during the interaction, whether it's face to face, via text, online, through **social media**, or all of the above, or in ways we don't even know about yet.

Interacting with an individual customer enables an enterprise to become both an expert on its business and an expert on each of its customers. It comes to know more and more about a customer so that eventually it can predict what the customer will need next and where and how they will want it. Like a good servant of a previous century, the enterprise becomes indispensable.

> Successful communication is no longer about generating messages. It's about *generating feedback*.

Customer-strategy enterprises ensure that individual customers get exactly what they need, no matter what, and this priority should extend from the front line all the way to upper management. To assist employees in **treating different customers differently**, JetBlue has partnered with the technology firm Gladly, Inc., to bring the relationship-building data of the contact center into the cabin. Through in-flight tablets, crew members can instantly see a customer's loyalty status, a timeline of their most recent interactions (through text, phone, email, or chat), and flight information, so if a customer has had a frustrating experience, flight attendants can offer them perks or upgrades as needed. For a company to be truly **customer-centric**, interaction must happen at all levels, so as many employees as necessary know what it feels like to be a customer.[2]

More and more, this learning and feedback includes participation in the social media platforms where your customers hang out—new media that are developing so fast that a listing here would be outdated by the time this book is published.

In this chapter, we show how a customer-strategy enterprise interacts with its customers in order to generate and use individual feedback from of them to strengthen and deepen its relationship with them. This two-way communication can best be referred to as a dialogue, which serves to inform the relationship.

DIALOGUE REQUIREMENTS

An enterprise should meet six criteria before it can be considered engaged in a genuine dialogue with an individual customer:

1. *Parties at both ends have been clearly identified*. The enterprise knows who the customer is, if they have shopped there before, what they have bought, and other characteristics about them. The customer, too, knows which enterprise they're doing business with.
2. *Both parties in the dialogue must be able to participate in it*. Each party should have the means to communicate with the other. Until the arrival of cost-efficient interactive technologies, and especially the internet, social media, and mobile, most marketing-oriented interactions with individual customers were prohibitively costly, and it was very difficult for a customer to make themselves heard.
3. *Both parties to a dialogue must want to participate in it*. The subject of a dialogue must be of interest to the customer as well as to the enterprise.
4. *Dialogues can be controlled by either party in the exchange*. A dialogue involves mutuality, and as a mutual exchange of information and points of view, it might go in any direction that either party chooses for it. This is in contrast to, say, advertising, which is under the complete control of the advertiser. Companies that engage their customers in dialogues, in other words, must be prepared for many different outcomes.

[2] Sara Castellanos, "JetBlue to Take Customer-Service Tech to the Skies," *Wall Street Journal*, October 1, 2019, available at https://www.wsj.com/articles/jetblue-to-take-customer-service-tech-to-the-skies-11569968137 accessed April 24, 2021.

5. *A dialogue with an individual customer will change an enterprise's behavior toward that individual and change that individual's behavior toward the enterprise.* An enterprise should begin to engage in a dialogue with a customer only if it can alter its future course of action in some way as a result of the dialogue.
6. *Every dialogue should pick up where it last left off.* This is what gives a relationship its **context** and what can cement the customer's loyalty. If prior communication between the enterprise and the customer has occurred, it should continue seamlessly, as if it had never ended.[3]

There are clear implications here for privacy. Using a customer's data for their own good and respecting a customer's privacy become key ingredients for getting them to collaborate by sharing mutual information. This is so important, in fact, that the entire next chapter is about privacy.

IMPLICIT AND EXPLICIT BARGAINS

Conducting a dialogue with a customer is having an exchange of thoughts; it's a form of mental collaboration. It might mean handling a customer inquiry or gathering background information on the customer. But that is only the beginning. Many customers are simply not willing to converse with enterprises. And rare is the customer who admits that they enjoy receiving an unsolicited sales pitch or telemarketing phone call. For an enterprise to engage a customer in a productive, mutually beneficial dialogue, it must conduct interesting conversations with an individual customer, on their terms, learning a little at a time, instead of trying to sell more products every time it converses with them.

For example, think about television. When advertisers sponsor a television program, they are in effect making an **implicit bargain** with viewers: "Watch our ad and see the show for free." During television's early decades, these implicit bargains made a lot of sense, because viewers had only a few other channels to choose from and no remote control to make it easy to change the channel. In the early days, everybody watched commercials. But as choices of content proliferated, the problem for marketers was that, because the traditional broadcast television medium has been **nonaddressable**,[4] there has been no real way to tie the particular consumer who watches the television show back to the ad, or to know whether they saw it in the first place. There is also no real incentive, usually, for the consumer to watch the ad, since with DVR or streaming, they can just avoid it.

[3]Don Peppers and Martha Rogers, Ph.D., *Enterprise One to One* (New York: Doubleday, 1997).

[4]Customers who are individually addressable can be sent individually different messages. Mass media are characterized by nonaddressability, since mass media send the same message to everyone simultaneously.

> Brand building today is so different from what it was 50 years ago. Fifty years ago you could get a few marketing people in a small room and decide, "This is what our brand will be," and then spend a lot of money on TV advertising—and that was your brand. If you as a consumer only had your neighbors to talk to, you had to believe what the TV was telling you. Today anyone, whether it is an employee or a customer, if they have a good or bad experience with your company they can blog about it or Twitter about it and it can be seen by millions of people. *It's what others say now that is your brand*.
>
> —Tony Hsieh, CEO of Zappos

But today's television viewer lives in a vastly different environment. Not only are there hundreds of channels from which to choose, but people are also watching television more selectively, with instant—and constant—control. Audiences have the power to tune out commercials at their will or even to block out the advertisements altogether. If a viewer doesn't click "Skip ad" on a YouTube video, that viewer is probably just a robot. Streaming and downloading video via internet connections is outpacing traditional broadcast and cable models, as more and more consumers wirelessly push full-length movies and series to their large-screen television monitors for viewing. Interactive TV has arrived and it's on a variety of devices. At the turn of the 21st century, more households in the United States had a TV than had a refrigerator, but the trend is reversing. As we go to print, 51.7 million homes in America are zero-TV households—that is, they have given up cable and satellite connections in favor of streaming content.[5] Tens of millions more combine traditional and streaming, and will eventually cut the cable cord. In streaming households, and many cable and satellite households, directing interactive personalized ads to a particular viewer is a real capability.[6] These technological trends are driven not just by innovation but by intense consumer demand for choice and immediacy.

However, interactive communications technologies are two-way and individually **addressable**. Because of these attributes, interactive media equip marketers with the tools to make *explicit* bargains rather than *implicit* ones with their consumers. They can interact, one to one, directly with their individual media customers. An **explicit bargain** is, in effect, a deal that an enterprise makes with an individual to secure the individual's time, attention, or feedback. Dialogue and interaction have such important roles to play, in terms of improving and enhancing a relationship, that often it is useful for an enterprise actually to "compensate" customers, in the form of discounts, rebates, or free services, in exchange for the customer participating in a dialogue.

[5]Alicia Phaneuf, "Most US Households Won't Have a Pay TV Subscription by 2024," eMarketer.com, October 8, 2020, available at https://www.emarketer.com/content/most-us-households-wont-have-pay-tv-subscription-by-2024, accessed June 23, 2021.

[6]Joe Flint, "Targeted Ads Headed Soon to Network TV," *Wall Street Journal* online, November 10, 2020, available at https://www.wsj.com/articles/targeted-ads-headed-soon-to-network-tv-11605016201, accessed June 23, 2021.

The interactive world is chock full of examples of explicit bargains. Hundreds of website operators around the globe, from Facebook to Google, offer free digital services to customers who are agreeable to receiving advertising messages or facilitating the delivery of ad messages to others. Some of the ads are highly targeted, and even based on the content of the email messages themselves. For example, if a Gmail user writes a personal message to a friend discussing, say, a trip to the Bahamas, Google will likely show banner ads on the email page that promote air travel, vacation packages, or hotels. Marketers routinely buy keywords from Internet search engines, so that when a consumer searches for, say, "flat-screen televisions," the marketer's ad will appear prominently within the search results. It is standard practice for a website operator to require a visitor to register, providing personal identifying data and preferences, in return for gaining access to the site's more detailed information or automated tools.

DO CONSUMERS REALLY WANT ONE-TO-ONE MARKETING?

Imagine a study that asks customers whether they like the idea of tailored ads and personalized news. The problems with such a survey should be obvious: First, people really don't like advertising and marketing messages in general. (Is that a surprise to anyone?) Of course, they don't want tailored advertising, but they don't want untailored advertising either. Imagine if a study asked this question instead:

> *Please tell me whether you would prefer the websites you visit to show you ads tailored to your interests or, instead, to charge you a small fee for viewing the websites.*

And, of course, we all know what the answer to that question would be. You don't need a survey to demonstrate it, because the history of the web already makes it very clear that free, ad-supported content will triumph over paid content the vast majority of the time. There's no interruption, as with TV commercials, and we get used to just looking past what we don't want to see.

Furthermore, any rookie market researcher can tell you that consumers who are asked generalized questions like this often have difficulty visualizing the actual situation. The right way to have asked this question would have been to demonstrate it to the consumer directly. For instance, prior to asking these questions, what if the interviewer had first asked:

> *Please tell me whether you prefer diet drinks or nondiet drinks.*

And then they could ask:

> *Please tell me whether you would prefer the websites you visit to show you ads for diet drinks or for nondiet drinks. (Pick one.)*

There is still, however, a very important lesson to be drawn from this discussion: The fact that consumers don't see any benefit to tailoring is an indictment of most of us marketers, because we have done such a lame job of tailoring our messages and making them genuinely relevant to our customers. It is not surprising that ordinary consumers would have difficulty visualizing personalized advertising messages, because even today, with all the computer power and interactive technologies available to marketers, most consumers have very rarely witnessed personalized ads that are genuinely relevant!

Explicit bargains with consumers are certainly not confined to the web either. One international survey discovered that online customers are not very aware of how and how much data about them is collected, but once they learn about it, they expect something in return. One example is product enhancement, such as when the Samsung Galaxy phone uses your calling information to populate a frequently called list automatically. Disney uses MagicBands in its parks as a way to swipe for room access, food payment, and preferred attraction access. Google's virtual assistant can read the time in your calendar that you have an appointment and remind you to leave in time to make it.[7]

In an interactive medium, an advertiser can secure a consumer's actual permission and agreement, individually. By making personal preference information a part of this bargain, the service can also ensure that the ads or promotions delivered to a particular subscriber are more personally relevant, in effect increasing the value of the interaction to the marketer by increasing its relevance to the consumer. Explicit bargains like this are good examples of what author Seth Godin calls *permission marketing* (a concept we discuss in more detail in Chapter 9), in which a customer has agreed, or given permission, to receive personalized messages.

Ubiquitous Interactivity

It used to be that the toll-free phone number was the primary mechanism for a customer to reach out to a company for the answer to a question about the product or service, or to ask for help with the product's installation, repair, or upgrade, or simply to inquire about the status of an order already submitted. But no longer. As customers increasingly try to serve themselves using all the interactive capabilities they have today, every enterprise must be on the alert for messages and interactions that may originate in a wider and wider variety of channels. When a customer tweets about a terrible experience at a retail store, posts a story on Facebook or Instagram about a defective product, or submits a two-star review to Yelp, the enterprise needs to know, and to try to follow up. Most importantly, the mere fact of interacting with individual customers requires that an enterprise think of those interactions, not as isolated events,

[7]Timothy Morey, Theodore "Theo" Forbath, and Allison Schoop, "Customer Data: Designing for Transparency and Trust," *Harvard Business Review*, May 2015, available at https://hbr.org/2015/05/customer-data-designing-for-transparency-and-trust, accessed August 26, 2021.

but as components of the different ongoing dialogues it is maintaining with different customers.

In contrast to the noninteractive media that characterized **mass marketing**, today's technology is highly interactive. In fact, middle-class customers in virtually all Western countries today spend more of their waking hours online than off. After all, we are all of us connected to the network via our smartphones, which we have on our person nearly every waking hour of every day. And our smartphones dutifully receive inbound messages, beeping and chiming with every new WhatsApp alert, text message, Facebook notification, or mobile app notification. In 2020 there were approximately 6 billion smartphones in use around the world, with this number expected to grow to 7.5 billion in just a few years.[8] In other words, nearly everybody will have them, pretty soon.

Ubiquitous interactivity is one of the three technological developments (along with databases and **mass customization** capabilities) that have allowed large enterprises serving millions of customers to build individual relationships with these customers, one customer at a time. But in addition, two-way interactivity makes it possible for the customer to gain access to information about the products offered by an enterprise all by herself, not just by turning to the company's own website, but by soliciting others' opinions and experiences, or consulting Yelp or some other review website. In other words, the customer no longer has to rely on advertising and marketing messages at all. Nor do they have to rely on making a phone call or having a face-to-face conversation when they have a question about the enterprise's product or service. Rather than having to visit a business or call in to it, they expect to find an answer to their question on the website.

For the enterprise, however, while the technology revolution has been extremely beneficial in terms of enriching its communications with customers, it has often raised customer expectations at an even faster rate. Yes, it's now possible for an enterprise to handle a customer's inquiry or question online, at a fraction of the cost and time required to handle a visit, a letter, or a phone call. But in addition to being possible, it's now a *requirement* for the enterprise to be capable of doing so – of handling the customer's inquiry online. And the customer will be comparing the enterprise's technological ability, not just to the technological abilities of the enterprise's own competitors, but to the abilities of technology leaders like Amazon, Apple, and Google.

Omnichannel: Myth versus Reality

Omnichannel is one of those high-sounding marketing buzzwords that has the lofty ring of ambitious **customer strategy** and high corporate purpose. This term only

[8] S. O'Dea, "Smartphone Users Worldwide 2016-2021," Statista, August 6, 2021, available at https://www.statista.com/statistics/330695/number-of-smartphone-users-worldwide/#:~:text=The%20number%20of%20smartphone%20users,a%20combined%201.46%20billion%20users, accessed August 26, 2021.

began to appear in marketing jargon in 2009, a couple of years after the Apple iPhone marked the introduction of a new kind of highly interactive smartphone.[9] Even today, however, when almost every customer is carrying an Apple iPhone, Samsung Galaxy, or some other brand of highly interactive smartphone, the vast majority of companies still do not provide an actual omnichannel customer experience.

Contrary to many of these companies' claims, an enterprise does not become omnichannel just by having the capability to interact with customers in every possible interactive channel—email, phone, SMS text, Instagram, WhatsApp, Twitter, mobile app, etc. Remember, if the word *omnichannel* is to mean anything at all, it must stand for a customer experience that is seamlessly *integrated* across all different interactive channels. At an omnichannel enterprise, all the various channels for interacting with customers also communicate among themselves, sharing information and data in such a way that any customer dialogue, begun on one channel, can be seamlessly taken up again by the next channel. Only in this way can the *context* of any customer's dialogue with the enterprise survive from one interaction to the next. For an enterprise to represent itself as operating in a truly omnichannel way, in other words, its mobile app must know what a customer inquired about on the website, and the contact center agent answering the customer's phone call must already have access to what the customer was trying to figure out from the website or the mobile app just a few minutes earlier.

The problem is that many companies aren't yet capable of preserving the context of their dialogue with an individual customer from one channel to the next. Think back to the last time you, as a customer, had some problem with a company's product or service. Almost certainly the first thing you did was to go to the company's website and try to solve the problem yourself. But after spending perhaps 20 minutes struggling to update some transaction, substitute one service for another, or do any one of a thousand other tasks that just never seem to fit into the online choices available, you gave up in frustration and decided to call the company, right?

> If the word *omnichannel* is to mean anything at all, it must stand for a customer experience that is seamlessly *integrated* across all different interactive channels.

More than half of all U.S. **customer service** calls are preceded by an online self-service session. But as of this writing, the first thing most customers must do when they finally speak with a live human being, is to explain everything again, from the very beginning. Even though a customer may have just spent 30 minutes on the company's very own website, and maybe using the company's very own chat feature

[9]The iPhone was introduced in January 2007 and Google's Ngram shows the first increase in use of the word *omnichannel* in 2009 (see https://books.google.com/ngrams/graph?content=omnichannel&year_start=1800&year_end=2019&corpus=26&smoothing=3&direct_url=t1%3B%2Comnichannel%3B%2Cc0#t1%3B%2Comnichannel%3B%2Cc0, accessed May 30, 2021).

(both tools programmed and operated by the company's employees), the associate who eventually answers the phone will likely have no clue whatsoever that the customer had even been on the site, much less what they had been trying to do there. In other words, the phone channel does not know what the website channel has already learned.

Today it's almost trivially simple to link a person's online session with a live **customer-care** interaction, and so we predict that companies will in fact be rushing to do it over the next few years, just to keep up with their competitors. But here are a few of the ways an enterprise could easily link its online and phone interactions, even with today's technologies:

- *Proactive chat*. One of the easiest ways for a business to provide a customer with human-to-human assistance while they're on the website is to offer a chat window at the appropriate time. It's important to be careful with this, because customers will simply tune out if they get a pop-up invitation to chat just by logging in, but when a company proactively offers to chat with a customer or prospect at the right time[10] it's an ideal way to reduce abandoned shopping carts, buttress low-performing pages on the website, or simply nail a difficult element of friction in the customer experience and avoid the greater expense of handling a customer-service phone call. And of course the employee responsible for conducting the chat with a customer will be able (with the customer's permission) to see the customer's screen, and to help the customer accomplish whatever task is being attempted.
- *A "Call Me" button*. Amazon and others use a "Call Me" button for when a customer can't figure something out on their website. Rather than simply seeing a toll-free number to call, customers can also ask Amazon to contact them. They then enter their own phone number, and in a few minutes (or whenever they specify), someone from Amazon calls *them*. And obviously, the associate tasked by the computer with making the outbound call will also be provided by the computer with details on what this customer was actually doing on the website in the moments before they asked to talk to someone.
- *A temporal phone number*. This is an ideal mechanism for splitting the difference between proactive chat and "call me." If a prospect or customer is on the website and decide to call in, when they click the "Contact us" button, what they will see is a toll-free number that is actually a unique, one-time-use phone number just for their individual use. It will only be valid for a few hours, but since they're only one who will have been shown that particular number, when they call it the enterprise will know what web session it came from and the associate who answers the phone will have been provided with the customer's clickstream just prior to the call.

[10]Les Melnichenko, "Proactive Chat 101: Definition, Best Practices, Useful Examples," HelpCrunch, May 8, 2020, available at https://helpcrunch.com/blog/proactive-chat-best-practices-dos-and-donts-to/, accessed May 30, 2021.

- *"Click to Call" button*. If a customer is accessing the company through its mobile app, installed on their phone, they shouldn't have to leave the app in order to make a call to the company. At an omnichannel enterprise, the customer's activities on the mobile app can be connected to the inbound phone if the app has its own button a user can press to chat or talk directly with a human customer service agent at the enterprise (or to get a call-back).

Customer Interaction Redefines "Integrated Marketing"

Don Schultz, Stanley Tannenbaum, and Robert Lauterborn's classic 1996 book, *The New Marketing Paradigm: Integrated Marketing Communications,*[11] documented the problems that occur whenever a customer sees a mishmash of uncoordinated advertising commercials, direct-mail campaigns, invoices, and policy documents, making a strong case for the importance of ***integrated marketing communications (IMC)***. And it's difficult to quarrel with the premise that a company's television commercials should never conflict with its magazine or newspaper advertising.

As strong and essential as this case was, however, in an era of proliferating media channels, interactive technologies since then have introduced a completely new and highly compelling variable, because today, when an enterprise **treats different customers differently**, it is no longer actually being consistent across media channels in its marketing communications to every customer. In fact, the enterprise is being *purposely inconsistent!* Its communications to different customers will be *different* from what it is to other customers, based not just on its customers' different valuations and needs, but also on the different interactive dialogues it is engaged in with each different customer. But it will be the same for *each* customer across channels. So this does not mean that integration isn't still important. It's just that ubiquitous interactivity has added a new *dimension* of integration to the task. An enterprise must still integrate its communications with any given customer *laterally*, across all its various channels of interaction with that customer, but it's also important for the enterprise to be consistent **longitudinally**—that is, *through time*. Every interaction with any individual customer must be integrated with the previous interactions with that customer. Each individual customer dialogue must pick up where that dialogue left off the last time, in whatever channel was used.

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[11]Don E. Schultz, Stanley I. Tannenbaum, and Robert F. Lauterborn, *The New Marketing Paradigm: Integrated Marketing Communications* (New York: McGraw-Hill, 1996). Since 1996, integrated marketing communications, also known as an omnichannel approach, has transformed from cutting-edge strategy to requirement for survival: see Holly Briedis, Brian Gregg, Kevin Heidenreich, and Wei Wei Liu, "Omnichannel: The Path to Value," McKinsey & Company, April 30, 2021, available at https://www.mckinsey.com/business-functions/marketing-and-sales/our-insights/the-survival-guide-to-omnichannel-and-the-path-to-value, accessed October 25, 2021; and Steve Olenski, "Integrated Marketing Communication: Then and Now," *Forbes*, May 31, 2012, available at http://www.forbes.com/sites/marketshare/2012/05/31/integrated-marketing-communications-then-now/, accessed August 26, 2021.

It is a continuing dialogue like this that enables the enterprise to learn and remember more about the customer with each successive interaction. The more the enterprise remembers about a customer, the more unrewarding it will become to the customer to defect and try to start all over again, recreating the relationship with a competitor. Providing customers with a means to engage in a longer-term dialogue, rather than in an unconnected series of transactional buy-or-don't-buy decisions will empower an enterprise to secure deeper, more profitable, and less competitively vulnerable relationships with each of them.

An enterprise must still integrate its communications with any given customer *laterally*, across all its various channels of interaction with that customer, and *longitudinally*—that is, through time.

Some customers don't want this. Those are customers who always look for the lowest price no matter what, who are always transactional, and who don't value what they have to repeat to vendor after vendor. These are, for many businesses, the least valuable customers or **BZs**. For many customers, in a wide range of income levels, the deeper each relationship with certain companies becomes, and the more it is based on a dialogue built up through interaction over time, the less regimented that relationship will be. Do it right, and the customer will want to expand the dialogue on their own volition, because they will know that each time they speak to the enterprise, it will listen, and then change its behavior toward the customer. Today, what most enterprises fail at is not the mechanics of interacting but the *strategy* of it—the substance and direction of customer interaction itself.

Today, what most enterprises fail at is not the mechanics of interacting but the *strategy* of it—the substance and direction of customer interaction itself.

CUSTOMER DIALOGUE: A UNIQUE AND VALUABLE ASSET

Interaction with a customer, whether it is facilitated by electronic technologies or not, requires the customer to participate actively. Interaction also has a direct impact on the customer, whose awareness of the interaction is an indispensable part of the process. Since interaction is almost always visible to customers, interacting customers gain an impression of an enterprise interested in their feedback. It is a vital part of the customer experience with the brand or the enterprise. The overarching objective on the part of the enterprise should be to establish a dialogue with each customer that will generate customer insight—insight the enterprise can turn into a valuable business asset, because no other enterprise will be able to generate that insight without first engaging the customer in a similar dialogue.

This is one of the key benefits of the Learning Relationship we've been discussing, and it is based on the fact that different customers want and need different things. This means we also should expect different customers to prefer different *interaction methods*. One customer prefers email to phone; another likes a combination of email and regular mail; still another only texting or visits **social networking** sites, such as Twitter. The level of personalization that the web affords should also be available in more traditional customer-facing venues. Retail sales executives in the store, for instance, should have access to the same knowledge base of customer information and previous interactions and transactions with the enterprise as a **customer service representative (CSR)** at corporate headquarters, **customer interaction centers**, or **customer contact centers**. Enterprises must be able to identify which channels each customer prefers and then decide how they will support seamless interactions. Those enterprises that fail to provide these interaction capabilities can lose sales and compromise relationships.

The goal for the customer-strategy enterprise is not just to understand a *market* through a *sample* but also to understand each *individual* in the population through *dialogue*.

The goal for the customer-strategy enterprise is not just to understand a *market* through a *sample* but also to understand each *individual* in the population through *dialogue*. An effective interaction is one from which the enterprise gains additional customer insight in the form of greater understanding with respect to one or both aspects of the customer value proposition—the customer's needs and the customer's valuation.

1. *Customer needs*. The best method for discovering what a customer wants is simply to interact with them directly. Data about customers accumulates with each click on the website or mobile app, and each time they buy—or don't buy—the enterprise discovers more about the preferences, desires, and goals of each. These interactions are all important ingredients for improving customer insight, not only because the customer is investing in a relationship with the enterprise, but also because the enterprise is accumulating substantive information about the customer that a competitor may not know and cannot act on.
2. *Customer valuation*. In addition to learning more about what the customer needs from the enterprise, with every customer interaction the enterprise will learn more about the customer's **actual value**, and it has the opportunity to acquire information about the customer's **potential value** as well. Consider, for instance, a loyalty program or mobile app that encourages a customer to designate a product or service desired in the future, either to earn additional

points or credits, or to improve the convenience of future shopping. This is exactly what the Starbucks mobile app is doing, by allowing a customer to specify their regular orders, even in advance of any specific buying occasion. It is convenient for the customer and illuminating for the enterprise. Additional insight into a customer's potential value could include, among other things: advance word of an upcoming project or pending purchase, information with respect to the competitors a customer also deals with, or referrals to other customers that could be profitably solicited by the enterprise. This type of information is not usually available from a customer's buying history or transactional records, but could easily be obtained through direct interaction and dialogue with the customer.

Because most customers will not sit still for extensive questioning at any given touch point, the successful customer-oriented enterprise will learn to use each interaction, whether initiated by the customer or the firm, to learn one more incremental thing that will help in serving the customer better, so as to grow the customer bigger and keep the customer longer. It is the concept we have called **drip irrigation dialogue**, but USAA Insurance in San Antonio, Texas, calls it ***smart dialogue***.[12] As the basis for intelligent interaction, USAA's highly capable customer data management system makes a customer's immediate history available to its CSRs as soon as a customer calls in and is identified. Often, the CSR handling a customer will also see a box on their computer screen that states a question USAA would like to have answered about a customer—a question that may involve the customer's recent change of address, future plans, or the college their child will soon be attending. Importantly, this will not be a question USAA is asking every customer who calls this month; it will be the next question for *this customer*.

Golden Questions

It would be ideal if an enterprise could ask every customer to complete an extensive questionnaire with respect to a customer's goals, plans, preferences, and desires, but this would impose on the customer and it's not likely most customers would want to expend the time or effort required. In general, an enterprise should avoid most product-focused questions, except in situations in which the customer is trying to specify a product or service, prior to purchase. Instead, the most productive type of customer interaction is that which reveals information about an individual customer's underlying need or potential value, while not requiring much effort at all from the customer. We call such interactions **Golden Questions** because they allow the enterprise to achieve quantum leaps in their understanding of an individual customer, without requiring a great deal of trouble on the part of the customer to answer. Golden Questions can often be interesting, or even enjoyable, for a customer to answer. Our favorite example of a Golden Question came from an online pet-supply company that wanted

[12]As told to one of the authors.

to identify its most valuable pet owners. To do so it posed a very simple yes or no question to new website visitors: "Last year, did you give your pet a holiday present?" It should be obvious what answer would indicate a higher-value customer. (Notice that the question was not product oriented: How much dog food did you buy last year?)[13]

But sometimes it's not so obvious, because the enormous amounts of data available to companies today can reveal interesting facts or **correlations** without providing a reason or a story behind the data. For instance, in the book *Dataclysm*, by Christian Rudder (one of OkCupid's founders), he says that the questions "Do you like scary movies?" and "Have you ever traveled to a foreign country?" are the two most highly predictive of relationship longevity:

> *In about three-quarters of the long-term couples OkCupid has ever brought together, both people have answered them the same way, either both "yes" or both "no."*[14]

For another example, consider a timeshare vacation company that knew that some of its customers bought a timeshare property primarily to vacation in that location once a year (the *stayers*), while others bought it for the purpose of trading it out every year and vacationing at other resort destinations. These customers composed two distinct needs-based groups (see Chapter 7) who should be treated differently to maximize the value each would create for the company. It turned out that the company's data showed a fairly reliable predictor for the stayers because the presence of small children greatly increased the likelihood that a family would be looking for a single place to vacation every year and would not be as interested in trading it out. To improve sales and better match customers with the kind of property they were looking for, the Golden Question the company's salespeople used near the beginning of any discussion with a new prospective buyer, was "How old did you say your children are?"

Golden Questions are designed to reveal important information about a customer while requiring the least possible effort from the customer.

Golden Questions do not have to be spoken or written questions. They can also be interactions that offer customers choices or options that are designed to help the enterprise learn about a customer's needs or other characteristics. An automotive client of Peppers & Rogers Group wanted to introduce a loyalty program for owners of its new car brands, whether they bought the car new from one of the company's dealers or used through any other channel. To incentivize owners to sign up for the program, the company was prepared to offer a gift for joining, and since the brand

[13]Special thanks to Tom Spitale, Partner at Impact Planning Group and co-author with Mary Abbazia of *The Accidental Marketer* (Hoboken, NJ: Wiley, 2014), whose insight helped shape the value and methodology of Golden Questions.
[14]Christian Rudder, *Dataclysm: Who We Are (When We Think No One's Looking)* (New York: Crown, 2014), Kindle location 1112.

was rather sporty, the initial idea was to offer each new member a complimentary pair of racing gloves with the brand's logo. However, market research showed that while most owners were in fact young men, a substantial minority were mothers, often with young children, while other were larger families, where this car served as a second car. So the joining incentive was changed. New members could choose one of three gifts: the racing gloves, or a package of three children's videos, or a collapsible umbrella and road atlas. The point is that the choice of gift constituted a Golden Question, revealing a great deal about the new member and how to better serve them in the future.

As this example shows, *any* interaction with a customer represents new data and has the potential to predict a customer's likely needs or their future value to the enterprise. It could simply be an interaction undertaken in the normal course of a customer's patronage. And the OkCupid story, based on a customer insight generated through a massive database and statistical analysis, clearly demonstrates a conundrum that enterprises will increasingly confront as they try to make sense of and understand the *why* behind extremely esoteric correlations and data-driven predictions.

Not All Interactions Qualify as Dialogue

Many interactions with customers are simply not welcomed by the customer. In fact, a large portion of customer-initiated interactions with businesses only occur because something has gone wrong with a product or service, and the customer needs to contact the enterprise to try to get things put right. It can be frustrating in the extreme for a customer to try to navigate through a complex IVR in order to get a problem resolved, only to realize later that the problem was not resolved and they need to contact the company again and wait on hold. Companies need to become one-stop shops when it comes to complaint handling. Research shows that only a small minority of complaining customers feel their problems are resolved on the first contact, and it's not unusual for a customer to need four or more contacts to get things resolved, although this has been improved somewhat in recent years by chatbots that enhance the efforts of the humans.[15] But in all cases, things work just fine until they don't, and then—just when a customer needs things to work the most smoothly, at the ***moment of truth***—the poor customer has to work really hard—without being on the payroll—to get what they should have had just for doing business with a company. One of the best books on managing contact-center interactions with customers is *The Best Service Is No Service: How to Liberate Your Customers from Customer Service, Keep Them Happy, and Control Costs*, by Bill Price and David Jaffe. (Price served as Amazon's first

[15] P. V. Kannan and Josh Bernoff, "The Future of Customer Service is AI-Human Collaboration," *MIT Sloan Management Review*, May 29, 2019, available at https://sloanreview.mit.edu/article/the-future-of-customer-service-is-ai-human-collaboration/, accessed May 9. 2021; Marc Grainer, Charles H. Noble, Mary Jo Bitner, and Scott M. Broetzmann, "What Unhappy Customers Want," *MIT Sloan Management Review* (Spring 2014), available at http://sloanreview.mit.edu/article/what-unhappy-customers-want/, accessed August 26, 2021.

Global VP of Customer Service.)[16] The whole point of the book is that customers hate having to make complaint calls, so doing things right to begin with offers a far better experience for customers than any kind of special treatment from the customer service department.

We should make it clear that Price and Jaffe are not talking about such interactions as placing orders, making payments, or using self-service solutions, such as checking balances, that customers freely choose to use. Instead, they are talking about when a customer *has* to call or take the time to write or visit a branch or website just to get something done or to get something fixed. After all, virtually every phone contact with a technical support area of an internet provider, computer manufacturer, or e-commerce company is a sign that something is broken, because the issue couldn't be dealt with via an online interaction. Ideally, customers should never need to make these contacts.

EFFICIENT AND EFFECTIVE CUSTOMER INTERACTION

When trying to use interactions to create the most value from customers, an enterprise should focus on both the *efficiency* and the *effectiveness* of its interactions. But as with many business goals, there is a balance to these qualities that must be carefully struck.

When we say *efficiency* we are talking about making it less costly and more convenient to engage in interactions with customers. This means, for instance, trying to increase the proportion of interactions that occur in more cost-efficient channels—driving manual interactions into automated channels with a mobile app, for instance, or driving more inbound phone calls into web interactions. For decades now, technology has been dramatically reducing the expenses required for a business to interact with a wide range of customers. Enterprises can now streamline and automate what was once a highly manual process of customer interaction. Different interactive mechanisms can yield widely different information-exchange capabilities, such as speed trackability, tangibility (the ability to hold the information or refer back to it later), and personalization. Interacting regularly with a customer via a website is usually highly cost efficient and can be customer driven, yielding a rich amount of information. Postal mail is not as practical for dialogue, of course, because it involves a lengthy cycle time, but it can prove more effective for delivering detailed information to a customer who prefers to keep hard copies. Telephone interaction has the advantages of real-time, person-to-person conversation, but neither phone nor face-to-face interaction facilitates easy tracking of the content of these conversations, and the enterprise trying to employ voice interactions to strengthen its customer relationships must be sure the employees responsible for the interactions are diligently and accurately capturing the key elements of whatever customer dialogue occurs (although scripted phone calls can aid in this effort). Social media offer a mix of opportunities to incorporate dialogue, with a string of caveats.

[16]Bill Price and David Jaffe, *The Best Service Is No Service: How to Liberate Your Customers from Customer Service, Keep Them Happy, and Control Costs* (San Francisco: Jossey-Bass, 2008).

Automation, when used as an interactive mechanism, has two very important qualities for the enterprise. First, the marginal cost of responding to a customer with an automated reply or self-serve tool that allows the customer to find exactly what they are looking for, is a tiny fraction of the cost of having to respond to the customer manually, whether in person or via a contact center. Second, because automation must be flawless to work properly, a well-automated interaction from the enterprise will take friction out of the customer experience, as well. For both of these reasons, automation tends to work extremely well, creating great value for the enterprise, whenever it is designed to handle routine and predictable customer interactions, and consumers generally *prefer* chatbots and other automated solutions for dealing more conveniently with such issues. For less predictable tasks however, or for problems that are more complex, most people still prefer human beings. Citing a Live Person survey of some 5,000 adults in six different Western countries (the United States, UK, France, Germany, Australia, and Japan),[17] for example, *Forbes* magazine contributor and AI authority Gil Press reported that:

> . . . more than [half] of respondents said they'd prefer a bot over a human agent to tell them their account balance or update an address; conversely, consumer confidence in bots is lower for more complex tasks—just 15% said they would want a bot to assist with correcting a mistake on a bill.[18]

Unfortunately many companies, eager to enjoy the cost benefits of a more and more automated set of individual customer interactions, end up overestimating the reliability of their automation tools and chatbots, often forcing an inappropriately high proportion of customer interactions into automated channels. The predictable result of this is that their customers become upset or irritated. So the proper way to view efficiency, as a goal for automated interactions, is to restrict it to dealing with highly routine issues (at least with today's technologies). People prefer using ATMs and retail banking mobile apps, rather than bank tellers, when it comes to doing routine things such as getting cash, depositing checks, or paying bills. But if a check bounces, or a payment is late, then people aren't as interested in the efficiency of the interaction. They would prefer to interact with a less efficient, but more capable, human being. In addition, such experiences can often be upsetting, and chatbots are not known for showing empathy or concern. Remember that customers, too, have an idea about efficiency, and waiting on hold 30 minutes while a problem remains unsolved is not efficient to them.

Regardless of how flawlessly automated an interaction with a customer is, it still costs something, if only in terms of the customer's own time and attention. The cost of

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[17]Live Person, "Consumer Preferences for Conversational Commerce," available at https://liveperson.docsend.com/view/c89dbkr, accessed May 31, 2021.

[18]Gill Press, "AI Stats News: 62% Of US Consumers Like Using Chatbots To Interact With Businesses," *Forbes*, October 25, 2019, available at: https://www.forbes.com/sites/gilpress/2019/10/25/ai-stats-news-us-consumers-interest-in-using-chatbots-to-interact-with-businesses-rise-to-62/?sh=52b300c73974, accessed May 31, 2021.

customer interaction can be minimized partly by reducing or eliminating the interactions that the customer does not want. But ranking customers by their value also allows a company to manage the customer interaction process more cost efficiently. A highly valuable customer is more apt to be worth a personal phone call from a manager, while a not-so-valuable customer's interaction might be handled more efficiently by a text message or via the website. An enterprise requires a manageable and cost-efficient way to solicit, receive, and process the interactions with its customers. It will need to categorize customer inquiries and responses in some effective way so it can customize its interactions for each customer.

An enterprise's second objective for interactivity, however, should be *effectiveness*. And by this we of course mean effectively resolving whatever issue the customer might have brought up in the interaction and improving the customer experience, but we also mean something else. An effective interaction for the enterprise is one which produces greater customer insight by gaining useful information from the customer during the interaction—insight that can help increase the context of the enterprise's overall relationship with the customer. Whenever an enterprise *learns* something about an individual customer, there is always the possibility that what it learns can help it better tailor the customer experience for that customer, developing a Learning Relationship with the customer and creating a competitive advantage for itself when it comes to retaining and growing that customer's business.

So customer-strategy enterprises must focus not just on the *efficiency* of the interactions they have with customers, but also on the *effectiveness* of each customer dialogue. Measuring efficiency might include monitoring how long customers stay on hold with the customer service department before they disconnect, or perhaps tracking the percentage of customer inquiries or searches were satisfactorily handled by the website.

Measuring effectiveness, however, might include tracking **first-call resolution (FCR)**, the ratio of complaints handled or problems resolved on the first call, but it could include the number of changes, profile updates, or triggered marketing events attributable to a customer's interaction. Critical to the success of any dialogue, however, is that each successive interaction with the individual customer be seen as part of a seamless, flowing stream of discussion. Whether the conversation yesterday took place via text, phone, the web, or any other channel, the next conversation with the customer must pick up where the last one left off.

COMPLAINING CUSTOMERS: HIDDEN ASSETS?

It's a well-known fact that if we put a pot of boiling water and a separate pot of lukewarm water into a freezer at the same time, the boiling water will freeze first. This phenomenon is used on a daily basis by ice cream makers and bartenders, but scientists still can't say why it happens, even though it's been studied since the time of Aristotle. Recently, in fact, the U.K.'s Royal Society of Chemistry put up a £1,000 prize for the first person who can offer a satisfactory explanation (no satisfactory explanation yet).[19] Similar to freezing a pot of boiling water, companies can often turn the hottest and most vociferous of complainers into raving fans—brand advocates even more positive in their views about the customer experience than other, more satisfied customers are.

Customers who are satisfied with the solution to a problem often exhibit even greater loyalty than do customers who did not experience a problem at all.

Knowing this is crucial because a whopping 96% of customers who have complaints don't voice them to the enterprise directly; however, more than half voice their complaints to others. Customers who have complaints about customer service issues tell an average of 15 of their friends, family members, and even casual acquaintances. And with ever more frequency they also post such complaints on social media, where they will often be seen by hundreds or more.[20] To a customer-centered enterprise, complaining customers have a collaborative upside, represented by a high potential value. In fact, they might have the highest potential value: Research from the Technical Assistance Research Program (TARP) has shown that the most loyal customers are the ones most likely to take the time to complain to a company in the first place. It has also found that customers who are satisfied with the solution to a problem often exhibit even greater loyalty than do customers who did not experience a problem at all.[21]

Customers generally contact an enterprise of their own volition for only three reasons: to get information, to obtain a product or service, or to make a suggestion or a complaint. Despite the fact that technology should make it easier for customers to contact companies, TARP found that customer complaints are declining—not because there are fewer problems but likely because, unfortunately, customers have been

[19]Royal Society of Chemistry, "RSC Offers £1000 For Explanation of an Unsolved Legendary Phenomenon," 2012, available at https://www.rsc.org/news-events/articles/2012/06-june/rsc-offers-1000-for-explanation-of-an-unsolved-legendary-phenomenon/, accessed March 28, 2021.

[20]And the longer you take to resolve the issue, the more "complaint publicization" via social media can hurt your brand. See Alireza Golmohammadi, Taha Havakhor, Dinesh Gauri, and Joseph Comp rix, "Complaint Publicization in Social Media," *Journal of Marketing* (July 2021), available at https://doi.org/10.1177/00222429211002183, accessed August 31, 2021. Also see Kilechi Okeke, "6 Reasons Your Customers Do Not Complain," CustomerThink.com, Nov. 1, 2017, available at https://customerthink.com/6-reasons-your-customers-do-not-complain/, accessed August 26, 2021.

[21]Marc Grainer, Charles H. Noble, Mary Jo Bitner, and Scott M. Broetzmann, "What Unhappy Customers Want," *MIT Sloan Management Review* (Spring 2014), available at http://sloanreview.mit.edu/article/what-unhappy-customers-want/, accessed August 26, 2021; Goodman, *Customer Experience 3.0: High-Profit Strategies in the Age of Techno Service*; Lambert, "LEARN from Complaints—A Framework for Handling Grievances Profitably"; and Barlow and Moller, *A Complaint Is a Gift*, pp. 104–105.

trained to expect problems as part of the cost of doing business.[22] So, whenever anyone takes the initiative to tell an enterprise something about their dissatisfaction or disappointment with the customer experience, that customer's first-person feedback represents an extremely valuable business opportunity for the enterprise, for two important reasons. The first has to do with turning the complaining customer's point of view around entirely.

Unlike the problem of why boiling water freezes first, this phenomenon is not hard to understand at all, because a complainer is someone whose expectations have been lowered, perhaps dramatically so. The second reason is that, whenever someone feels that a company has wronged them in some way, they're likely to examine every new interaction for evidence to confirm this belief (the confirmation bias at work). As a result, something that might have begun as a flawed company policy of some kind, or an oversight or simple mistake by someone in the firm, could soon be interpreted by the complainer as bad intentions on the company's part. And bad intentions constitute the most serious breach of trust possible. Moreover, because trust is largely a social concept, the damage from such a breach is not limited to the patronage of the individual customer, but can also quickly infect the customer's friends and associates. Even a single complainer's dissatisfaction and distrust can soon have a negative influence on a large number of others. So complainers, if left alone and not addressed directly, do immense damage to the overall value of a company's customer franchise.

However, the good news is that the mere fact a complainer has already developed and become habituated to a particular (highly negative) point of view means that as soon as the company does something to objectively *contradict* that point of view—reaching out to handle the complaint proactively, for instance, or apologizing sincerely and trying to make things right—its action has the potential to completely reverse the customer's **mindset**, violating the customer's expectations once again, but this time in a highly memorable and positive way. The more a business exceeds the customer's own pessimistic expectations, the more noticeable and memorable its initiative will be. When done right, like the boiling pot of water that freezes faster, a simmering complainer will often become a highly convinced brand advocate even faster than someone who never even had a complaint to begin with.

One 2016 U.S. study examined 400,000 customer service complaints posted on Twitter that mentioned either one of the top five airlines or the top four wireless carriers. Researchers first divided the tweets into two categories: (1) those that were never responded to by the company, and (2) those that were responded to in any fashion at all, whether or not the complaint was actually resolved to the complainer's

[22]John Goodman, *Customer Experience 3.0: High-Profit Strategies in the Age of Techno Service* (New York: American Management Association, 2014); Trevor Lambert, "LEARN from Complaints—A Framework for Handling Grievances Profitably," LinkedIn Pulse, November 19, 2014, available at https://www.linkedin.com/pulse/20141119082756-7848549-learn-from-complaints-a-framework-for-handling-grievances-profitably?trk=prof-post&trkSplashRedir=true&forceNoSplash=true, accessed August 26, 2021; and Janelle Barlow and Claus Moller, *A Complaint Is a Gift: Recovering Customer Loyalty When Things Go Wrong*, 2nd ed. (San Francisco: Berrett-Koehler, 2008), p. 74.

satisfaction. Then they surveyed these two populations of responded-to and not-responded-to complainers with respect to their willingness to recommend the company (the NPS question). What they found was that when a company simply responded, individually, to a complaint, this action alone generated a stunning increase of 37 NPS points for airlines and a full 59 points for wireless carriers![23]

Over and above this direct impact on a complaining customer, however, when the enterprise focuses its attention on unpacking the reasons behind a single customer's complaint, there is a good chance that the problem itself will not be entirely unique, that is, that there will have been other problems similar to the one now being investigated, whatever it is, and these similar problems were experienced by other customers who never went to the trouble of registering their complaint with the company or posting it on social media. So, in addition to fixing the issue with the individual complainer, when an enterprise investigates the root causes behind whatever problem gave rise to a complaint, and undertakes an effort to fix these issues before the same problem recurs in the future with other customers, the overall quality of the customer experience going forward will be that much better. Examining and remedying complaints, in other words, is a very fruitful and practical way to identify and root out friction in the customer experience.

> Because the handling of complaints has so much potential upside, a one-to-one enterprise will not avoid complaints but instead will seek them out.

Moreover, because such a small proportion of those who have complaints actually take the initiative to tell the enterprise, it's important to reach out to as many customers as possible to discover all the *unvoiced* complaints. The most frequent way companies engage in **complaint discovery** activities today is by using a transactional voice of customer (VOC) survey that simply *asks* customers, once a transaction or other interaction has been concluded, whether they were satisfied with their experience.

There are other ways to discover complaints, as well. "Mystery shopping" on the enterprise's website or store (and at competitors' businesses as well) is a valuable resource for discovering unreported friction and unvoiced complaints. Or we can use simple observational data, such as Travelocity did (see Chapter 3), when it tabulated all the null searches that visitors encountered on its website. Amazon engages in complaint discovery with a post-interaction VOC survey designed to assess the quality of its customer service. After all phone or chat interactions, Amazon contacts the customer to ask them a simple question: Did the interaction resolve their issue? Obviously, when a customer answers "no," Amazon then tries to drill down into the problem, both to remedy the situation with that customer and to remove whatever friction might cause the problem to recur. The company's most important metric of

[23]Wayne Huang, John Mitchell, Carmel Dibner, Andrea Ruttenberg, and Audrey Tripp, "How Customer Service Can Turn Angry Customers into Loyal Ones," *Harvard Business Review*, January 16, 2018.

success in this effort is something it calls the ***non-resolution rate***, or "***NRR***," which is the percentage of all voice and chat interactions that customers say did *not* resolve their problem. The company wants to drive its NRR down into the low single digits in an effort to continue rooting out and eliminating friction in the customer experience.[24] A truly **frictionless** customer experience is one that presents absolutely no obstacles or barriers to the customer meeting whatever need or doing whatever job they want to hire a company's product or service to do. And for a customer experience to be truly frictionless, the enterprise must be both **product competent** and **customer competent**. (See Chapter 2.)

Because the handling of complaints has so much potential upside, a one-to-one enterprise will not avoid complaints but instead will seek them out. An effort to discover complaints—to seek out as many opportunities for customer dialogue as possible—becomes part of dialogue management. Complaint discovery contacts typically ask two questions:

1. Is there anything more we can do for you?
2. Is there anything we can do better?

And often, simply providing the opportunity for a customer to voice any dissatisfaction will improve the customer's feelings and intentions with respect to the enterprise doing the asking. Most customers see complaint discovery, or having an easy way to get problems solved, as a highly friendly and service-oriented action on the part of a firm.

> By complaining, a customer is initiating a dialogue with an enterprise and making himself available for collaboration.

At one European book club, for example, customer service representatives contacted new members during their first month and asked one simple question: "Is there anything we can do better?" No sales pitch or special promotion. The results of this customer satisfaction initiative speak volumes to its effectiveness in retaining customers: nearly an 8% increase in sales per member, and 6% fewer dropoffs after the first year of membership, among those contacted. And a survey commissioned by an auto dealer discovered that for the vast majority of the 6,500 automobile owners included in the survey, the very act of asking for their opinions made them into happier and more loyal (i.e., more valuable) customers. Customers who received a phone call simply asking about their opinion tended to become more satisfied with the automobile dealer than those who did not receive a call.

Of course, today many of the complaints don't need to be discovered via direct interaction with the customer. Now that it's so much easier to tweet a problem, give a low product rating online, or reach a rep easily by chat on computer or mobile,

[24]The information about NRR and Amazon came from an email received by the authors from a friend who is a professional in the business.

companies can often simply "observe" complaints, as they are made, allowing them to spend less time seeking complaints and more time resolving them.

By complaining, a customer is initiating a dialogue with an enterprise and making himself available for collaboration. The enterprise focused on building customer value will view complaining customers as an asset—a business opportunity—to turn the complainers into loyal customers. That is why enterprises need to make it easy for a customer to complain when they need to, and to resolve the complaint seamlessly.

The Dollars and Sense of Social Media

A colleague of ours was angry about the way Orbitz handled a service issue, so she tweeted about it. She also sent a complaint via the company's website customer support page. Orbitz responded to her Twitter posts via email and resolved the issue. But in response to our friend's email sent via the "contact us" form on the website, the company only sent a generic "we're reviewing your inquiry" email. Obviously, the company was monitoring social media commentary even more carefully than it was monitoring its own direct contacts.

This is just one of the many examples of customer interaction via social channels benefiting customers. The question is, does it benefit the company as well? It does, and here are a few examples:

- To generate mass brand awareness among digital natives, Pringles' launched their #PlayWithPringles campaign, where customers were asked to "get creative" with a Pringles can and post a video on TikTok. Targeting users in Germany, Italy, and France, the campaign quickly went viral and resulted in 1 billion hashtag views, 343,000 videos created, a 13% average engagement rate, and an explosive increase in user-generated content.[a]
- During the COVID-19 pandemic, when many found themselves working from home and in less-than-ideal environments, video conferencing company Zoom launched a Virtual Background Awards campaign, to allow users to showcase their creativity and educate others on how to make the most of their software.[b]
- Spontaneous customer fan pages had appeared on the web for Italian food company Barilla's White Mill (Mulino Bianco) products; one cookie had 700,000 fans. Barilla created their own Facebook pages for products, and invited customers to participate in product development by suggesting and voting on product ideas. One fan suggested bringing back the Soldino cookie of their youth. The idea received over 6,000 votes and was selected by the firm. They reissued the cookie in a limited-edition run, and it was a great success.[c]
- Tibco Software's customer community enables customers to help each other solve technical issues (that's what **crowd service** is). Every time that

(*continued*)

happens, a customer gets the help they need but the company also saves about $1,000 on a support call. The savings to the company more than cover the cost of hosting an online community. "We can show tangible value from our social media strategy," says Ram Menon, executive vice president of worldwide marketing for Tibco.

Clearly, marketers are increasing their spending on social media, email, and search with clear bottom-line benefits.[d] The hard-dollar benefits include increased buzz, improved search results, increased customer influence, deeper insights into customer value and needs, and crowd service: customers helping other customers online.

[a]"Pringles: Generating Engagement and Brand Awareness with the TikTok Community in Germany, Italy, and France," TikTok: For Business, available at https://www.tiktok.com/business/en-US/inspiration/pringles-79, accessed December 12, 2021.
[b]Jenn Chen, "Marketing Campaigns and Social Media Examples to Inspire You in 2021," SproutSocial, June 24, 2021, available at https://sproutsocial.com/insights/social-media-marketing-examples/, accessed December 15, 2021.
[c]Antonella Martini, Silvia Massa, and Stefania Testa, "Customer Co-creation Projects and the Social Media: The Case of Barilla of Italy," Business Horizons 57, no. 3 (May–June 2014): 425–434.
[d]Paul Greenberg, *The Commonwealth of Self-Interest: Business Success through Customer Engagement* (56G Press, 2019); and *CRM at the Speed of Light: Social CRM Strategies, Tools, and Techniques for Engaging Your Customers*, 4th ed. (New York: McGraw-Hill, 2010).

Source: Excerpted and updated from Don Peppers and Martha Rogers, Ph.D., "The Dollars and Sense of Social Media," in *The Social Contract: Customers, Companies, Communities, and Conversations in the Age of the Collaborative Relationship* (2010).

Social media can be employed by an enterprise in a number of ways, but we should highlight four that are highly important for an enterprise trying to build stronger customer relationships:

1. Engaging and activating the enterprise's most enthusiastic supporters to spread the word about the brand.
2. Empowering customers to defend the enterprise's brand in times of stress, and help it recover from missteps or disasters.
3. "Observing" customer sentiment directly, by listening in on customer conversations that involve the enterprise and/or its competitors.
4. Enlisting the enterprise's own customers (and, sometimes, other volunteers) to help provide service for other customers.

So far we have been talking about interaction and dialogue as if the only thing of importance to a marketer is the dialogue that can take place between an enterprise and a customer. But customers are human beings, and humans prefer conversing with other humans much more than with brands or businesses. Humans are social animals, and the same internet-based technologies that have made it possible for businesses to interact directly with their customers have also made it possible for humans to interact socially with other humans anywhere on the planet. Moreover, the capabilities inherent on the internet, via computers, mobile phones, and other devices, make it possible for individual consumers to produce vast quantities of their own content, from blogs and written comments, to pictures, podcasts, and videos. People can now create and upload this content to the network for others to see on a wide array of social platforms, from Facebook and Twitter to TikTok and YouTube. They can choose to make the content available only for select friends or associates, or for a variety of categories of other users, or for everyone.

The social media revolution that has occurred as a result of these new technological capabilities may soon dwarf the Industrial Revolution itself, in terms of its ultimate impact on the human race, making possible an entirely new, noneconomic production system based not just on money and exchanges of value, but on social ties, trust, generosity, status, and informal normative mores. Complex works and projects, from **open-source** software such as the Mozilla family of web browsers or the Linux operating system,[25] to detailed and evolving documents such as the user-generated reference work Wikipedia, demonstrate how this new production system has flourished. And presumably, trillion-dollar firms like Google and Amazon don't choose to power their own Web servers with open-source software because it's free, but because it's *good*.

During the political debate between left and right that dominated economic discussion throughout the twentieth century—with the right advocating more free-market solutions while the left advocated more government regulation—social production was never considered. The very idea of it would have seemed economically preposterous, like suggesting that we boost GDP with a series of barn raisings. But over the last 20 years, hundreds of thousands of unpaid volunteers have created billions of dollars' worth of software, generating time savings, entertainment, instruction, new information, and knowledge, through a wider and wider variety of social-production enterprises. According to SourceForge.net, a kind of registration site for open-source software projects, there are now more than 500,000 such open-source projects involving more than 30 million registered users around the world, each of whom, more or less, is an unpaid volunteer software coder.[26]

[25]One of our sources about Linux is Yochai Benkler's *The Wealth of Networks* (Yale University Press, 2007), p. 64. Another is Eric von Hippel's *Democratizing Innovation* (MIT Press, 2006), p. 80. "Free software has played a critical role in the recognition of peer production, because software is a functional good with measurable qualities. It can be more or less authoritatively tested against its market-based competitors. And, in many instances, free software has prevailed. About 70% of web server software, in particular for critical e-commerce sites, runs on the Apache Web server—free software. More than half of all back-office email functions are run by one free software program or another. Google, Amazon, and CNN.com, for example, run their web servers on the GNU/Linux operating system. They do this, presumably, because they believe this peer-produced operating system is more reliable than the alternatives, not because the system is inexpensive" (p. 64). "Contributors to the many open source software projects extant . . . also routinely make the code they have written public" (von Hippel, p. 80).

[26]SourceForge, "About SourceForge," SourceForge.net, available at https://sourceforge.net/about, accessed June 16, 2021.

But this is a topic for another book. What we are concerned with here is how these rapidly flourishing social ties among people, mediated by a proliferating assortment of software and interactive technologies loosely termed *social media*, are likely to alter an enterprise's ability to interact with its customers and prospects and to create and manage profitable, mutually beneficial relationships with them.

As we've learned so far in this chapter, interaction is a key component of any relationship, facilitating a mutual exchange of information and building on itself into what should amount to an ongoing dialogue with a customer. Generating unique dialogues with individual customers, one customer at a time, is a principal objective for a customer-strategy enterprise. It is through such a dialogue that the enterprise will learn more and more about each customer, developing ways to add value that spring from the products and services most desired by *that* customer. And, like drip irrigation, which never overwhelms or parches, a sustained dialogue with a customer enriches the context of the relationship over time, enabling the enterprise to develop greater and greater customer insight, providing a more and more accurate view of the customer's individual needs from the enterprise, as well as the value that the customer could create for the enterprise.

> It's a rare person who wants to hear what he doesn't want to hear.
>
> —Dick Cavett

The interactions that fuel these customer dialogues can take place in a variety of ways—not just face to face at a sales meeting or in a store, but through a wide array of electronic or digital mechanisms distributed across an assortment of electronic platforms, from email and phone calls to mobile apps, website interactions, and social media comments. But to manage a sustained dialogue with any individual customer, the enterprise must be capable of assembling and integrating all the interactions from *that* customer, one customer at a time, so as to preserve each dialogue's context, always picking up where the conversation left off in the last interaction.

EMPOWERING CUSTOMERS TO DEFEND THE BRAND

On Wednesday, February 14, 2007, just prior to the President's Day holiday weekend, a snow-and-ice storm hit New York City, crippling operations at several airlines. The degree to which it incapacitated JetBlue, however, was of a different order of magnitude altogether. A new low-fare entrant that had previously earned high marks among passengers for efficient service and friendly, capable employees, JetBlue had to cancel more than 1,000 flights over the course of a few days. Angry mobs formed at several of its gates. Passengers were stuck on one plane for a full 10 hours without taking off (and then interviewed about their experience on major network news programs). In the aftermath of the crisis, previously loyal customers publicly bemoaned what an awful company JetBlue had suddenly become, and congresspeople began beating the drum about customers' rights. This nightmare would be enough to make the average CEO want to curl up and hide.

Instead, JetBlue's founder and then-CEO David Neeleman responded quickly and with sincere atonement, hitting every media outlet he could, taking responsibility for the problem, discussing its causes openly and honestly, and issuing apologies not just to all the inconvenienced flyers but to his airline's own crew members as well. He sent **apology** emails to every customer affected and also to the members of the airline's True Blue loyalty program who weren't even flying that weekend. The company posted Neeleman's video apology on its website, and the video was soon circulated and posted on YouTube and a variety of other sites, all over the web.

In addition, the airline announced a customer bill of rights, promising specific compensation payments for delayed and inconvenienced customers in the future, including travel vouchers worth at least $25 for passengers experiencing a ground delay of more than 30 minutes once they arrive at their destination airports (ranging up to full round-trip refund vouchers for arrival ground delays of more than three hours) and vouchers worth at least $100 if ground delays of more than three hours occur on departure. In media interviews, Neeleman said the airline would make its bill of rights for customers retroactive and send the appropriate travel vouchers to all passengers already inconvenienced by the previous weekend's operational catastrophe, which he estimated would cost the company $30 million or more, in total. Even after Neeleman's extensive apologies and new policy announcements, however, many customers continued to rail against the airline in a blogosphere thick with customer outrage. Blog sites such as Church of the Customer (now inactive) seethed with resentment at JetBlue for this unmitigated service disaster.

But just when it looked as if no one, anywhere, would step up to JetBlue's defense, someone did. Who? The company's most frequent flyers. These were the folks who, month in and month out, had been treated decently in the past by JetBlue—actually, a good deal more decently than other airlines were treating them. These customers knew that JetBlue's intentions were good, and they trusted in the airline's ability to make it better next time. They believed the company's apology, applauded the remedial steps, and came to the blogs themselves to join the discussion and defend the young airline's reputation. Notice that there's an important trust implication in this story about JetBlue: You can't buy trust equity from customers; you have to earn it every day. When customers lost trust in JetBlue, there was nothing JetBlue could do to rebuild it beyond their own positive actions. Only their customers could help restore JetBlue's lost trust—because of the trust JetBlue had already built with their own MVCs in the past. Building trust today will save a company when it makes an error in the future—something that will happen to everybody, sooner or later.

In their book *Authenticity*,[27] Jim Gilmore and Joe Pine suggest that JetBlue was able to recapture its reputation with its customer bill of rights primarily because it fit authentically into the character of the airline's brand. It was, in fact, exactly the kind of thing you would expect from JetBlue, which had built its reputation on being fair, open, and honest with customers. Its authentic reputation was already one of trustability.

[27]James H. Gilmore and B. Joseph Pine II, *Authenticity: What Consumers Really Want* (Boston: Harvard Business School Press, 2007).

Listening to Customers

Social media platforms are two-way media, and in most cases the interactions and dialogues on social media sites have been initiated and are largely conducted by private individuals, not by company representatives or officials. This means the conversations are objective, frank, and highly informative. They can serve as an excellent resource for understanding what a brand's own customers are thinking about the brand. Yes, listening has never been part of most mass marketers' primary skill set, but forward-thinking companies are now realizing what an invaluable resource these social media conversations actually provide.

According to author and consultant Becky Carroll,[28] how we interact with customers via social media can be seen as analogous to attending a cocktail party. Upon entering a room, it would be considered rude for you to walk up to a group of people already conversing and start talking about yourself. Unfortunately, however, this is exactly how many firms use social media. If an enterprise sees social media as just another communication channel, it is likely to use the same mass-messaging and marketing spin that infuses the company's direct mail campaigns, its website, and its advertising. These messages talk *at* people, not *with* people, and are rarely tuned to the needs and concerns of the individual customers being addressed. Definitely rude behavior at a cocktail party, and not appropriate for social media either. Social media is social, and requires *social* activities—conversation, not pronouncements.

If you are a savvy partygoer and you approach a group of people at the cocktail party who are already conversing, you don't say a word. Instead, you spend a few minutes listening to see what's being discussed and to get the proper context. Then, after introducing yourself briefly, you may begin to engage in the conversation by sharing your viewpoint or something relevant and interesting to the other party guests. Or you may enter the discussion by asking a question related to the topic at hand. Either way, you are engaging the other partygoers in a meaningful dialogue. Nontransactional conversations like this are the foundation for using social media to build stronger customer relationships. The familiarity created by a series of social media interactions tends to build better relationships than any series of advertisements could.

One important key to social media is what Dr. Natalie Petouhoff calls the 1-9-90 rule, which describes how to visualize the ratio of contributions different participants will make in an online social community. In most communities, about 1% of the population post, about 9% respond to posts, and 90% just read the posts. To return to the cocktail party analogy often used to characterize the dynamics of social media, at a party you have several different types of people in the crowd. There are some who are interested in others and interested in sharing, and aren't shy about doing so. They are driven by a need to contribute. Some other guests, as they come in the door, spot those gregarious folks who have a crowd around them. Although they aren't the type to lead the crowd themselves, they enjoy hanging with the 1% who do, and they're good at

[28]Becky Carroll, Associate Partner in Data, Analytics, and AI at IBM, is the author of *The Hidden Power of Your Customers* (Wiley-Blackwell, 2011).

responding to or riffing off what the crowd leaders are saying. And then there is the rest of the party, and you could think of them as the audience. They come to the party to be entertained, to rub shoulders with and to listen to the 1- and 9-percenters. This is not only the way a party comes together; it's the makeup of a healthy online community as well.

Two things are important to understand about the 1-9-90 dynamic.

1. If you want a vibrant online social community, you have to invite the people who will drive the conversation. So you must ask yourself: Have you invited this 1%? That is, have you publicized the community in venues where these 1 percenters can be found, and will your community be attractive for them? You may also need a community manager to help others participate in the conversation.
2. Just as important, you must realize that for 90% of your community's population, *engagement* might not involve actual *participation*. It would be easy to mistake lack of actual conversational input as lack of interest. These people still read, they consider, they think . . . and they *use* the information you have in the community to make decisions, to make recommendations, to solve their own problems, and so forth. I have worked with companies that, when they see just 10% of registered users posting or responding, wonder if the effort was really worth it. But you have to remember, if someone comes to a party and just hangs out, never even opening their mouth, they still must be enjoying it in some way. Otherwise, why would they come to the party at all?[29]

Dr. Petouhoff's mention of the 1-9-90 rule and of super-users (the 1-percenters) is worth thinking carefully about whenever an enterprise begins to participate in social networks of any kind. Social networks are known to follow a "power law" distribution of influence, rather like the classic 80-20 distribution of customer value known as the Pareto principle (see Chapter 6). Influence within a network—or value within a customer base—is not something that can be arrayed along a more traditional bell-curve distribution. Rather, in networks of customers, employees, constituents, or influencers, we are almost always likely to find that a relatively small number of super-users have a disproportionate influence over the network.

This means that in order to participate in social media with any real success, an enterprise has to recruit super users to its team. In most corporate social network situations, this should be done by providing the trappings and symbols of status—designations such as gold or platinum supporter, for instance. Status and recognition of super-users can best be facilitated in an enterprise's social networking platform by allowing readers and responders to rate the contributions of different participants, and then the platform ranks them, for all to see.

[29]Dr. Natalie L. Petouhoff, "Crowd Service: Customers Helping Other Customers," in Don Peppers and Martha Rogers, *Managing Customer Relationships and Experience*, 3rd edition, p. 271.

It is this noneconomic aspect of social media, characterized by a power-law distribution of influence and importance, that offers the possibility of transforming our entire economic system, over time. In a seminal work on the economics and justice of a more networked information society, *The Wealth of Networks: How Social Production Transforms Markets and Freedom*, Yochai Benkler suggests that two different kinds of rewards have always motivated human behavior: the quest for economic standing and the quest for social standing. According to Benkler:

> These rewards are understood as instrumental and, in this regard, are highly amenable to economics. Both economic and social aspects represent "standing"— that is, a relational measure expressed in terms of one's capacity to mobilize resources. Some resources can be mobilized by money. Social relations can mobilize others. For a wide range of reasons—institutional, cultural, and possibly technological—some resources are more readily capable of being mobilized by social relations than by money. If you want to get your nephew a job at a law firm in the United States today, a friendly relationship with the firm's hiring partner is more likely to help than passing on an envelope full of cash. If this theory of social capital is correct, then sometimes you should be willing to trade off financial rewards for social capital.[30]

If Benkler's model is correct, when an enterprise goes to the trouble of creating a social media community of customers serving other customers, social rewards will be much more beneficial to motivate super-users than economic rewards. Economic rewards (from free products to cash payments) may erode the effectiveness of the network entirely.

Klout was founded in 2007, as a way for companies to get a glimpse of the social influence of their customers (and job applicants). Customers with high scores were given perks and samples, but keeping the score up was very difficult, and the scoring process often seemed capricious to users, because while Klout was tabulating people's influence in the aggregate—across all social media platforms combined—they weren't taking account of the fact that people often favor *particular* social media channels, to the exclusion of others. Donald Trump had a serious influence on social media, but because he relied primarily on Twitter and was absent from Instagram, Facebook, and many of the other channels, his Klout score would not have reflected his influence accurately. In 2014 Klout was acquired by Lithium, and in 2017 Lithium was acquired by a private equity group and merged with another tech company (Spredfast), then renamed Khoros in 2018, at which point Klout was closed down altogether because, according to Mike Betzer, a senior executive for five years at Lithium and Khoros, "Klout was a great 1.0 influence evaluation tool. We took the learnings from that 1.0 tool and applied it to the 2.0 platform, Khoros' customer engagement hub."[31]

[30]Yochai Benkler, *The Wealth of Networks: How Social Production Transforms Markets and Freedom* (New Haven, CT: Yale University Press, 2006), pp. 95–96.

[31]Private conversation with Mike Betzer, CEO of Hypergiant, on August 19, 2021. Mike served as Chief Customer Officer and Chief Digital Transformation Officer at Lithium Technologies and Khoros from November 2016 through May 2021.

Khoros' tools for evaluating individual social media presence and influence are more nuanced than Klout's tools were, prioritizing those particular channels that an individual customer might love. If, for instance, a consumer were to post a review of a company's product on Facebook, where the consumer is highly influential, then the company should try to engage with that particular customer *on Facebook*—and not on Twitter, LinkedIn, YouTube, or some other platform. Social media influence is not monolithic, and when dealing with customers via social media channels, it's vital to *treat different customers differently*.

AGE OF TRANSPARENCY

If there is one all-pervasive requirement for social media effectiveness, by people and companies alike, it is the need for honesty, straightforwardness, and transparency. On one level, these values are driven by people themselves, because no one will tolerate deception and dissembling for long in any ordinary social relationship. Trustability is probably the most important element when it comes to social relations among people. If companies wish to engage in the same kinds of social relations as people do, then trustability will be required of them as well.

It may be shameful to reflect on, but traditional mass marketing does not really require trustability at all. It merely requires believability. Marketing and public relations (PR) messages are carefully crafted to be as appealing as possible, and the spin put on a tagline or a press release is an important marketing asset. Inherent in the whole idea of spin is the fact that there is a genuine reality— presumably known to the marketer or the author of the spin—while a separate, created reality is meant to be conveyed by the spin. Because customers aren't stupid, and they know that sellers have a vested interest in persuading them to part with their money, they have learned to maintain a healthy skepticism about advertising claims, in general. Consumer research bears this fact out. According to a special report from the Edelman Trust Barometer, nearly 70% of consumers actively avoid ads, with 78% of individuals ages 18 to 34 and 73% of people ages 35 to 54 using advertising avoidance strategies.[32] There is nothing evil here, and no one can really blame a marketer for wanting to put a brand or a story in the best possible light. The only reason such deception was tolerated in the past, however, was that it was beyond anyone's capacity to detect, and even when the deception was detected, it was beyond anyone's capacity to spread the news. But no longer. Spin is out, transparency is in, and the fact that this higher ethical standard is being applied today by more and more consumers in a wider and wider variety of marketing and selling situations owes much to the social media revolution and to the kind of **word-of-mouth** recommendations and experience sharing that goes on among consumers now electronically.

[32]Edelman, "Trust Surges to Become the Second Most Important Purchasing Factor for Brands," June 25, 2020, available at https://www.edelman.com/news-awards/brand-trust-2020-press-release, accessed August 19, 2021.

Think of it this way: Unless you are talking about true trade secrets, such as the magic formula or recipe or the patents undergirding a product, the best way to manage a company is to no longer consider meetings—even important ones—as occurring behind closed doors—unless the doors have big glass panels and microphones. The cost of keeping secrets is going up, and the security for maintaining them is going down, so the best companies are just behaving openly with constituents—not just customers, but also employees, shareholders, regulators, communities, and pretty much everybody. If you need to keep secrets from anyone but your competitors, in other words, you may need to rethink your strategy. Which reprises an important and recurring theme.

As Interactions Multiply, Trust Becomes More Important

Trust has always been important, certainly, but it is becoming a more essential **attribute** of human **culture**, for several reasons, as people connect with one another more efficiently. First, of course, is the simple fact of transparency. The more interacting we do, the more transparent things will inevitably become. From WikiLeaks to the way George Floyd died,[33] people will find things out.

From Wikileaks to the way George Floyd died, people will find things out.

It's important, however, not to confuse transparency with trust itself. Transparency increases the importance of trust because if something can be transparently exposed to the light of day without causing undue embarrassment then it must be considered inherently trustable and ethical. On the other hand, *the reverse is not always true*. We've already noted that keeping a secret might be valid for reasons of discretion, privacy, or competition, and not exposing everything all the time does not necessarily imply unethical or untrustable behavior. Businesses and governments have legitimate reasons for keeping secrets, and often these reasons are even enforced by laws and regulations. If your marketing department, for instance, were to voluntarily release its confidential pricing plans for a new product, tipping off your competitors, your executives could be jailed for collusion.

[33]Peter Walker, "Amnesty International Hails WikiLeaks and Guardian as Arab Spring 'Catalysts,'" *Guardian* (UK) online, May 13, 2011, available at https://www.theguardian.com/world/2011/may/13/amnesty-international-wikileaks-arab-spring, accessed August 26, 2021; Lynne Peeples, "What the Data Say about Police Brutality and Racial Bias—and Which Reforms Might Work," *Nature* 583 (2020), 22–24. https://doi.org/10.1038/d41586-020-01846-z accessed May 9, 2021. Since Dave Carroll and Sons of Maxwell posted their legendary YouTube video "United Breaks Guitars" in July 2009, which generated a keynote speaking career and case study materials, a genre of luggage-mishandling videos has cropped up on YouTube. For just one example, see "Mistreating Luggage," available at https://www.youtube.com/watch?v=lzmJr1a-BHU, accessed August 26, 2021.

Transparency increases the cost of hiding the truth. More efficient interactivity exposes truths that used to be inexpensive to hide.

However, if your marketing department knowingly sets up a false narrative for its customers, these more transparent times mean that you will almost certainly be found out. In September 2006, Walmart set up a blog entitled “Wal-Marting Across America,” which featured two intrepid recreational vehicle (RV) owners, known only as Jim and Laura, driving from Walmart to Walmart across the United States, visiting stores to buy things and interviewing a whole stream of ever-upbeat Walmart employees, and then posting their insights on the blog. Other bloggers, however, suspected that Jim and Laura were fictitious, and not real people driving their RV across the country. Soon it was revealed that the two bloggers were actually paid contract writers for Walmart and that they had been hired by Edelman Public Relations, the company’s PR firm, to create a series of glowing articles. This ignited a firestorm of protest from others in the blogosphere, and Richard Edelman himself apologized on his own blog for having created the idea.[34] In fact, Edelman himself created the Edelman Trust Barometer in 2000, which annually measures levels of public trust in institutions and publishes their research in the form of actionable insights.[35]

Enterprises wanting to engage their consumers via social media need to be highly cognizant of the requirement for straightforward transparency in all social media communications. If a company creates a blog for communicating with customers and others, or for promoting its **content marketing** (see Chapter 7), it has to pay close attention to the authenticity and sincerity of its postings. Spin and marketing language are just not close enough to transparency for the blogosphere. A blog can be an incredibly powerful and persuasive tool for an enterprise, but only if it is used in a trustable and honest way.

In his manual for companies engaging their customers in social media, *The New Influencers*, Paul Gillin argues:

> *The premium on transparency may be the single greatest cultural shift that businesses will face as they engage with social media. The move from messages to conversations will tax many marketers and swamp some. The emerging culture of transparency and openness in social media is a story taking shape, but it’s clear that companies that choose to participate will need to speak to their communities in very different ways.*[36]

[34]Pallavi Gogoi, “Wal-Mart vs. the Blogosphere: Fallout from the Retailer’s Blog Scandal May End Up Hitting PR Firm Edelman,” MSNBC citing *Newsweek*, October 16, 2006, cited at https://www.nbcnews.com/id/wbna15319926, accessed August 26, 2021.

[35]Richard Edelman, “Introduction: The New Trust Compact,” Edelman company website, available at https://www.edelman.com/20yearsoftrust/, accessed August 19, 2021.

[36]Paul Gillin, *The New Influencers: A Marketer’s Guide to the New Social Media* (Sanger, CA: Quill Driver Books, 2007), p. 14. Also see Daniel D. Dennett and Deb Roy, “Our Transparent Future,” *Scientific American* 312, no. 3 (March 2015).

Walmart eventually came back to the blogosphere with a series of honest, employee-written blogs—conversational postings from real people about real issues, treated personally, and fully disclosed. Occasionally, a Walmart blogger will even advise readers what products aren't such good deals. Most companies that have figured out how to infuse their social media activities with honesty, transparency, and authenticity have come at it from the same direction.

Posting positive book reviews for a fee has become a lucrative business for many as favorable reviews boost sales for authors. One provider of fraudulent reviews was eventually exposed by an angry customer who posted a negative review of his service, saying he didn't produce the quality of review she felt she deserved for her money. Consequently, Google took ads for the reviewer's services off its site, and Amazon removed his reviews from its database.[37]

So what about the opposite of faking your own good reviews? What if a competitor poses as your customer and posts a negative review? This can be a problem in an online world characterized by anonymous user IDs, where masquerading is practical and easy, and registrations can be treated as disposable. Remember the old *New Yorker* cartoon? On the Internet, nobody knows you're a dog.[38]

> The move from messages to conversations will tax many marketers and swamp some.

But here's the point of transparency: Any competitor who stoops to this kind of dirty trick (either positive *or* negative) is playing a very dangerous game itself. Even if it succeeds for a while in remaining anonymous, sooner or later it will almost surely be outed by the same transparency dynamic that operates on everyone and everything else.

For example, Samsung faced a lawsuit in Taiwan and significant fines when the company was accused of hiring students in South Korea to post negative reviews of a competitor's product and positive comments about its own. When the deceit was sniffed out, as it so often is, Taiwan Samsung felt compelled to make a public apology on Facebook, reaffirming its values of honesty and transparency.[39] Getting caught is a problem that continues to loom large. Bing Liu, a researcher at the University of Illinois–Chicago who is working on a program to detect illegitimate reviews, estimates "one-third of all consumer reviews on the Internet are fake."[40]

[37]"Book Reviewers for Hire Meet Demand for Online Raves," *New York Times*, August 8, 2012, available at https://www.nytimes.com/2012/08/26/business/book-reviewers-for-hire-meet-a-demand-for-online-raves.html, accessed August 26, 2021.

[38]This classic "no one knows you're a dog" cartoon first appeared in the *New Yorker* July 5, 1993, p. 61.

[39]BBC, "Samsung Probed in Taiwan over 'Fake Web Reviews,'" BBC News, April 16, 2013, available at https://www.bbc.com/news/technology-22166606, accessed August 26, 2021.

[40]For more on Liu's work, see "Opinion Spam Detection: Detecting Fake Reviews and Reviewers," available at https://www.cs.uic.edu/~liub/FBS/fake-reviews.html, accessed August 26, 2021.

A *sockpuppet* is an online anonymous persona employed to hide a person's identity. And sockpuppeting has become a time-honored technique not just for protecting your own privacy but also for getting up to mischief—deceiving others, manipulating opinion, cheating on your spouse or partner, or violating trust in some other way.

Fake reviews and other forms of opinion spam are a significant enough threat that sites depending on reviews for their credibility have often put in place complex algorithms designed to filter out fakes. These algorithms are similar to the spam filters that block out inauthentic email messages.

Amazon's customer review system is considered integral to the success of the company. Amazon has made several moves to protect this asset and its credibility. Amazon's review system averages all the ratings submitted for a product to award it a star rating, one to five stars. Fake reviews, or reviews bought by sellers to boost rating of product and sales, undermine the system. In April 2015, Amazon sued four websites that offer review writing and placement services for a fee, and in October 2015, it sued more than 1,114 providers of fake review services.[41]

In June 2015, Amazon rolled out a new review platform that has learning technology. Developed in-house, the new system gave "more weight to newer reviews, reviews from verified Amazon purchasers, and those that more customers vote up as being helpful."[42] The new criteria for sorting reviews affected the order the reviews appear in and the calculation of the five-star rating. Amazon also solicits reviews of products from verified buyers to boost reliable product assessment.

Amazon has maintained and even increased its commitment to prevent fake reviews over time. In 2020, they prevented more than 200 million suspected fake reviews from being posted publicly. As their ability to detect the source of fake reviews improved, Amazon discovered that an increasing number of these reviews were being solicited by third-party services via other social media sites. In addition to reporting this activity directly to the social media sites when detected, Amazon made a public appeal to social media companies to help them stop fake reviews and shut down offending groups more quickly.[43]

Amazon is believed to have the largest review bank, outranking even big specialist stores in certain categories. And though thought to be by some a rather clunky example

[41]BBC, "Amazon Targets 1,114 'Fake Reviewers' in Seattle Lawsuit," BBC.com, October 18, 2015, available at https://www.bbc.com/news/technology-34565631, accessed August 26, 2021; and Jonathan Stempel, "Amazon Sues to Block Alleged Fake Reviews on Its Website," Reuters, April 9, 2015, available at https://www.reuters.com/article/us-amazon-com-lawsuit-fake-reviews/amazon-sues-to-block-alleged-fake-reviews-on-its-website-idUSKBN0N02LP20150410, accessed August 26, 2021.

[42]Ben Fox Rubin, "Amazon Looks to Improve Customer-Reviews System with Machine Learning," Cnet.com, June 19, 2015, available at https://www.cnet.com/tech/services-and-software/amazon-updates-customer-reviews-with-new-machine-learning-platform/, accessed August 26, 2021.

[43]Amazon Staff, "Creating a Trustworthy Reviews Experience," Amazon.com, June 16, 2021, available at https://www.aboutamazon.com/news/how-amazon-works/creating-a-trustworthy-reviews-experience, accessed October 26, 2021.

of social media, no one argues with the Amazon review system's success for leveraging community feedback.[44]

But something interesting about the e-social revolution is that it is rapidly reducing the usefulness of anonymous comments when it comes to sharing and evaluating brands, opinions, products, or services. One of Facebook's biggest assets, for instance, is that it's almost impossible to pose as someone else on the service. After all, who's going to friend someone they never heard of? And if you do agree to be friended by someone you don't know very well, isn't it because you share some mutual acquaintances, or perhaps a school or business relationship? Chris Kelly, Facebook's onetime head of privacy, maintains that "the friend infrastructure and an identity base ultimately is the key to safety. Trust on the Internet depends on having identity fixed and known."[45]

One of the quickest ways for people to verify the trustability of information or opinion, including product reviews, is to see whether their friends or associates find it trustable—if they vouch for it.

As the importance of trust increases and our e-social connections multiply, you can look for a rising number of services and applications that allow consumers to filter what they pay attention to by tapping the opinions or judgments of their friends and colleagues. More and more, it becomes a part of the "experience" on the way to buying or using a product or service, as well as living the rest of life.

This kind of social filtering will soon come to dominate how people evaluate information and opinion for its trustability. Rather than just looking at the opinions of complete strangers when they evaluate a product or service, your customers will very possibly check the opinions of their friends first. Or of the friends of their friends.

So, although many customers will trust a five-star review from a stranger they never heard of (and who could easily be a paid shill) more than they will trust advertising claims, the dynamics will change as we all gain more access to what our friends, or the friends of our friends, or maybe even *their* friends have said about some product or service we are investigating.

Today, of course, we are just scratching the surface of consumer-to-consumer interaction. In 15 or 20 years, Moore's law suggests there will likely be a thousand times as many product and service reviews and a thousand times as much information content, from news articles to blog posts and social media trends. And 15 or 20 years after that we'll have a million times as much as today. So service applications that get the jump on helping consumers benefit from social filtering are likely to see a strong

[44]BBC, "Amazon Targets 1,114 'Fake Reviewers' in Seattle Lawsuit"; Stempel, "Amazon Sues to Block Alleged Fake Reviews on Its Website"; Rubin, "Amazon Looks to Improve Customer- Reviews System with Machine Learning"; and Himanshu Sareen, "Why Amazon Is the Most Social, Least Social-Friendly Commerce Platform," Social Media Today, September 4, 2013, available at https://www.socialmediatoday.com/content/why-amazon-most-social-least-social-friendly-commerce-platform, accessed August 26, 2021.
[45]Chris Kelly is quoted in David Kirkpatrick, *The Facebook Effect: The Inside Story of the Company That Is Connecting the World* (New York: Simon & Schuster, 2011), p. 13.

competitive advantage, because we'll all be relying more and more on our friends' opinions for help. It will be part of a trusted relationship in the long run and part of the customer experience in the short run.

If a company wants to influence social sentiment, but in a trustable way, forget sockpuppeting and instead start by trying to think about what actually motivates an influential blogger or Twitter user—someone whose opinions matter to thousands of followers. Yes, most key influencers would be offended if you offered to compensate them for a favorable post, but there is still something they want and it's not financial remuneration; they are still human beings, and like all the rest of us, they have ambitions too. They want to be noticed and to increase their own influence. They want to write better, more original and authoritative posts. And there are a number of noneconomic services or benefits you can provide to key social media influencers that will help them achieve some of these ambitions. If you're a student of employee motivation, what we're talking about here is focusing not on extrinsic benefits, such as compensation and perks, but on intrinsic benefits, such as appreciation, encouragement, camaraderie, and fulfillment.

Before delving into the intrinsic benefits that influencers will find most appealing, a quick word of caution: Be sure you understand your influencers' own perspectives. The overwhelming majority of social influencers do not consider themselves to be experts on any particular business category, company, or brand per se. Rather, they think of themselves as having an authoritative point of view with respect to some particular issue or problem of concern to them and their followers. It might be a business issue or a health issue or a relationship issue. But it's unlikely that they will think of their own central mission in terms of rating or evaluating the products and services offered by you or your competitors. Their central mission is to be of value to their friends and followers—those who depend on their opinion and thinking. Talking favorably or unfavorably about a particular brand or product has to be seen in this context—as a service they are performing for the benefit of their own network of friends.

Influencing the Influencers

The intrinsic benefits social media mavens value most can be categorized in terms of acknowledgment, recognition, information, and access. You can remember these benefits easily if you remember the mnemonic ARIA, as in the solo sung by your favorite opera star.[a]

Acknowledgment: Simply identifying influential bloggers or social media influencers and acknowledging them with your own message will go a long way toward having a positive influence. If you haven't yet assigned people in your organization the task of identifying those tweeters and bloggers with the most credibility and influence in your particular category, then it's time to do so. When you identify someone important, reach out to them, and do it genuinely. Post a comment on their blog, retweet a smart update, email them with a thoughtful (but non-self-serving) suggestion. Acknowledge their existence, and

(*continued*)

by implication their significance, by letting them know that you know they exist and that you are paying attention.

Recognition: Bloggers, product reviewers, and others who become expert in your business's category want to be recognized as such. Recognition is a key motivator for all of us, but it's even more crucial in the social media world, where monetary compensation is completely inappropriate. So be sure to recognize a key blogger by forwarding the link to their Web site on to others. You might even consider mentioning very authoritative bloggers in your own press communications, providing not only recognition to the blogger but additional sources for whatever reporters or other commentators follow your firm. If you have a crowd service system that relies on some knowledgeable customers handling the complicated inquiries of other customers, be sure to recognize the most expert contributors or the most prolific participants with special badges, emblems, or status designations. Everyone wants to be platinum in something.[b]

Information: Information is power. Think about it. More than anything else, *information* is exactly what influential bloggers want to provide their readers, and what Twitterers want to provide their "tweeps" (like "peeps" for "people"). Key influencers want the inside dope, the straight skinny. So when you identify social media influencers in your category, be sure to provide them with all the information you can reasonably manage. Don't provide truly confidential or commercially sensitive information, unless you think it might do more good for you if it were to become widely known (assuming, of course, that it's not illegal or unethical to release it). But even without violating anyone's confidence or divulging the kind of "inside" information that might get a public company in trouble, you can almost certainly provide a key influencer with a more useful perspective and insight about your business or your category, including the problems you face, the threats to your business you are trying to avoid, and the opportunities you see.

Access: Just as useful as providing insightful information is letting an influencer make direct contact with the author of the insight, or the operating person at your business who is most connected to the information. Talk about getting the straight scoop. Probably nothing will pay bigger dividends in terms of social media influence than simply allowing the influencers themselves to have access to some of your own people, your own experts and authorities. Providing this access is, all by itself, a form of acknowledgment and recognition also. Not everyone gets this kind of access, because you can't take the time for everyone. But you should definitely take the time for someone who has an important enough following in social media.

[a]Thanks to Zeynep Manco, a consultant in the Istanbul office of Peppers & Rogers Group, for the clever ARIA acronym.
[b]See Taffy Brodesser-Akner, "Influencers: Turning Microcelebrity into a Big Business," *New York Times Magazine*, September 19, 2014, pp. 44–50.

Source: From Don Peppers and Martha Rogers, Ph.D., *Extreme Trust: Turning Proactive Honesty and Flawless Execution into Long-Term Profits* (New York: Portfolio/Penguin, 2016).

Cultivating Customer Advocates

Some customers will always be more enthusiastic and influential than other customers. Innovative companies know that their "lead users" are those particular customers who tend to pioneer new ways of using a product or of getting benefit from it, while "influencer" customers are more authoritative or knowledgeable experts whose opinions are sought out by others, and "**customer advocates**" are those who actively promote the use of a product to other customers. In the push toward improving the quality of the customer experience, it makes sense to focus on eliminating friction and improving satisfaction levels, but value can also be created by cultivating an enterprise's most enthusiastic customer advocates, and leveraging their enthusiasm to generate even more business.

Influencing the influencers, if done right, will help empower customers to share their ideas and thoughts with other customers, to help other customers solve their problems, and to simply participate more in the social world that surrounds every set of commercial transactions. In addition to the benefits a company will realize in terms of being seen as more trustable, this kind of customer-oriented activity is almost certainly going to create better customer experiences and generate additional revenue and business as well. Decades-old eBay, for instance, created customer support forums for its customers so buyers and sellers could exchange tips and suggestions, but it later found that customers who were active users of the support forums were generating 50% more revenue for the firm!

As a result of social media, the word gets out, and it can't be stifled. Secrets—particularly dirty, nasty, deceptive secrets—are quickly exposed for what they are. Word of mouth spreads faster than ever through social media, as customers share their experiences and impressions with each other. Good products are easier to find by checking out customer reviews, and bad products die quicker deaths, as people communicate with each other more and more prolifically. Sacha Baron Cohen's 2009 movie *Bruno*, for example, was apparently awful, at least in the eyes of those who paid to see it the night it was released. In an event remarkable for its speed and severity, box office receipts fell 40% within 24 hours of the movie's release, as opening-night viewers texted and tweeted it into oblivion, interacting with their friends through what is now a vast social media infrastructure. According to *L.A. Times* film critic John Horn, this rapid a death for a bad movie was unprecedented. "Even if they had a turkey, [studios] used to get two weeks of business before the stink really caught up to the film," according to Horn. "Now they have 12 hours."[46] Sacha Baron Cohen has gone on to create newer, much more successful movies and is an international star, but even he

[46]NPR (formerly National Public Radio), "Summer at the Movies, and the Livin' Ain't Easy," All Things Considered, hosted by Robert Siegel and Madeleine Brand, July 17, 2009; transcript available at https://www.npr.org/transcripts/106742097, accessed August 26, 2021. Also see Todd Cunningham, "'Ted 2' Struck by Lightning-Fast Negative Social Buzz at Box Office," The Wrap, June 28, 2015, https://www.thewrap.com/ted-2-struck-by-lightning-fast-negative-social-buzz-at-box-office/, accessed August 26, 2021.

discovered that audiences can be immediately merciless. In other examples, some movies have prospered so fast immediately after they were released that theaters had to reconfigure the number of screens offering the popular films.[47]

Before customers connected, advertising ruled. Now that customers talk to each other, it's the customer experience that counts.

Before customers connected, advertising ruled. Now that customers talk to each other, it's the customer experience that counts.

In this chapter, we have outlined how a forward-thinking enterprise can best employ the tools and capabilities of dialogue and social media to engage with customers. Our goal here has been to discuss the principles, since the technology will continue to change rapidly. Without question, social media has exponentially increased opportunities for companies to interact with their customers and develop Learning Relationships at rates previously impossible. But at the same time, successful marketing today requires a much higher standard of trustability and transparency.

Enterprises, however, cannot simply interact with individual customers and expect them to remain loyal. The Learning Relationship must mature even further. The enterprise needs to address the fourth task in the IDIC process by *customizing* the experience delivered to each customer, by modifying how it behaves, communicates, and manufactures products or provides services for them as individuals. A relationship can't exist without customization; without a change in behavior that results from feedback, the best a company can do is give the appearance of a relationship. But how can customization be done effectively and efficiently? Is it really practical or economical for an enterprise to *treat different customers differently?* This is the issue we will tackle in Chapter 10, after we first consider the personal privacy issues that inevitably arise from all our interactions with individual customers.

[47]Cunningham, "'Ted 2' Struck by Lightning-Fast Negative Social Buzz at Box Office."

CHAPTER 9

IDIC Step 3: Interact/Privacy Considerations

Being good is good business.

—Anita Roddick

Obviously, no business can **treat different customers differently** if it knows nothing about the differences among its customers. And yet, simply *knowing* something—anything at all—about an individual customer inherently involves depriving that customer of some privacy. Getting customer-specific information is easy. You can buy data to help you infer an individual customer's preferences, choices, and requirements from the **social media** platforms the customer engages with, or from professional list brokers, or from the government, or from other businesses—even direct competitors. There is a substantial market involving customer data, and the more **interactive** and connected we all are, the richer this market has become, in terms of the **customer insights** and data available for sale.

Moreover, as we have seen, the information an enterprise has about its own customers can provide the enterprise with a substantial competitive advantage, so it makes economic sense for any enterprise to try to accumulate this kind of data. The **benefit** for a customer involves the convenience of not having to tell the enterprise their preferences over and over again, so they can zero in more quickly and effortlessly on whatever benefit they get from buying the product or service. Customer-specific information allows the enterprise to streamline its services and offerings, tailoring them to the different interests of different customers.

The downside, however, is still there, because every new bit of data and insight about a customer whittles that customer's privacy down a bit more. So the question for the **customer-strategy enterprise** should be: "How much privacy versus how much convenience does *this* customer want?"

Interestingly, for the first time since we all became aware of privacy as an issue, enterprises and customers share a common interest: protecting and securing the customer's information. At least that's true of customers who are thinking about the implications of their far-flung data and of enterprises that are building their value through strategies designed to build the **value of the customer base**. We are providing this overview of privacy as a part of the discussion on interacting with customers. But privacy is a huge field with a variety of far-flung regulations and specific expertise and research. The subject is far beyond the scope of a textbook on managing customer relationships and experiences, but we hope to provide an updated way to think about customer privacy protection in a competitive landscape where customer information is competitively essential.

Every day, millions of people provide personally identifiable information about themselves to data collection experts, not just by their explicit actions as they interact with particular brands or companies, but also simply by carrying their phones with them, driving in their cars, communicating with their friends, or using any of the many computer programs and mobile phone apps available—playing games, reading news items, booking an Uber or a table at a restaurant, checking out new photos on Facebook, or just replying to a chat inquiry from a friend. Literally every computer-assisted activity or interaction that a person undertakes or participates in today generates digital data, and this data is now collected by the companies that own the phone, email, chat, or other platforms, and are quickly sold to or traded with an increasing number of companies that make their money by selling advertising or just stimulating additional interactions to produce even more data.

> Your mobile phone's GPS location data reveals where you are 24 hours a day.

As just one example, your mobile phone's GPS location data reveals where you are 24 hours a day, and even if your GPS function is turned off, your phone carrier still has your rough location based on the cell towers that receive your signal. This locational data is sold to vendors so they can deliver ads to you when you're near their store, or perhaps increase the price they quote (to you) if you aren't near a store with a competitive product.[1] And location data is just the beginning, because every chat message you view or send on WhatsApp, every picture you post or look at on Instagram or Pinterest, every search you do on Google or Bing, every product you view on Amazon, and even every private email message you send to someone else on Gmail—literally 100% of your digital activity today is subject to observation, capture, and resale, to be used by companies trying to persuade you or simply manipulate you for commercial gain.

Indeed, the meteoric rise of the entire online economy has been fueled largely by the economic value of personal data—data that is invaluable to a competitor wanting to persuade and sell. The "free" aspect of the internet itself has largely been subsidized by the money generated in this manner.

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[1]Bruce Schneier, *Data and Goliath: The Hidden Battles to Collect Your Data and Control Your World* (W. W. Norton, 2015), p. 2.

And as the **Internet of Things** continues to develop, connecting more and more devices, products, and ordinary "things" to the web in real time, the proliferation of individual data available to be harvested and put to use by manipulative companies and other bad actors will accelerate even further, with the result that our entire existence, as human beings, will be observable to others, from businesses trying to persuade us or to sell things to us, to governments seeking to curb dissent or ensure "law and order," and bad actors trying to find a way to blackmail or extort us.

As a result, an average U.S. consumer is buffeted by thousands of marketing messages daily[2]—far too many to hit any consumer's consciousness. (Ask yourself this: How many do *you* remember from yesterday? All the others wasted their money trying to get a message across to you!) Yet the proliferation of data has been so sudden that many are only vaguely aware of the issue. When deciding to download smartphone apps, for instance, while 90% of app users report that knowing how their personal information will be used is "very" or "somewhat" important,[3] many are nevertheless shocked to discover just how much personal data is sent to their smartphone manufacturers without their knowledge.[4] We say "without their knowledge" even though, technically, users do give companies permission to share this data, when they click "agree" on the multi-page privacy and information use documents that accompany new apps and programs. Popularly known as "click-wrap,"[5] these agreements can run to many pages of fine-print terms and conditions, far too cumbersome to read carefully and usually too technical for anyone but a lawyer to fully understand. If a user chooses not to agree, however, then whatever app or product they are acquiring may not be provided at all, or may not function properly. In her book *The Age of Surveillance Capitalism: The Fight for a Human Future at the New Frontier of Power,* Harvard professor Shoshana Zuboff reported (see also Chapter 4):

[2]As we go to press, the number circulating (on the level of urban legend) is 6,000 to 10,000 marketing messages daily. In 2009, Forrester predicted an average of 9,000 marketing messages sent annually to the primary inbox by 2014. Shar VanBoskirk, "U.S. Interactive Marketing Forecast, 2009–2014," Forrester Research, Inc., July 6, 2009, p. 19; available at http://www.forrester.com, accessed September 1, 2010. VanBoskirk also noted, "By 2019, marketing leaders will spend more than $103 billion on search marketing, display advertising, social media marketing, and email marketing." Shar VanBoskirk, "US Digital Marketing Forecast, 2014 to 2019," Forrester Research, Inc., November 4, 2014, available at www.forrester.com.

[3]Monica Anderson, "Key Takeaways on Mobile Apps and Privacy," Pew Research Center, available at http://www.pewresearch.org/fact-tank/2015/11/10/key-takeaways-mobile-apps/, accessed January 11, 2016.

[4]Jeff Rossen, "Is Your Smartphone Tracking Where You Go," NBC Nightly News, April 29, 2015, 8:05 PM ET, available at http://www.nbcnews.com/nightly-news/your-phone-snooping-you-n350511, accessed January 11, 2016; and Craig Timberg, "Verizon, AT&T Tracking Their Users with 'Supercookies,'" *Washington Post*, November 3, 2014, available at https://www.washingtonpost.com/business/technology/verizon-atandt-tracking-their-users-with-super-cookies/2014/11/03/7bbbf382--6395--11e4-bb14--4cfea1e742d5_story.html, accessed January 11, 2016.

[5]Shoshana Zuboff, *The Age of Surveillance Capitalism: The Fight for a Human Future at the New Frontier of Power* (Profile Books, 2019), p. 48.

> A detailed analysis of Nest's policies by two University of London scholars concluded that were one to enter into the Nest ecosystem of connected devices and apps, each with their own equally burdensome and audacious terms, the purchase of a single home thermostat would entail the need to review nearly a thousand so-called contracts. Should the customer refuse to agree to Nest's stipulations, the terms of service indicate that the functionality and security of the thermostat will be deeply compromised, no longer supported by the necessary updates meant to ensure its reliability and safety. The consequences can range from frozen pipes to failed smoke alarms to an easily hacked internal home system.[6]

> If the product is free, then you're the real product.

Consumers sometimes unknowingly divulge their personal data during commercial transactions, financial arrangements, and survey responses. And the web has escalated the privacy debate to new heights. For all the benefits, efficiencies, and sheer convenience of personalized offers and tailored messages, the technologies that make this kind of personalization possible have created a substantial downside as well, and the downside is becoming more and more noticeable as the sheer wealth, concentration, and power of various internet platforms continue to grow. Because for many of the largest platforms, the users themselves clearly are not the real customers at all. The actual product being sold is data about users' behaviors, and it is being sold to companies trying to make money by influencing these users' future behaviors. Remember, as the saying goes, "If the product is 'free,' then you're the real product."

But wait a minute, you might ask: Wouldn't such outright manipulation of users' behavior, without their genuine knowledge or agreement, represent a violation of customer trust? Absolutely. A truly **customer-centric** competitor would be focused on respecting the customer's interest at all points, which would preclude the kinds of privacy intrusions that characterize so much of our online existence. Moreover, because consumers' own privacy preferences vary tremendously among individuals, as well as across different nations and cultures, a truly customer-centric competitor would try to learn each customer's privacy preferences and accommodate them individually by, for instance, offering each customer a choice of whether to allow other companies to access their data, or how often to send promotions or ads, and so forth.

PROTECT PRIVACY AND EARN CUSTOMER TRUST TO ENCOURAGE INTERACTION

Tapping into feedback from customers is an immensely powerful tactic for improving a company's sales and marketing success. But customers will share information only with companies they trust not to abuse it.

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[6]Shoshana Zuboff, *The Age of Surveillance Capitalism: The Fight for a Human Future at the New Frontier of Power* (Profile Books, 2019), p. 7.

Here are some ways to earn this trust, encouraging customers to participate more productively, improving both the cost efficiency and the effectiveness of customer interactions:

- *Use a flexible* ***opt-in*** *policy*. Many opt-in policies are all-or-nothing propositions, in which customers must elect either to receive a flood of communications from the firm, or none at all. A flexible opt-in policy will allow customers to indicate their preferences with regard to communication formats, channels, and even timing. To the extent possible, give each customer a choice of how much communication to receive from you, or when, or with regard to what topics, or under what conditions.
- *Feel free to offer an explicit bargain*. Customers are used to getting news and entertainment for free, in exchange for the **implicit bargain** of being exposed to ads or other commercial messages. But as customers gain more power to avoid advertising and marketing messages altogether, if you want to talk to customers you may need to make an explicit bargain with them, something like this: “Click here to receive email offers from us in the future and to save 15% on this order,” or perhaps “Opt in to be entered in a monthly prize drawing, for a $50 rebate!”
- *Accept that the lines are blurring among interaction channels*. Elizabeth Glagowski mentioned that a Weight Watchers member who is sitting at a restaurant and is unsure what menu item to order can live chat with a certified coach via mobile app any time day or night. Customers interested in a mobile phone can be routed directly to a sales expert who already knows the types of phones and plans they’ve searched for on the web and what city they’re in to recommend the most appropriate products and services more quickly.[7]
- *Tread cautiously with targeted web ads*. Even though targeted online ads are popular with marketers, research has shown that consumers are especially wary of sharing information when targeted web ads are the result. This doesn’t mean don’t do it, but it does mean to be discreet and resist the urge to pile on. In any case, for behavioral targeting to succeed, an enterprise must have the customer’s informed consent. **Third-party data** is already on the way out for most browsers, and **second-party data** should be used only sparingly.
- *Create a* ***culture*** *based on customer trust*. Emphasize the importance of privacy protection to everyone who handles personally identifiable customer information, from the CEO to contact center workers. Frontline employees provide the **customer experiences** that matter (to customers), and your workers will determine whether your **privacy policy** becomes business practice or just a piece of paper. If your business culture is built around acting in the interest of customers at all times, then it will be second nature at your company to protect customers from irritating or superfluous uses of their personal information—things most consumers will regard as privacy breaches, whether they formally agreed to the data use or not.

[7]Elizabeth Glagowski is editor-in-chief at *Customer Strategist* executive journal and adjunct professor at Southern Connecticut State University.

- *Remember: You're responsible for your partners, too.* It should go without saying that whatever privacy protection you promise your customers, it must be something your own sales and channel partners—as well as all your suppliers and other vendors—have also agreed to, contractually. Anyone in your ecosystem who might handle or come into possession of your own customers' personally identifiable information and interactive feedback has the capacity to ruin your own reputation.

> Anyone in your ecosystem who might handle or come into possession of your own customers' personally identifiable information and interactive feedback has the capacity to ruin your own reputation.

- *Always ask how you'd like to be treated.* As an overall guide to a trustable privacy policy, make sure that your actions and intentions always square with this principle: Treat the customer the way you yourself would like to be treated, if you were the customer. Think of this as a smart insight for trustability; it will almost never let you down.

If an enterprise wants to conduct dialogues with customers, it must remember that the customers themselves must *want* to engage in these dialogues. Simply contacting a customer, or having the customer contact the enterprise, does not constitute dialogue, and will likely convey no marketing benefit to the enterprise.

GENERAL DATA PROTECTION REGULATION

The problem is that the majority of companies are not truly customer-centric at all. Most companies today—even most of the large, internet-spawned networks and e-commerce players—are locked into their product-centric **business models**, and to a product-centric competitor customer trust has little value, when compared to quarterly sales goals or growth projections. Nor is privacy protection very well established as a business activity yet. Most publicly held companies have established formal privacy protection and data security policies, if only to demonstrate publicly that they take the issue seriously. But these privacy policies vary tremendously, as does compliance with the policies, which is largely self-enforced and monitored. There is, in other words, no agreed-upon "standard" for what actually constitutes a privacy violation, despite the proliferation of new privacy laws that have been introduced in various jurisdictions in the past.

It should be no wonder that academics and commentators have begun an increasingly urgent campaign to encourage governments in the United States and elsewhere to take the initiative and either to break up or rein in some of the larger, more powerful information brokers (e.g., Facebook, Google, Amazon, Apple, Netflix, Microsoft, etc.). Recently enacted legislation around the world is designed to limit companies' abilities to collect and maintain data about the individual customers they deal with. In May 2018 the European Commission implemented its **General Data Protection**

Regulation (GDPR), requiring companies that collected consumer data to respect the rights of individuals in eight specific areas:

1. The right to be informed;
2. The right of access;
3. The right to rectification;
4. The right to be forgotten;
5. The right to restrict processing;
6. The right to data portability;
7. The right to object; and
8. Rights in relation to automated decision making and profiling.[8]

Even before this comprehensive regulation was adopted, EU rules required member states to amend their national legislation to guarantee individuals certain rights to protect their privacy and to control the contents of electronic databases that contain personal information. The data covered by that directive included any information about an individual that somehow identified the individual by name or otherwise. Under the directive, information about consumers could only be collected for specific, legitimate purposes and stored in individually identifiable form. Those collecting the data must tell the consumer who ultimately will have access to the information. The rules were stricter for companies that wanted to use data in direct marketing or to transfer the data for other companies to use in direct marketing. The consumer had to be explicitly informed of these plans and given the chance to object.

Europeans do not allow the sharing of personal information between enterprises; this area is not yet regulated by the U.S. government.[9] In contrast to the United States, where more of a free-market approach is taken to many things, including customer privacy protection, the European Privacy Directive prohibits enterprises from transferring electronic records of personal information— including names, addresses, and personal profiles—across borders. It is at least partly intended to reduce trade barriers within the EU by standardizing how various companies treat individual information in different countries. If European nations must follow the same standards about privacy protection, then trade between nations can occur more freely. Personal data on EU citizens could only be transferred outside the 15-nation bloc to countries deemed to provide "adequate protection" for the data. But the rising use of **social networking** sites worldwide has put the EU's regulations to the test. A strict reading, for instance, could imply that those who "tag" their friends in Facebook, upload videos to YouTube, or post other personal material to social networking sites without everyone's consent are breaking the law.

[8]"GDPR—Key Provisions," Dixon Wilson Chartered Accountants, March 1, 2019, available at https://www.dixonwilson.com/technical-updates/gdpr-key-provisions, accessed June 14, 2021.

[9]European Code of Practice for the Use of Personal Data in Direct Marketing, available at http://www.fedma.org/fileadmin/documents/SelfReg_Codex/FEDMACodeEN.pdf, accessed February 7, 2016; and Jeff Langenderfer and Anthony D. Miyazaki, "Privacy in the Information Economy," *Journal of Consumer Affairs* 43, no. 3 (Fall 2009): 380–390.

As a first step in reigning in the data-hungry tech giants, however, the European Union's GDPR has been widely praised by consumer advocates and other defenders of privacy around the world.

The European Union's GDPR has been widely praised by consumer advocates and other defenders of privacy around the world. A similar comprehensive privacy-protection law, the California Consumer Privacy Act (CCPA), went into effect in the state of California on January 1, 2020,[10] while both Colorado[11] and Virginia[12] implemented their own comprehensive new CCPA-like privacy-protection laws in 2021, and as of this writing other privacy laws have been introduced with mixed success in 24 additional states.[13] On June 5, 2020, Japan amended its 2003 Act on the Protection of Personal Information (APPI), significantly toughening its provisions.[14] Canada's Consumer Privacy Protection Act was introduced in the legislature in November 2020 and is still in negotiation, while in New Zealand, Singapore, and Brazil new privacy laws have gone into effect in 2020 and 2021.[15]

Importantly, while all these various privacy laws do work toward the objective of protecting people from having their personal data usurped or abused by commercial powers, few say much about or do anything to check the information-collection powers of governments, or the growth of government databases.[16]

The importance of all these new regulations should not be lost on the marketer. What governments are telling businesses is that personal data is of value *to the individual,* and the individual's rights should be respected. Lest any large enterprise not take this regulation seriously, under the EU's GDPR, Facebook Ireland has now been cited for violations that will amount to between $200 million and $800 million in

[10]"California Consumer Privacy Act (CCPA vs. GDPR)," Varonis, available at https://www.varonis.com/blog/ccpa-vs-gdpr/, accessed June 14, 2021.

[11]"The Colorado Privacy Act: Explained," Beckage, July 8, 2021, available at https://www.beckage.com/privacy-law/the-colorado-privacy-act-explained/, accessed December 13, 2021.

[12]"Virginia Passes the Consumer Data Protection Act," IAPP Privacy Tracker, March 3, 2021, available at https://iapp.org/news/a/virginia-passes-the-consumer-data-protection-act/, accessed July 6, 2021.

[13]David Stauss, "Status of Proposed CCPA-Like State Privacy Legislation as of June 14, 2021," Husch Blackwell, June 13, 2021, available at https://www.bytebacklaw.com/2021/06/status-of-proposed-ccpa-like-state-privacy-legislation-as-of-june-14-2021/, accessed July 6, 2021.

[14]Hiroyuki Tanaka and Noboru Kitayama, "Japan enacts Amendments to the Act on the Protection of Personal Information," IAPP, June 9, 2020, available at https://iapp.org/news/a/japan-enacts-the-act-on-the-protection-of-personal-information/, accessed June 14, 2021.

[15]"Singapore's Personal Data Protection Act (PDPA)," Piwik, February 1, 2021, available at https://piwik.pro/privacy-laws-around-globe/#chapter-9, accessed June 14, 2021.

[16]See Phil Lee, "How Do EU and US Privacy Regimes Compare?" Field Fisher Privacy and Information Law Blog, March 5, 2014, http://privacylawblog.fieldfisher.com/2014/how-do-eu-and-us-privacy-regimes-compare, accessed January 11, 2016; and the proposed EU General Data Protection Regulation, January 25, 2012, available at http://ec.europa.eu/justice/ data-protection/document/review2012/com_2012_11_en.pdf, accessed February 7, 2016.

total,[17] and in July 2019 the United States Federal Trade Commission separately imposed an unprecedented *$5 billion* fine on Facebook for its actions during the Cambridge Analytica scandal, while separately imposing significant new restrictions on how the company uses the consumer data it collects.[18]

One problem with enforcing all these various privacy laws and regulations, of course, is that internet giants like Facebook, Google, and Amazon do business in a multitude of countries all around the world, so they can often play one country's rules off against another's, choosing their "privacy domain" based on how lenient a particular country's laws or rulings have been, in the same way that they avoid taxes by choosing which "tax domain" to report their earnings in. Even within the EU, there is infighting among the nations responsible for enforcing the GDPR. Ireland is the European headquarters for many of the large internet firms operating in Europe (including Facebook), so under the GDPR the EU has brought most of its cases against these companies in Irish courts. But this has created a backlog of more than two dozen cases against various big tech firms,[19] and the countries that are bringing cases have typically sought far more in penalties than the Irish courts have agreed to. In an early case against Twitter, for instance, regarding the company's disclosure of private tweets, the Irish court leveled a fine of $547,000, while Germany had proposed a fine of between $7 and $22 million.

Another problem, of course, is that even while they pay lip service to the benefits of protecting privacy, the big tech companies clearly do not *want* to protect their users' privacy, because their highly successful business models and immense profitability are based on *not* protecting privacy. In a 2019 article for the *Berkeley Business Law Journal,* Dina Srinivasan, a tech researcher and fellow with the Thurman Arnold Project (studying "rigorous competition policy and enforcement") at the Yale School of Management, explained quite starkly Facebook's resistance to the rules about allowing customers to **opt out** of tracking:

> First, Facebook itself did not and does not allow consumers to opt-out of the new off-site tracking. Second, Facebook chose to ignore consumers' explicit requests, enacted via the browsers' Do No (*sic*) Track option, to not be tracked. Third, when consumers installed ad blockers to circumvent

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[17]Neil Hodge, "Facebook reserves $366M for expected GDPR fines in Ireland," *Compliance Week*, Dec 11, 2020, https://www.complianceweek.com/gdpr/facebook-reserves-366m-for-expected-gdpr-fines-in-ireland/29829.article, referenced June 14, 2021.

[18]"FTC Imposes $5 Billion Penalty and Sweeping New Privacy Restrictions on Facebook," Federal Trade Commission, July 24, 2019, available at https://www.ftc.gov/news-events/press-releases/2019/07/ftc-imposes-5-billion-penalty-sweeping-new-privacy-restrictions, accessed June 14, 2021.

[19]Scott Ikeda, "Outgoing Privacy Commissioner Calls GDPR 'Broken,' Says That Basic Model 'Can't Work,'" *CPO Magazine*, July 1, 2021, available at https://www.cpomagazine.com/data-protection/outgoing-privacy-commissioner-calls-gdpr-broken-says-that-basic-model-cant-work/, accessed July 6, 2021.

tracking and targeted advertising, Facebook responded by circumventing the users' installed ad blockers.[20]

And Google resists the privacy-protection movement every bit as energetically as Facebook does, but, says Roger McNamee, an inveterate Silicon Valley investor, while both "Facebook and Google have used their design skills to craft dialogue boxes that minimize the number of users who opt in for GDPR protection . . . Google does not seem to understand that the primary reason its users and policy makers are not up in arms is because Facebook is worse. If Facebook gets its act together before Google, the shoe will be on the other foot."[21]

> Metcalfe's Law states that the value of a network increases in rough proportion to the square of the number of people (or nodes) in the network.

The main reason Facebook, Google, and other "big tech" firms even get away with these privacy-be-damned policies is that there is precious little competition for these large internet platforms. The platforms themselves are quick to buy up any potential competitors (the way Facebook bought WhatsApp and Instagram, for instance). And for the user, there is the extreme value of each network enhanced by "network effects," often known simply as **Metcalfe's Law** (see also Chapter 5).[22] Facebook, Apple, Google, and many other internet-based platforms represent networks, and as a network adds nodes, its value increases even faster. Consider the phone network, as an example. If only one person has a phone, the phone has no value at all, because there's no one to call. But if two people have phones, they can each call one other person. If we have a phone network of five people, that network has ten possible connections. But if you have ten people in the phone network—twice as many as five—then there are fifty possible connections, etc. That's Metcalfe's Law at work: the value of a network increases in rough proportion to the square of the number of people (or nodes) in the network.

And in the case of the internet giants, the value of each network is greatly enhanced by the network's *universality*. Each such big-tech internet platform represents the *one place* where connections can be made to everyone, and information can be quickly found. As Roger McNamee says of Facebook, "[t]he company enjoys all the privileges of a monopoly. It has network effects on top of network effects, protective moats outside of protective moats, with scale advantages that make life miserable for Snapchat, to say nothing of every startup that wants to innovate in social."[23] When there is dissent at Facebook, employees vent their grievances via a different network altogether: Blind. As the debate about privacy violations at the company raged, Blind allowed employees to

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[20]As quoted in Thomas Philippon, *The Great Reversal: How America Gave Up on Free Markets* (Harvard University Press, 2019), Kindle loc. 5218.

[21]Roger McNamee, *Zucked: Waking Up to the Facebook Catastrophe* (Penguin, 2019), Kindle loc. 3671.

[22]Dictionary.com, "Metcalfe's law," available at https://www.dictionary.com/browse/metcalfe-s-law, accessed December 3, 2021.

[23]*Zucked,* Kindle loc. 3475.

speak frankly (and therefore anonymously), while attempts by Facebook's HR executives to penetrate the network were repelled by the participants.[24]

Consumer resentment toward Facebook and other big tech monopolies is building, and sooner or later it will likely lead to tougher government regulation and control, and possibly the actual breakup of one or more of these firms entirely. After all, as Thomas Philippon says, "Google, Amazon, Facebook, and Apple in some sense owe their present success to the DoJ, which prevented Microsoft from monopolizing the internet in the late 1990s. It is therefore disingenuous to hear Google claim that antitrust enforcement is not needed."[25] One key to market competition, in Philippon's view, would be "giving people the property rights to their data. This is where competition and privacy become deeply intertwined."[26]

There are important precedents in the United States not just for breaking monopolies up, but also for ensuring that they remain competitive, and there's an interesting analogy for "giving people property rights to their data" in the mobile phone category. Cellular phones first became available in the 1980s, but by the mid-1990s the nascent mobile phone category in the U.S. was mired in a very non-technological logjam involving monopolistic practices. It wasn't that there weren't enough competitors in the industry (there were several major players), but that customers were reluctant to switch from whatever company they had initially signed up with because to switch cell phone carriers a customer had to drop their current phone number and get an entirely new one.

The only reason the world has a thriving and innovative mobile phone industry today is that nearly all countries have implemented laws or regulatory regimes that require mobile carriers to allow their customers to take their phone numbers with them, if they choose to do business with some other carrier—essentially giving the user the "property rights" for whatever number they have been assigned. Regulatory action was required to make phone number portability possible because no incumbent carrier would ever willingly make it easier for a customer to switch. And it's only because of this regulatory intervention that today, if Verizon or Vodafone begins providing bad service or charging too much, a customer can simply choose to leave and deal with a different carrier, without having to change their phone number. Every mobile company now has an incentive to maintain quality, improve service, and protect its customers' interests; if they don't do so, then customers have recourse to competitive companies that will.

A similar regulatory action could restore at least a measure of competition to the social networking category. Luigi Zingales, a professor of entrepreneurship at University of Chicago, has suggested making a relatively straightforward regulatory change that is directly analogous to the phone number portability rule.[27] He argues that people

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[24]Vivek Wadhwa, Ismail Amla, and Alex Salkever, *From Incremental to Exponential: How Large Companies Can See the Future and Rethink Innovation* (Berrett-Koehler Publishers, 2020), Kindle loc. 1247.

[25]*The Great Reversal*, Kindle loc. 5175. DoJ refers to the U.S. Department of Justice.

[26]*The Great Reversal*, Kindle loc. 5143.

[27]Luigi Zingales and Guy Rolnik, "A Way to Own Your Own Social Media Data," *New York Times*, June 30, 2017, available at https://www.nytimes.com/2017/06/30/opinion/social-data-google-facebook-europe.html, accessed July 6, 2021.

should own their own social graph data—that is, the data about their connections, their past interactions and posts, and so forth. So when you switch social media platforms, you should be able to take with you the connections you've made and the interactions you've engaged in, the same way you can take your phone number with you when you switch telecom providers. If we were simply to make it mandatory for all online competitors to turn over an individual customer's social graph data on request, in a machine-readable format, then we would ensure that the next time anyone is dismayed or worried at Facebook's privacy violations or its passive acceptance of fake news posts, or if we felt that Google was oversaturating us with targeted ads, these companies would at least have competitors to answer to. Simply giving consumers the power to seek alternatives would likely go a long way toward restoring competition.

CUSTOMER LOYALTY: IS A CUSTOMER LOYAL TO A COMPANY, OR A COMPANY LOYAL TO A CUSTOMER?

Privacy concerns have long existed in traditional shopping methods, not just online. Walk into a supermarket or department store, and the customer is often asked to hand over a loyalty card in exchange for a purchase coupon. But what if they buy something in a retail store and simply use a standard bank credit card? In such a case, the store has very little way of tracing the information about that shopping transaction and may have difficulty linking it to a particular customer, unless the customer is having the merchandise delivered. (It should be noted that the credit card company will have a complete record of that transactional information, for that customer, store to store.) Some stores have found a way to gather information from nearly all in-store purchases, regardless of payment type. Its store personnel ask customers for permission to affix a bar code to the back of a customer's own (say, non-Nordstrom) credit card, giving the store the capability to track its customers' purchases made with other credit cards. Starbucks and other merchants that have mobile apps that enable payment from a device can link purchases to personal ID info. Stores are also using beacons/cameras to track customers; if a customer has given their personal information to an app, the store can link behavior/transactions to make a personal profile. Facial recognition technology is so advanced, it could become the *de facto* ID of the future, and debate has already begun about the privacy issues inherent in in-store cameras scanning faces and **identifying** customers.[28]

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[28]Hannah Towey, "The Retail Stores You Probably Shop at That Use Facial-Recognition Software," *Business Insider*, July 19, 2021, available at https://www.businessinsider.com/retail-stores-that-use-facial-recognition-technology-macys-2021-7, accessed August 31, 2021; Stephanie Clifford and Quentin Hardy, "Attention, Shoppers: Store Is Tracking Your Cell," *New York Times*, July 4, 2013, available at https://www.nytimes.com/2013/07/15/business/attention-shopper-stores-are-tracking-your-cell.html?_r=0, accessed August 26, 2021; and Jimmy Rose, "How Facial Recognition Will Change Shopping in Stores," ExtremeTech, June 23, 2015, available at https://www.extremetech.com/mobile/208815-how-facial-recognition-will-change-shopping-in-stores, accessed August 26, 2021.

Profiling of a customer's personal data is standard protocol in the direct-mail industry and has been for nearly a century. Traditionally, this has meant that catalog retailers and credit card companies have collected names and addresses for their own use and have sold or rented those lists to other direct marketers. Phone a catalog merchant, and the buying process involves divulging an address and phone number. For that matter, call L.L. Bean or many other catalog companies, and the **customer service representative** might even be able to identify the customer before they state their name, thanks to the caller ID technology integrated into the company's call center. **Interactive voice response** systems, when programmed with metadata detailing the kind of calls individual customers have made in the past, can ensure that the **most valuable customers** end up at the top of the queue, not only to speak directly with a customer service representative, but also with the most experienced.[29] NICE (www.nice.com) and other companies now offer voice-recognition software that rapidly authenticates caller ID from any phone to save time and reduce fraud.

Remembering a customer and their logistical information makes it easier for them to order and also leads them to believe they are important to the enterprise. The internet offers the greatest opportunity to date for gathering personal customer information, as long as a **mutually** valuable relationship between provider and consumer is honored. Over time, data collected about website visitors empower companies with a keen ability to identify their most valuable customers and deploy relevant marketing campaigns—as long as the information customers enter is true, that is.[30] But, in general, customers themselves are recognizing the convenience[31] of being known by the websites they visit: The Ponemon Institute has followed people for years and discovered that only a small percentage of people "very frequently" delete **cookies** (down from 14% in 2004), and generally, even more people "never" delete them.[32]

However, even questionable security is a deal breaker for most customers. Of respondents to a National Cyber Security Alliance and Symantec poll, 63% did not complete a website purchase due to security concerns—with the majority of those choosing not to purchase being "simply not sure" about whether the site was secure. As important as convenience may be, more than 75% of respondents said they would be just as likely to make a purchase from a website if it required additional steps to verify their identity. According to a Forrester report, "About three-fifths of consumers

[29]Eric Buesing, Vinay Gupta, Becca Kleinstein, and Subhrajyoti Mukhopadhyay, "Getting the Best Customer Service from Your IVR: Fresh Eyes on an Old Problem," McKinsey & Company, available at https://www.mckinsey.com/business-functions/operations/our-insights/getting-the-best-customer-service-from-your-ivr-fresh-eyes-on-an-old-problem, accessed August 31, 2021.

[30]Mindi Chahal, "Consumers Are Dirtying Databases with False Details," *MarketingWeek*, July 8, 2015, available at https://www.marketingweek.com/2015/07/08/consumers-are-dirtying-databases-with-false-details/, accessed August 26, 2021.

[31]Martha (one of the authors) was recently told by a health insurance company that for her application to work, she would "just have to delete all the cookies on her computer." She refused and said it would be easier to find a new health insurance provider. Similarly, when told that a banking transaction required all her cookies to be deleted, she opted to go to the bank in person, rather than sacrifice being known at her favorite websites.

[32]Dr. Larry A. Ponemon of the Ponemon Institute has been the go-to expert for decades of privacy facts, ideas, and policy around the globe.

actually look at privacy policies [even if they don't read them]," and "When a company's privacy policy (including for its mobile apps) seems confusing or leaky, many consumers will forego completing a transaction with that firm."[33] Clearly, customers want both maximum convenience and maximum (identity) security, creating a very precise tightrope for customer-centered businesses to walk.

Managing customer relationships in the interactive age requires enterprises to collect information about customers in a virtuous cycle in which they can deliver additional value to individual customers.

Enterprises gather information about their customers and create loyalty programs to build lasting relationships. But with increasingly complex product choices, many sophisticated customers enjoy comparing and contrasting products to find the best price and most efficient service—and want both the information and the privacy to make a decision on their own terms, without being pressured too soon to make a purchase. The goal, therefore, is for the enterprise to find out as much information *about* a customer and use it *for* that customer to make the buying experience more valuable to that customer in various ways. Managing customer relationships in the interactive age requires enterprises to collect information about customers in a virtuous cycle in which they can deliver additional value to individual customers. Once the customer begins receiving personalized attention and **customized** products, they are motivated to divulge more information about themselves.

But we need to be aware that customers are thinking less and less about loyalty to a company and looking more for companies to be loyal to them. Only one-third say that loyalty programs are an effective way to earn their favor. Nearly two-thirds say they are loyal to their favorite brand because of a personal connection. Seventy-five percent said their loyalty was driven by product quality, 66% said value for money and 57%, **customer service**.

Meanwhile, 55% of consumers who are enrolled in loyalty programs use them infrequently—a few times a month or less. Ninety-six percent of Millennials surveyed said companies need to find new ways to reward loyal customers altogether.[34]

Nevertheless, consumers do like the customized offerings and other advantages companies can give them by tracking their data, but it is essential to guarantee that the customized benefits provided will not jeopardize their privacy. Customers must know

[33]Fatemeh Khatibloo, "Personal Identity and Data Management Success Starts with Customer Understanding," Forrester Research, Inc., March 17, 2015, available at http://www.forrester.com.

[34]See "The Truth About Customer Loyalty," KPMG, available at https://home.kpmg/xx/en/home/insights/2019/11/customer-loyalty-survey.html, accessed August 26, 2021; and also Jennifer Samuel, "With Customer Loyalty Harder to Win, Four Ways Retailers Can Revitalize Loyalty Programs," November 20, 2019, available at https://home.kpmg/xx/en/home/media/press-releases/2019/11/four-ways-retailers-can-revitalize-loyalty-programs.html, accessed May 9, 2021.

that the company will use that data in a limited way for services agreed on in advance. Without such trust, customization is not a benefit. Once earned, trust in an enterprise enhances customer loyalty. But enterprises need to address customer concerns about privacy, to offer guarantees, and stick to them. (We talk more about privacy pledges later in this chapter.) Those enterprises that gain the customer's trust first will often have the first-mover advantage. Most important, Dr. Dimitrios Tsivrikos found trust to be more powerful than rewards for consumers: "The extent to which individuals [were] reported to trust an organization was four times more important than any other factor based on exchange rewards such as receiving specially tailored offers or free products."[35]

Some believe that a customer might be more trusting of an enterprise and would provide the personal information that can foster a mutually beneficial relationship if the enterprise simply first asks the customer their permission to do so. The relationship in which a customer has agreed to receive personalized messages and customized products forms the basis of *permission marketing*, an idea from author Seth Godin, who points out that "The combined shortage of time and attention is unique in today's **Information Age.** Consumers are now willing to pay handsomely to save time, while marketers are eager to pay bundles to get attention." He compares *interruption marketing,* which is the kind we're all used to, with *permission marketing,* which offers marketers a chance to talk only to the customers who volunteer to get their messages. Godin likens the two kinds of marketing to two ways of getting married:

> *The Interruption Marketer buys an extremely expensive suit. New shoes. Fashionable accessories. Then, working with the best database and marketing strategies, selects the demographically ideal singles bar.*
>
> *Walking into the singles bar, the Interruption Marketer marches up to the nearest person and proposes marriage. If turned down, the Interruption Marketer repeats the process on every person in the bar.*
>
> *If the Interruption Marketer comes up empty-handed after spending the entire evening proposing, it is obvious that the blame should be placed on the suit and the shoes. The tailor is fired. The strategy expert who picked the bar is fired. And the Interruption Marketer tries again at a different singles bar.*
>
> *If this sounds familiar, it should. It's the way most large marketers look at the world. They hire an agency. They build fancy ads. They "research" the ideal place to run the ads. They interrupt people and hope that one in a hundred will go ahead and buy something. Then, when they fail, they fire their agency!*
>
> *The other way to get married is a lot more fun, a lot more rational, and a lot more successful. It's called dating.*

[35]Dr. Dimitrios Tsivrikos, a business and consumer psychologist at University College London, is quoted in Aimia, "Aimia Global Loyalty Lens Report," 2015, available at https://silo.tips/download/2015-aimia-global-loyalty-lens-report, accessed August 26, 2021.

> *A Permission Marketer goes on a date. If it goes well, the two of them go on another date. And then another. Until, after 10 or 12 dates, both sides can really communicate with each other about their* ***needs*** *and desires. After 20 dates they meet each other's families. Finally, after three or four months of dating, the Permission Marketer proposes marriage.*
>
> *Permission Marketing is just like dating. It turns strangers into friends and friends into lifetime customers. Many of the rules of dating apply, and so do many of the benefits.*[36]

Trust, as discussed in Chapters 3 and 4, is always critical. Customers are dubious of unfamiliar enterprises that have not been recommended to them. Some customers won't buy anything online until they've seen other customers' reviews and comments, even though those other customers are total strangers.

Although we talk about privacy as if it were a single topic, it is really an umbrella term, and if you ask customers what bothers them about privacy, you will get several answers.

- The most common concern is about criminal activity—misuse of stolen credit card numbers, usurpation of identity. This concern nearly always comes back to the issue of data security.
- Distinct from the first point is a concern about others knowing things about them they would rather not have out there as common knowledge.
- Another issue is the idea that they would rather not be bothered if they don't want to be: Spam is driving them crazy (if it comes through their mobile device, they may even have to pay for the minutes and the texts!), and marketing calls at dinner are a nuisance.

Meanwhile, if you ask enterprise executives what the term *privacy* means to *them*, and they're honest with you, you may find that *privacy* is a risk of fines on each breached record and a potential minefield for public relations. To the lawyers, it may be about regulation compliance and litigation avoidance. But to those in the organization whose mission is to build the value of the customer base, *privacy* is whatever customers think it is, but it's also:

- Getting information from customers who are comfortable giving it
- Using the information to build mutual value with each customer
- Protecting customer data as a valuable competitive asset (through data security, protective processes, and **customer-focused** culture)
- Communicating data protection to customers

[36]Thanks to Seth Godin for his contribution to this section. See also his classic book *Permission Marketing* (New York: Simon & Schuster, 1999).

Relationships require trust, and privacy is one of its underpinnings.

Relationships require trust, and privacy is one of its underpinnings.

Moreover, as each organization moves to globalize its operations, its leaders will need to be aware of and comply with the many legal requirements of the nations in which it serves customers, and they will need to respect the individual cultures of these countries. Enterprises will also need to protect the accuracy, transmission, and accessibility of their customer records.

Remember, a trustable privacy policy is a prerequisite for robust customer interaction. Customers will only share information with companies they trust not to abuse it. See the section "Protect Privacy and Earn Customer Trust to Encourage Interaction," above.

PRIVACY PLEDGES BUILD ENTERPRISE TRUST

If the enterprise is to establish a long-term relationship with a customer based on individual information, it will recognize that customer data as its most valuable assets, will secure and protect those data, and will share the policy for that protection in writing with its customers, partners, and vendors in the form of a privacy pledge. That pledge will permeate its own culture and be part of its employees' DNA. The privacy pledge will spell out:

- The kind of information generally needed from customers
- Any benefits customers will enjoy from the enterprise's use of this individual information
- Any events that might precipitate a notification to the customer by the enterprise
- An individual's options for directing the enterprise not to use or disclose certain kinds of information
- Specific steps to secure and protect customer information

Enterprises sometimes jeopardize their relationships with customers by engaging in unethical moves that compromise customer privacy for short-term marketing gain. That's why enforcing a privacy policy is reassuring to many customers. But being careful with customer data is not enough for the enterprise. A company must also get agreements in writing with all its vendors and partners that confirm they too will comply with enterprise privacy standards. A Midwestern bank committed to protecting its customers' information learned that a printing company that produced checks for the bank's customers had been copying the names and addresses of customers, routinely printed in the upper-left corner of the checks, and reselling that information to list brokers. These list sellers in turn were selling the information to insurance agencies, garden supply companies, competitive financial services institutions, and others.

The Web That Might Have Been

For anyone who is tired of all the advertising and marketing messages we need to wade through every time we try to navigate somewhere online, it's interesting to note that the web didn't have to develop this way. In fact, it almost turned out completely differently.

In 1965 Ted Nelson coined the term *hypertext* to describe using computer programming to link written documents together. The concept of creating hypertext links between concepts was not unprecedented, even before computers. Footnotes are a form of hypertext, for example. And the Talmud, which has blocks of commentary arranged in concentric rectangles, represents a kind of hypertext. But Nelson's vision used computers to do the linking. With an assortment of young hacker friends, Nelson began working on a project he called Xanadu, which aimed to link up and cross-reference all the information in the world. Unfortunately, despite two decades of on-and-off effort, Project Xanadu never really got off the ground, as explained in a story chronicled in a comprehensive 1995 *Wired Magazine* article, "The Curse of Xanadu."[a]

But hypertext links were exactly what the first web browsers were all about. Invented in the early 1990s, browsers relied on hypertext links to connect information in one computer to information in another. However, unlike the links Nelson had worked on for Xanadu, the hypertext links that created the World Wide Web were one-way in nature, rather than two-way. This saved a great deal of energy, not requiring a lot of two-way messaging between computers, but it meant that any computer making itself available for linking can be linked to, at will, by any other computer. In plain English, the website cannot control who links to it.

As Walter Isaacson said in his book *The Innovators*, "Had Nelson's system of two-way links prevailed, it would have been possible to meter the use of links and allow small automatic payments to accrue to those who produced the content that was used. The entire business of publishing and journalism and blogging would have turned out differently."[b] Imagine, for instance, that to access the web a user was required to provide an initial credit card deposit, against which micropayments could be charged by publishers of original content. Instead of having to endure a series of pop-up ads just to read a magazine article online, your account would simply be charged a few pennies for accessing the article, or maybe just a few tenths of a penny. A popular blogger might charge something, too. No additional sign-up necessary, and little or no advertising, either. Go to a site and choose whether to pay 3¢ to access an article without any ads, or pick it up for free, with advertising—in the same way many smartphone apps are sold today.

Had the web been based on two-way hypertext links from the beginning, a range of different for-pay business models would have evolved.

HTMLs use of one-way links to online content fueled a very rapid growth of the World Wide Web from its outset, but it nearly destroyed the publishing industry. Because people no longer had to buy a newspaper or magazine to read its articles, publishers rushed to ensure that their online offerings were at least generating revenue from advertising. Of course, a few publishers have been successful in putting

(*continued*)

up pay walls to require some form of monetary payment, but the vast majority of them couldn't make that kind of model stick. Moreover, because printing presses aren't required to publish online, the barriers to entry in the publishing business were demolished. Anyone could become an online publisher, and nearly everyone did—from corporate content marketers to individual writers and bloggers. Overall, the result has been nothing short of economically catastrophic for most publishers.

But now consider how **blockchain technology**—the same sort of computer tool that underlies Bitcoin—might in fact someday be used by publishers to resurrect their ability to sell the intellectual content they develop, rather than simply giving it away in hopes of attracting advertising dollars. Blockchain technology is made possible by encryption that requires computer processing to unlock. And every time the encryption is unlocked a data record is added to the blockchain of data.

So, in terms of digital currency, blockchain technology makes it impossible to simply copy a Bitcoin and have two of them. This, in turn, limits the actual supply of Bitcoins and gives them their economic value, in the same way that governments protect the economic value of their paper currencies by preventing counterfeiting. If anyone could simply run $50 bills through a copying machine and make more of them, paper currency itself would have no economic value.

This is why blockchain technology offers the possibility of resurrecting the business of creating and selling intellectual content. By using a blockchain it's entirely possible that a publisher could in fact restrict the supply of copies made, or downloaded, or viewed. Businesses are already being formed to make aspects of it into a reality. In Argentina, Sergio Ortiz Latorre is the founder and CEO of a startup called SolDataBank, a business designed specifically for the purpose of helping the owners of intellectual content to protect and monetize their content through use of blockchain technology. Some of the use cases they have in mind are represented as what-if scenarios on their website, from a housekeeper who wants to be able to sell their own cookbook online to a company trying to crowdsource a new product and compensate participants for their contributions. The old Scout motto—Be prepared!—applies to everything we are talking about in this book. It used to be that marketing was all about the kind of creativity that resulted in witty headlines and beautiful graphics. Now, marketing, customer relationships, customer experience, IDIC, privacy, and all the new and future technologies require us to be creative in a different way and to imagine how to make what we do more profitable, and safer for customers and producers too. This is just one example: Maybe soon the web will have a substantial amount of published content being made available for viewing via micropayments, rather than via macro-ads.

But even here, you might have noticed that there's a missing piece, having to do with the friction encountered in the payment process. The solution to eliminate the friction between the publisher and the would-be reader, as well as the privacy protection, is technological, but that is a discussion for another time.

[a] Gary Wolf, "The Curse of Xanadu," Wired.com, June 1, 1995, available at https://www.wired.com/1995/06/xanadu/, accessed July 13, 2021.

[b] Walter Isaacson, *The Innovators: How a Group of Hackers, Geniuses, and Geeks Created the Digital Revolution* (New York: Simon & Schuster, 2014), Kindle loc. 7243.

As the privacy debate rages, customers are, more and more, aware of whether they are given a chance either to opt in (proactively elect to receive future communications from the enterprise) or opt out (tacitly choose to receive them by inaction, unless they actively opt out). Consumer groups tend to favor opt-in as a better protection for consumers, whereas industry groups point to very low participation levels and, ironically, fewer targeted messaging efforts, and therefore tend to favor opt-out. Frequently, however, this opt-in or opt-out choice is an all-or-nothing toggle switch. To treat customers in a more one-to-one fashion, today's best practice, as we've mentioned before, is to offer them choices, with respect not just to the types of information they may choose to receive, but also as to the frequency with which they are contacted.

What greater assets do any company, online or off, have to dangle in front of other companies than the private data of thousands, or even millions, of customers? Do the rules change when a company is bought out or goes bankrupt? What happens to a company's privacy pledge when there no longer is a company? And what guarantee is there that the new owner of your data will honor the same privacy standards as the former owner?

There is a simple, universal solution: The global business community needs to prevent such abuses, and preferably without government intervention. In this Age of Transparency, technologies are cropping up to help the process. Software enables online users to control how sites collect, control, use, and share their personal information. With privacy pledges under scrutiny, more enterprises are adopting and publicizing them. Nonetheless, many enterprises still do not state their policies, and others never share user data with third parties.

Points to Consider in Developing a Company's Privacy Pledge

What constitutes a good privacy protection policy? For starters, it should explain to customers what kinds of information the company needs from them, how the information will be used, and how it will not be used. It should also explain the benefits a customer would gain by sharing personal information. Enterprises need to promote their privacy policies beyond the website, mobile apps, and corporate promotional collateral, including it in direct-mail pieces, invoices, and other company mailings. A privacy policy will reinforce the foundation on which each customer relationship is built. Trust is an essential part of any **Learning Relationship**, and a privacy policy helps build that trust.

Building a trusted relationship goes far beyond simply writing a privacy policy and posting it on the website. Unless the enterprise is careful as to how it uses sensitive customer information, the opportunity for forming Learning Relationships may disappear. It is important to recognize, however, that some individuals do not want companies to know which websites they visit or anything about their personal information. In the headlong rush of enterprises to use the latest databases, **data-mining** techniques, neural nets, and internet-based information collection systems, some have neglected or overlooked this important issue. Moreover, a

(*continued*)

customer's willingness to **collaborate** with an enterprise by interacting with the firm could be one important measure of the customer's value to the enterprise.

It is important to explain the motives for wanting to create a relationship with a customer. Enterprises need to describe to customers how they will benefit by exchanging personal information with them. Once customers have read the privacy pledge and understand that their personal information will not be sold or shared irresponsibly, they simply want to know how providing their personal data will affect their own customer service. Beyond the security or convenience of the actual transaction, what assurance does a customer have that their personal information will not be misused or abused? After all, most customers have experienced the irritation of getting on a list and, as a consequence, receiving unsolicited direct mail and outbound telemarketing calls. Ironically, if a customer does not provide information to an enterprise about what they like to buy, the likelihood is that they will receive more junk spam or direct-mail pieces that promote products and services of little interest to them and their needs.

These and many other privacy-related questions may never be fully settled. But the customer-based enterprise has to monitor changing privacy issues closely. Intensifying the privacy debate is the way customer information is being collected and used on the internet. The web has created a powerful medium to collect and analyze customer data. But how can enterprises afford customers the same privacy protection online as they do in the real world? And how sensitive are customers to divulging personal information on the web?

Every enterprise that maintains a website or collects personal customer information needs to establish an explicit privacy protection policy. The enterprise might call it a Privacy Pledge or a Privacy Bill of Rights, but it needs to consider these 10 key points:

1. Itemize the kind of information it collects about individual customers.
2. Specify how personal information will be used by the company. If its policy is to use this kind of information only within the company on a need-to-know basis, and not to make it accessible to unauthorized employees at any time, the enterprise needs to explain this policy explicitly.
3. Make whatever commitments it can make with respect to how individual customer information will *never* be used (e.g., personal information is never sold or rented to others or never used to change prices or insurance premiums, etc.).
4. State the benefits an individual customer can expect as a result of its use of their information (faster or preferential service, reduced costs, etc.).
5. List a customer's options for directing the enterprise not to use or disclose certain kinds of information.
6. State how a customer can change or update personal information it has collected. For example, can the consumer access their profile or account information online or modify it?

(*continued*)

7. Identify events that might precipitate a notification to the customer by the enterprise. If, for instance, a court subpoenas your customer records, will you notify any customers whose information was subpoenaed?
8. Specify the situations in which it accepts or denies liability for damages incurred through the collection and use of customer data, such as through credit card fraud or misuse.
9. Provide specific procedures allowing a customer to order the company to stop collecting data about them, or to purge their information files at the company.
10. Make the pledge readable and easily accessible—easy to find, easy to read, easy to understand. Let the customer people override the legalese. The point is not what the pledge says, but what customers understand about it. Be brief, concise, clear, and fair.

The bottom line is that the information that technology provides about your customers, and the increasingly cost-efficient tools you have to interact directly with customers and to facilitate them interacting with each other, should be used to build more trust. It really won't matter what your formal privacy protection policy is, or how well you comply with whatever antispam regulations are enforced, if you don't see the problem through the right end of the telescope—that is, from the customer's perspective. Fail to take this point of view and you are still going to be undermining your customers' trust.[37]

Companies can't forget that a trustable privacy policy is part of an organization's overall trustability. Remember that you can set yourself apart by having a clear, readable privacy policy for your customers to review. As a rule, company privacy policies tend to be overly long, bizarrely complex, and difficult to read, although they vary widely. Airbnb's privacy policy[38] is 4,000 words of lawyer-speak that requires 35 minutes to wade through, while Craigslist's policy is under a thousand words[39] and can be read completely in just two minutes. And according to the Lexile test, a reading comprehension test developed by Metametrics, an education company, CNN's privacy policy is more difficult reading than Immanuel Kant's *Critique of Pure Reason,* while

[37]"With Big Data Comes Big Responsibility: An Interview with MIT Media Lab's Alex 'Sandy' Pentland," *Harvard Business Review* 92, no. 11 (November 2014): 101–104.
[38]"Airbnb.org Privacy Policy," Airbnb.org, December 7, 2020, available at https://www.airbnb.org/legal/privacy, accessed June 1, 2021.
[39]"Craigslist Privacy Policy," Craigslist, September 15, 2020, available at https://www.craigslist.org/about/privacy.policy, accessed June 1, 2021.

the BBC policy can easily be read and understood by a middle-schooler.[40] So when putting your privacy policy together, be like Craigslist or the BBC, not CNN or Airbnb.

Finally, the fluid collaboration between enterprise and customer is ceaseless throughout the life of the relationship. But for the relationship to flourish, customers sometimes will have to reveal personal information about themselves to the enterprise. The enterprise, in turn, will have to promise to keep this private information private. Indeed, privacy—the customer's right to it, and the enterprise's protection of it—has become an important, and controversial, subject of the Information Age.

[40]Kevin Litman-Navarro, "We Read Through 150 Privacy Policies. They Were an Incomprehensible Disaster," *New York Times,* June 12, 2019, available at https://www.nytimes.com/interactive/2019/06/12/opinion/facebook-google-privacy-policies.html, accessed June 1, 2021.

CHAPTER 10

IDIC Step 4: Customize to Build Learning Relationships

Any customer can have a car painted any color that he wants, so long as it is black.

—Henry Ford

Accepted wisdom is that, on average, each American household has about 300 branded products—food items, cleaning goods, over-the-counter remedies, grooming products. Yet there are about 30,000 stock-keeping units (SKUs) in the average supermarket, and many more in the big stores. This means the average shopper has to sort through 100 different brands, sizes, and labels on the products they don't want just to find each single product they buy. When shopping online, a customer may be offered thousands of options before getting to the one they want. But the truth is that choice is not the same as getting things our way. Most of the time, in fact, especially for routine purchases, people don't want more choice. They just want what they want. Having to choose is a hassle that represents just one more bit of friction in the **customer experience**. **Customization**, however, removes the friction of having to make a choice, and today's digital technologies allow an enterprise not just to remember what a customer has previously specified, but to digitally configure its product or offering for that customer so as to meet those specifications. And this is the payoff step for a **Learning Relationship**—the step that ensures immense convenience to the customer and great value for the company. The whole point is to know more about a customer than the competition does and then to deliver something in a way the competition cannot. Ultimately, to realize the business benefit from its ongoing relationships with customers, the **customer-strategy enterprise** will ***treat different customers differently***, changing how it treats each customer based on what it has learned through its dialogue with that customer. In other words, it must now customize its treatment of each customer, which is the fourth step in the **identify-differentiate-interact-customize (IDIC) methodology** of relationship building, and the subject of this chapter.

In the beginning there was customization. Before factories and assembly lines and television advertising, the products people bought were quite often tailor-made. By tailors. Or by blacksmiths. Or by any one of a hundred other types of craftsmen, each of whom made nearly everything to order. The cobbler didn't start by making a bunch of shoes in different sizes and styles, then putting them in their store window for people to choose from. They waited until they had a customer, and the customer chose a preferred style and placed an order; then the cobbler carefully measured the customer's feet and crafted the shoes to the customer's size and preference. The craftsman's message to a customer was: "Tell me what you want and then I'll make it for you that way." Before the Industrial Age, in other words, before mass production and **mass marketing**, merchants *treated different customers differently*.

But as the Industrial Age blossomed, cobblers, blacksmiths, and other craftsmen were quickly put out of business, because factories and assembly lines could mass produce things in large volumes at a tiny fraction of the unit cost of using individual craftsmen. Every product coming off an assembly line was the same, so instead of saying, "Tell me what you want and I'll make it," the mass marketer's message to customers was "Here are the products I've made. Who wants one?" Every customer was offered every product, and it was up to the customer to choose the one they wanted. Mass marketers used advertising and promotion to persuade customers that their products were different from and better than other marketers' products, but they treated all their customers the same. For the past 100 years, businesses have standardized their products and services to take advantage of **economies of scale**. They have standardized their messages about the product, and they have standardized its distribution. In the process, they have also standardized their customers.

> For the past 100 years, businesses have standardized their products and services to take advantage of economies of scale. They have standardized the product and their messages about the product, and they have standardized its distribution. In the process, they also have standardized their customers.

However, as we've mentioned before, once the **Information Age** gained traction, digital technology made it possible not only to remember individual customers (even if a company had millions of them), but to *customize* individual products and services for these customers, not by hand-crafting each product, but by **mass customizing** them, cost efficiently, at scale.

HOW MASS CUSTOMIZATION WORKS

Mass customization can be defined as the mass production of goods and services in lot sizes of one. Stan Davis, who first coined the term in his groundbreaking book

Future Perfect, says the term implies delivering "customized goods on a mass basis."[1] The mechanics of mass customization are simple in theory, because a mass customizer doesn't actually *customize* a product—at least not from scratch. Rather than customization, the process a mass customizer engages in is *configuration*. The mass customizer starts by creating dozens, or hundreds, of standardized modules for all the various components of a product and/or its related services, delivery options, payment plans, and the like, and then simply uses **business rules** to configure each final product by combining different modules.

As a simple example, consider how a window manufacturer, for instance, could offer 12 different window frame sizes, five different sash types, 10 windowpane styles, and three grades of insulation. A customer can select the particular size and sash type they need, as well as the pane style and insulation they want, and then the manufacturer could make the window by setting a few dials on the assembly line. Altogether, this total of just 30 different modules could be combined in $12 \times 5 \times 10 \times 3$ ways, for a total of 1,800 different finished window products. Many of these 1,800 possible products will never actually be requested, but any one of them *could* be requested at any time and then manufactured, on demand. Moreover, the window maker could offer even more to its customers by including options for various services, either performing these services itself or contracting for them with other firms—say, for example, four different financing alternatives, three delivery options, and two different types of warranty agreement. These extra nine modules increase the total number of finished products on offer from 1,800 to more than 40,000. An important part of this process is the customer interface that makes individual configuration easy for both the customer and the company.

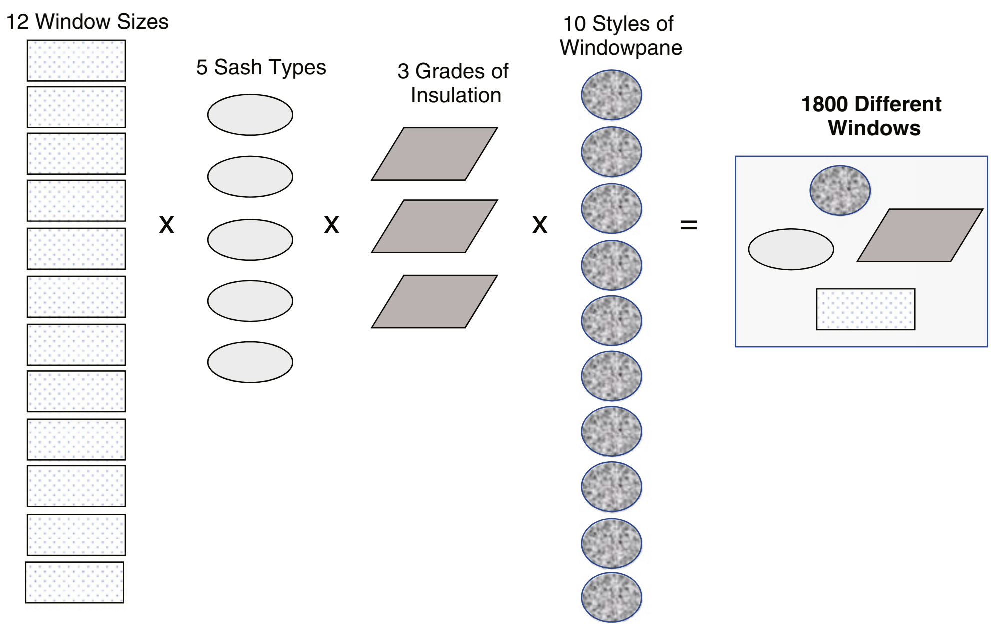

EXHIBIT 10.1 How Mass Customization Works

[1] Stanley M. Davis, *Future Perfect* (Reading, MA: Addison-Wesley, 1987).

And of course, as more and more physical objects are connected to the web and the **Internet of Things (IoT)** begins to proliferate, we can anticipate mass-customized tools, devices, products, and services that will render themselves in literally *billions* of possible combinations.

At its heart, mass customization is a *digital* process, and this sort of digital customization is to a craftsman's customization as digital music is to a musician's music. The Spotify tune you are listening to through your earbuds is not an *exact* reproduction of the sound created by your favorite band, but a digital approximation, created by using millions of tiny individual bytes of data. The bytes are so tiny, however, that the music sounds perfectly good to your ear, and not like an approximation at all. In the mass customization process, the modules are the bytes, and when done with small enough bytes, the approximation can be similarly exact, yielding the number of *possible* product configurations in the thousands, billions, trillions, or more, even though the customer will only be purchasing one of these possible configurations at a time.

> Digital customization is to a craftsman's customization as digital music is to a musician's music.

The principles of mass customization are not limited to physically produced goods, either; they can be even more easily applied to the customization of an enterprise's services and its digital **interactions** with customers. For many customers, being treated individually with personalized services and communication may be an even more important dimension than being able to specify uniquely tailored products made possible through mass-customized production processes.[2]

Consider the services that a retail bank offers through its automated teller machines (ATMs). When you use the machine, you begin by selecting from a series of modules: Do you want to deposit checks, withdraw cash, or check your balance? Receipt by paper, email, both, or neither? And because people are creatures of habit, many of us use the ATM for the same basic transactions, so the ATMs at most banks will remember your usual transaction, if you have one. Put your card into the machine and enter your PIN code, and your bank's ATM may ask you whether you'd like your usual transaction, a $200 cash withdrawal from your checking account, in twenties, no receipt.

[2]Forrester calls these "individualized experiences": see Tony Costa, "Personalization and the Rise of Individualized Experiences," Forrester Research, Inc., December 9, 2014, available at https://www.forrester.com/report/personalization-and-the-rise-of-individualized-experiences/RES115794, accessed August 31, 2021. One survey by Epsilon and GBH Insights showed that 80% of responders want a personalized experience from retailers; see "New Epsilon Research Indicates 80% of Consumers Are More Likely to Make a Purchase When Brands Offer Personalized Experiences," Epsilon, January 9, 2018, available at https://www.epsilon.com/us/about-us/pressroom/new-epsilon-research-indicates-80-of-consumers-are-more-likely-to-make-a-purchase-when-brands-offer-personalized-experiences, accessed August 31, 2021. As cited in Erik Lindecrantz, Madeleine Tjon Pian Gi, and Stefano Zerbi, "Personalizing the Customer Experience: Driving Differentiation in Retail," McKinsey & Company, available at https://www.mckinsey.com/industries/retail/our-insights/personalizing-the-customer-experience-driving-differentiation-in-retail, accessed August 31, 2021.

Remember the story from Chapter 3, about how St. George Bank's ATMs were programmed to remember a customer's usual? This meant not only that the ATM customer experience was more **frictionless** (the customer spent less time making a selection), but because the bank's customers were served more efficiently, the ATM could also serve more customers per day. In other words, remembering a customer's usual order provided faster and more frictionless service for the customer, and also yielded more efficient asset utilization for the bank, with fewer ATMs needed to serve however many customers the bank has.

As more of our interactions with businesses occur electronically, either via a website, a mobile app, or some connected device, the easier it will become for businesses to customize those experiences to the likely **needs** and desires of each individual customer. In *One-to-One Personalization in the Age of Machine Learning: Harnessing Data to Power Great Customer Experiences*, authors Karl Wirth and Katie Sweet dissect the way a modern enterprise can tailor its online offerings so as to treat different customers differently, using the basic principles of **modularization** and mass customization. To begin with, they advise, think of three different sorts of logical patterns, or algorithms: boosters, filters, and variations. You could use a booster, for instance, to "ensure that a person's favorite brands are prioritized across your site, that she sees recommendations within her preferred price range, or that she sees content related to her preferred topics or that aligns with her stage of the buyer's journey."[3] A filter, on the other hand, would be used to exclude from the customer's online experience anything considered irrelevant—so, for instance, if your online clothes site was serving someone who had been viewing men's shirts and pants, you could use a filter to avoid suggesting children's or women's items until and unless they were asked for. And variations can help you keep your website fresh-looking, as you change up what an individual visitor might see from session to session.

There are many additional business rules, algorithms, and data points that can be applied to customize the online customer experience, taking into account not just a customer's previous online behavior, but whatever data the enterprise already has in its database about the customer, from their registration details, history and previous usage patterns to demographic or psychographic insights. For an e-commerce site, Wirth and Sweet would break the business rules around personalization into basic algorithms and advanced algorithms. Basic algorithms would include:

- Trending items
- Similar items
- Recently published items
- Soon to expire items
- Co-browsed items (what other users have viewed)
- Co-buy items (what others have purchased)[4]

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[3]Karl Wirth and Katie Sweet, *One to One Personalization in the Age of Machine Learning: Harnessing Data to Power Great Customer Experiences* (Evergage, 2017), p. 33.
[4]*One to One Personalization*, pp. 29–30.

Wirth and Sweet argue, "[w]hile a basic algorithm would show Product X to everyone who looked at Product Y, for example, advanced algorithms predict the best experience for each individual, growing smarter over time as they have more data to leverage."[5] And then they suggest four types of advanced algorithms, including ***collaborative filtering***, as well as decision trees, text analysis and contextual analysis.[6] The point is that by using algorithmic business rules an enterprise can conveniently modularize how the website is presented, serving up a uniquely different and highly customized experience for each customer—an experience completely unlike the experience delivered to any other customer. The online world really is a world where it costs almost nothing to treat different customers differently, and as a greater and greater proportion of customer experiences migrate to online interactions, including via the IoT, customers everywhere will begin to expect customized treatment from the enterprises they deal with.

HOW CAN CUSTOMIZATION BE PROFITABLE? ANSWER: CONFIGURATION

The biggest obstacle to mass-customizing a manufactured product is simply ensuring that the different physical parts work with one another and can be fit together easily. But if a product's components can be modularized and then assembled in a standardized way, then the manufacturer's costs can actually decline. And building products to order, if it can be done inexpensively at scale, will be inherently more efficient than building products to forecast, because the mass-customizing enterprise won't even need to build a product until it's already been ordered and paid for by a customer. A mass manufacturer, on the other hand, must start by forecasting the likely volume of products that will eventually be sold, and then it must manufacture that volume of products and try to sell them. A product that isn't already in the inventory can't be sold, and there's always a risk entailed in making a bad forecast and producing more products than can be sold (or failing to produce enough products to keep up with demand). A mass customizer, on the other hand, only makes and delivers a product once it has *already* been sold. So while a mass manufacturer must stockpile many finished products in order to have them available for sale, a mass customizer only has to inventory a supply of components, re-ordering them as and when purchases are made. The result is that the mass customizer will generally not have to carry as much inventory, which means the business won't require nearly as much working capital. Indeed, cost reduction is one of the principal reasons manufacturing companies consider mass-customization technologies in the first place.[7]

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[5] Ibid, p. 30.

[6] Ibid, pp. 30–31.

[7] David M. Anderson, *Design for Manufacturability: How to Use Concurrent Engineering to Rapidly Develop Low-Cost, High-Quality Products for Lean Production*, second edition (Productivity Press, 2020).

Consider Nike, which has been customizing shoes since 1999, and now capitalizes on sharing sites such as Instagram, where buyers show off their newly configured colors and styles.[8] Indochino offers made-to-measure suits, shirts, and clothing for men, with customized selections that range from 69 shades of blue to purple velvet. They also go to great lengths to support the customer's buying experience: For example, if you don't trust your own measurements, you can visit one of more than sixty showrooms across North America, where an in-house tailor can measure you.[9] More and more new cars are mass customized, at least partly, for their new owners. We may be headed toward a day when new cars are routinely customized, and only used cars are already configured.

With respect to online services, it should be clear by now that when a few lines of computer code are able to mass customize the customer's online experience, not only will an enterprise be likely to generate higher sales from its more satisfied customers, but the IT assets dedicated to maintaining the website and its online connections will be more efficiently used, requiring not just less computer time to serve the same number of customers, but probably less human effort as well, because this sort of automation will serve those customers better, faster, and with fewer mistakes, and will require less human interaction. In other words, the process of mass customization—customizing products or services *at scale*, using business rules and modularization—can actually *reduce* a company's all-in costs, when compared to traditional mass-production processes.

But we haven't even discussed the most precious resource of all that will likely be greatly conserved through mass customization: the human attention span. If there is one single cost reduction that should take precedence over all others, it is this one: that less human effort will be expended. With mass customization, less human attention will have to be devoted to doing the routine things, the meaningless tasks, and the repetitive jobs. As mass customization—*digital* customization—accounts for a greater and greater share of the consumer and business economies, both online and off, human beings everywhere will save immensely in terms of the activities and interactions that they must pay attention to. So we can expect the average quality of life in general—and relevant to this discussion, business life, to improve immensely.

[8]Peter Verry, "Nike Will Reveal Custom Air Maxes Every Week for #AirMaxMondays," *Footwear News* (online), May 12, 2020, https://footwearnews.com/2020/focus/athletic-outdoor/nike-by-you-air-max-mondays-1202985241/, accessed May 15, 2021; Mary Lisbeth D'Amico, "Nike Gears Customized Shoe Campaign to Instagram Users," ClickZ, April 26, 2013, available at https://www.clickz.com/nike-gears-customized-shoe-campaign-to-instagram-users/40835/, accessed August 31, 2021.

[9]See Indochino's company website at https://www.indochino.com/ accessed May 15, 2021; and Steve Kistulentz, "The 5 Best Online Custom Suit Makers [Dress Good, Feel Good]," ChatterSource, April 16, 2020, https://www.chattersource.com/article/custom-suit-makers, accessed June 28, 2021. Some showrooms are slated for Nordstrom's.

Demand Chain and Supply Chain

When a firm remembers a customer's specification and uses this memory to deliver a product or service to that specification later (i.e., customization), the customer has a clear incentive to stay loyal. The more complex the product or service is, and the more customization that can be embedded in the company's treatment of the customer, the more likely the customer will be to remain loyal, even in the face of pricing pressure. It's partly the convenience factor, and partly simple trust. However, to create such a Learning Relationship, the enterprise must be capable not only of *remembering* the customer's information but also of acting on it. It must be able to integrate its back-end production or service-delivery operations, or **supply chain,** with its front-end sales, marketing, or **customer service** operations, or **demand chain.** (See the discussion about frictionless **customer experience (CX)** in Chapter 3.)

For this reason, managing individual customer relationships effectively requires that an enterprise's demand-chain activities be coordinated with, if not integrated into, its supply-chain activities. Good customer relationships on top of a weak supply chain merely provide customers with a clearer view of the mediocrity of a company's underlying logistical capabilities, undermining a customer's trust in the enterprise by calling the company's competence into question. **Customer experience management** that is not effectively tied to supply chain management (SCM) results in:

- *Underdelivering*. Front-office strategies and processes will increase customer interactions—and customer expectations. If the back office can't deliver on what the front office promises, then hollow **customer relationship management (CRM)** will result, and customer satisfaction will decrease. This is a violation of the competence element of trust discussed in Chapter 4, which is *do things right*.
- *Overdelivering*. Customer strategies and processes that don't provide cost transparency into SCM information may result in delivering products or services that are unprofitable for the firm. Even while customers may be satisfied that their individual needs are being met, the firm loses money on every transaction, and such overdelivery is clearly not sustainable.
- *Lost* ***share-of-customer*** *opportunities*. Without integration, the supply chain can't capitalize on the information about customer needs that **customer insight** uncovers in order to form new supplier partnerships that intelligently and profitably increase the scope of a firm's offerings.

Because implementing CRM technologies and adopting customer strategies require supply-chain activities to be coordinated with and integrated into demand-chain activities, it is clear that managing customer relationships should no longer be thought of as a purely customer-facing set of business processes.[a] When an enterprise truly succeeds in its customer-specific initiatives, that critical business

(*continued*)

practice will impact virtually all the firm's processes, with customer-specific insight and action permeating the supply chain, the product development cycle, the financial systems, service delivery, and even the firm's organizational structure.

Trying to build a great relationship on top of a lousy product/service offering will never work, and may even hasten the product's demise. This is because the quality of your ad campaign is based on your ad agency's creativity and has nothing at all to do with the quality of your customer experience. In fact, nothing kills a bad product faster than great advertising! Without strong supply-chain capabilities, the CX will suffer.

The quality of your ad campaign is based on your ad agency's creativity and has nothing at all to do with the quality of your customer experience.

Once an enterprise truly embraces "building customer value" as a business practice, it will find itself compelled to drive every activity, every process, and every strategy around the customer. Everything that the firm *does*—every action it takes—eventually will revolve around the customer. Moreover, this process integration will extend even beyond the enterprise itself, allowing customers to serve themselves (and each other, using **crowd service**) in increasingly sophisticated and detailed ways and enabling channel members to configure, order, install, and service products according to the individual requirements or preferences of particular customers. Customized treatment of individual customers requires robust yet flexible processes that join demand chain and supply chain together.

[a]As Ginger Conlon puts it; formerly editor of 1to1 Media and the author of many blogs on this topic, Ginger serves as Thought Leadership Director at Genesys.

Not All Customization Is Equal

Management adviser Joe Pine literally wrote the (classic) book on mass customization.[10] He and his business partner, James H. Gilmore, have chronicled a business evolution—from creating standardized value through mass production to creating customer-unique value through mass customization. Pine and Gilmore have hypothesized four distinct approaches to mass customization:

1. ***Adaptive customization*** offers a standard, but customizable, product that is designed so that customers can alter it themselves. One lingerie company makes a slip that a customer can cut off in a finished way to make the slip the length they want.

[10]B. Joseph Pine II, *Mass Customization* (Cambridge, MA: Harvard Business Press, 1993).

2. ***Cosmetic customization*** presents a standard product differently to different customers. Catalog company Lillian Vernon encourages buyers to personalize backpacks and sleeping bags with a child's name.
3. ***Collaborative customization*** conducts a dialogue with individual customers to help them articulate their needs, identify the offering that fulfills those needs, and then make customized products for them. Ross Controls, a Michigan-based manufacturer of pneumatic valves and other air control systems used in heavy industrial processes in such industries as automobile, aluminum, steel, and forestry, learns about its customers' business needs so it can **collaborate** with them on precisely tailored designs.
4. ***Transparent customization*** provides each customer with a customized product or service without necessarily telling them about the customization itself. This is what the Ritz-Carlton does, when it configures a guest's stay based on the preferences the guest expressed during previous visits to the hotel chain. The guest who gets a hypoallergenic pillow in their room may not even be aware that this is customized service; they may think that their request was such a good one that now all the pillows in all the hotels have been changed to what they want.[11]

Notice that *adaptive* and *cosmetic* customizers offer customers a better way to get what they want, compared to a mere standardizer; but also notice that these customizers *have no memory* of the personalization they do offer, thereby requiring customers to begin the specification process again with the next order. And that next transaction will depend entirely on the customer for its initiation. Therefore, adaptive and cosmetic customization offer no real *sustainable* competitive advantage against a competitor offering the same thing.

In contrast, notice that *collaborative* and *transparent* customizers *maintain a distinct competitive advantage* because they *remember* what a customer wants and can therefore better predict what they will want next time—reducing the customer's need to make a choice. In many instances, the company takes a proactive role in offering to the customer what they're most likely to want next. The customer is able to get from a collaborative or a transparent customizer something they can't get elsewhere—even from a competitor that offers the exact same thing—unless they go to the trouble (and risk) of starting all over in a new Learning Relationship.

The customer is able to get from a collaborative or a transparent customizer something they can't get elsewhere—even from a competitor that offers the exact same thing—unless they go to the trouble (and risk) of starting all over in a new Learning Relationship.

[11] For more on the four types of mass customization, see James H. Gilmore and B. Joseph Pine II, "The Four Faces of Mass Customization," *Harvard Business Review* 75, no. 1 (January– February 1997), available at https://hbr.org/1997/01/the-four-faces-of-mass-customization, accessed August 31, 2021.

Gilmore and Pine say that many companies resist mass-customizing their offerings and instead manage the supply chain by placing more and more variety into their distribution channels and leaving it to buyers to fend for themselves. Manufacturers maintain large inventories of finished goods, and service providers maintain excess personnel and provisions to meet potential demands. These practices add costs and complexity to operations. Customers then must sort through numerous alternatives they don't want to find the one that most closely approximates what they do want. In many situations, a majority of buyers never do find an exact match for their own personal tastes; instead, they settle for the one that seems to be the best fit overall, considering both the positives and the negatives. Gilmore and Pine call this ***customer sacrifice***—it's also known as the **satisfaction gap**—the difference between what customers want and what they're willing to settle for. Producing greater variety in anticipation of potential, yet uncertain, demand often represents a last-ditch attempt to preserve the mass-production mind-set in the face of rapidly fragmenting markets, say Gilmore and Pine.[12]

An enterprise focused on building customer value, by contrast, brings information about an individual customer's needs directly into its operations in order to achieve efficient, on-demand production or provisioning. This effectively turns the old supply chain into the back end of a *demand chain*.[13] In this process, the firm diminishes the importance of product price in favor of *relationship value* (see Exhibit 10.2).

EXHIBIT 10.2 Supply Chain versus Demand Chain

Mass Production	Mass Customization
Supply chain management	Demand chain management
Economies of scale	Economies of scope
Make to forecast	Make to order
Speculative shipping costs	Goods presold before shipping
Inventory carrying costs	Just-in-time inventory

Requiring a customer to *choose* can be a burden on the customer. In fact, in the direct mail business it widely known that one way to *reduce* the response rate on a mailing piece is to introduce more options for a respondent to choose from! Customers don't really want choice. They just want exactly what they want, and if they have to

[12]James H. Gilmore and B. Joseph Pine II, *The Experience Economy* (Cambridge, MA: Harvard Business School Press, 1999); and Pine, Mass Customization.
[13]Paul Grefen, *Beyond E-Business: Towards Networked Structures* (New York: Routledge, 2016), p. 85–87; Pankaj M. Madhani, "Demand Chain Management: Enhancing Customer Value Proposition, *European Business Review*, March 10, 2013.

choose, then they will.[14] Usually. But the more decisions and choices required of a customer, the more effort the customer must exert—and the more friction the customer is encountering.

> Customers don't really want choice. They just want exactly what they want, and if they have to choose, then they will. Usually.

Mass customizers can adjust to changes in markets and technology easily, as they can rapidly shift their production, creating new products to accommodate changing environments. Fewer customer orders will be lost because mass customization always can, within overall capacity limits, build the products in demand. This contrasts again with mass-production factories, each of which has its own capacity limitations, which cannot usually be offset by excess capacity elsewhere in the company. Distribution based on lower inventory levels at a build-to-order factory can prevent shortages caused in distribution channels, resulting in fewer opportunity losses. And mass customization can identify potential manufacturing problems with particular configurations before the company invests in large-scale changes, reducing risk.[15]

Because customized products can be ordered with only the options customers want, customers will not be forced to buy a bundled package to get the one option they really want. Even at a premium price, customers may still save money by avoiding unwanted options.

The mass-customizing enterprise is driven by observing and remembering individual customer requests and by comparing them to what other customers have requested. The success of mass customization as a relationship-building tool stems from the fact that a customer can participate in the actual design and development of their own product. As a result of their own collaborative effort, the customer is much more likely to be satisfied with the overall performance of the product and to find it costly to start over with a competitor, even when that competitor could do the same thing the same way.

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[14]Don Peppers, "Increase Sales by NOT Giving Customers Choices," LinkedIn Pulse, October 10, 2012, available at https://www.linkedin.com/pulse/20121010175029-17102372-increase-sales-by-not-giving-customers-choices/, accessed August 27, 2021.

[15]Vicki Holt, "Five Expert Insights into Digital Manufacturing and Mass Customization," *IndustryWeek*, July 19, 2018, https://www.industryweek.com/technology-and-iiot/article/22025978/five-expert-insights-into-digital-manufacturing-and-mass-customization, accessed June 28, 2021; Stephen E. Chick, Arnd Huchzermeier, and Serguei Netessine, "Europe's Solution Factories," *Harvard Business Review* 92, no. 4 (April 2014): 111–115; and Anshuk Gandhi, Carmen Magar, and Roger Roberts, "How Technology Can Drive the Next Wave of Mass Customization," McKinsey & Company, February 2014, available at https://www.cob.unt.edu/itds/faculty/becker/BCIS5520/Readings/How_technology_can_drive_the_next_wave_of_mass_ customization_2014_02.pdf, accessed February 8, 2016. Also see H. Agbedo, "A Note on Parts Inventory and Mass Customization for a Two-Stage JIT Supply Chain with Zero-One Type of Bills of Materials," *Journal of the Operational Research Society* 60, no. 9 (September 2009): 1286–1291, for more on the realities of material management in the electronics and automobile industries, which have found mass customization most profitable.

Examples of mass customization abound in business today, both in business-to-consumer (B2C) and in business-to-business (B2B) settings. Navistar (previously International Truck & Engine Corp.) has used mass customization to learn more about its customers. It has introduced a custom truck configurator on the company's website, where prospective customers can create hundreds of different designs—providing important information about each designing customer in an industry where the manufacturer often has little contact with the buyer. Customers still need to buy from the dealer, but now even the dealer can know more about its customers' preferences before they buy. Serious website inquiries are sent to the dealer closest to the prospective client for direct follow-up.[16] Also, since the mid-1990s, Harley-Davidson has been encouraging bikers to design their own motorcycles using their online Customizer program, where they can create a custom design and take it to a dealer to build it.[17]

TECHNOLOGY ACCELERATES MASS CUSTOMIZATION

No matter how much value an enterprise adds, it is the value a customer adds for themselves makes a product or service worth a higher price. As the demand for personalized and customized products grows, improvements in technology have made it possible for more enterprises to offer build-to-order services, enabling customers to configure products to their own needs. Technology is enabling companies to meet their customers' demands through mass production, but in ways that offer people their own choice of products that are personalized and made to measure.[18] The web, for instance, has become an ideal tool for mass customization, precisely because *anything that can be digitized can be customized*. It permits consumers to submit their specifications online directly to the manufacturer or sales executive.

Capital One Financial Corp. developed a successful mass-customization model that changed the credit card industry.[19] The company is best known for gathering and analyzing consumer

> Anything that can be digitized can be customized.

[16] See company website at https://www.internationaltrucks.com/shopping-tools/build-your-own, accessed May 15, 2021.
[17] "Customized Bikes," Harley-Davidson, available at https://www.harley-davidson.com/us/en/shop/c/motorcycle-customized-bikes, accessed June 28, 2021.
[18] Gandhi, Magar, and Roberts, "How Technology Can Drive the Next Wave of Mass Customization," McKinsey & Company, available at https://www.mckinsey.com/~/media/mckinsey/dotcom/client_service/bto/pdf/mobt32_02-09_masscustom_r4.ashx, accessed August 27, 2021.
[19] See https://www.capitalone.com/credit-cards/benefits/, accessed August 31, 2021. Capital One, of course, mass-customizes products that take the form of digitized information and, in that sense, has an easier challenge than, say, an industrial manufacturer. But the same principles—modularization, closing the feedback loop, improvement through increased service levels at decreased cost to serve, and so forth—apply to both.

and customer data. Technology enables Capital One to observe and evaluate customer preferences and behavior and to do so dynamically, by **market segment**. The company can forecast trends and strategically shift its focus away from **commoditized** products, such as balance transfer cards, before the market is saturated with offers from competitors. Capital One planned for the obsolescence of balance transfer cards and plotted a course to move the credit card company into mass customization. This strategy enabled the firm to leverage its information resources to identify customers with low-limit, high-fee potential and to send these customers the marketing materials about products that would likely interest them, such as secured cards for people with poor credit. Using a database that contains the histories of all consumer interactions with Capital One enabled the firm to customize its credit card offerings.[20] This and thousands of other efforts to **decommoditize** their own products have paid off for companies who have used mass customization to shift their most common products away from price-driven competition.

It is the value a customer adds for herself that makes a product or service worth a higher price.

One technology that has begun to deliver real value with affordable customization is **3D printing**, a process that works somewhat in the way a laser printer works. A laser printer uses a laser beam to fuse a single layer of ink onto a single sheet of paper, while a 3D printer employs similar processes (including but not limited to lasers) to deposit many different layers, gradually building on top of one another to create a three-dimensional object. Today the list of commercially viable 3D printed products includes nuts, bolts, earbuds, eyeglasses, athletic cleats, jewelry, cremation urns, Star Wars figurines, and architectural models.[21] What's more, 3D printing has become so accessible that consumers themselves are 3D-printing things, both for their own use and to sell to others. A fully operational 3D printer can be bought at Amazon for less than $200 (about the cost of an inexpensive laser printer),[22] and pop-up stores in shopping malls now offer 3D selfies, so you can have a tabletop statue of yourself or your pet.

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[20]Capgemini Consulting, "Doing Business the Digital Way: How Capital One Fundamentally Disrupted the Financial Services Industry," 2014, available at https://www.capgemini.com/wp-content/uploads/2017/07/capital-one-doing-business-the-digital-way_0.pdf, accessed August 27, 2021. According to Serverside Group, customized cards have proven their ability to foster loyalty, reduce churn, and increase card utilization with front-of-wallet placement. Some of the results they tout for their bank and credit union clients include BBVA Compass Bank (54% account activation increase), American First Credit Union (68% increase in member usage), Newscastle Permanent Building Society (15% increase in customer acquisition rate), and BBVA Compass Bank (3% increase in customer retention), available at https://thefinancialbrand.com/35074/custom-bank-debit-credit-card-designs/, accessed August 27, 2021.

[21]Jerome Groopman, "Print Thyself," *New Yorker*, November 24, 2014, available at https://www.newyorker.com/magazine/2014/11/24/print-thyself, accessed August 27, 2021.

[22]"ANYCUPIC Photon Mono Printer," Amazon, available at https://www.amazon.com/ANYCUBIC-Photon-Mono-Printing-Monochrome/dp/B08HH329TR/ref=sr_1_5?crid=2HHH6O6B0G0GQ&dchild=1&keywords=3d+printers&qid=1630011835&smid=A2NFTZ4BL4JP2G&sprefix=3D%2Caps%2C235&sr=8-5, accessed August 26, 2021.

As Andrew McAfee and Erik Brynjolfsson relate in their groundbreaking book *Machine, Platform, Crowd: Harnessing Our Digital Future,*[23] with the right computer-directed instructions a 3D printer can create objects so complex that they would be virtually impossible to manufacture—not just on an assembly line, but even with handcrafting. For example, a 3D printer could print a mostly hollow but intricately honeycombed structure that is both incredibly strong and extremely light. And, because a 3D printer's lasers can fuse powdered metals as well as other, more malleable substances such as plastics, ceramics, wax, and even food, not only is complexity virtually free, but so is hardness, while each of these **benefits** is much more costly to achieve with a traditional manufacturing process. Large machines are even being used to print inexpensive housing. In 2021, a New York homebuilder placed the first 3D-printed home on the retail market in the United States, a 1500-square-foot home with three bedrooms and a garage, and listed at $299,000, or about half the price of a comparable newly built home in the area.[24]

One benefit of 3D printing, according to McAfee and Bryn, is that it facilitates faster and much less costly experimentation. "The path from idea or need to finished, useful part no longer has to include the time-consuming and expensive steps like mold making and other conventional manufacturing practices."[25] No need to build a prototype. This has stimulated a dramatic upsurge in individual entrepreneurialism, and 3D printing has become a big factor in powering the "maker movement," described in the *MIT Sloan Management Review* as "a cultural phenomenon that celebrates shared experimentation, **iterative** learning, and discovery through connected communities that build together, while always emphasizing creativity over criticism."[26]

When it comes to *treating different customers differently*, 3D printing has opened up a whole new arena of mass customization and extreme personalization. The ultimate in customization may be 3D printing of biological parts that allow custom-made, individually unique medical solutions—stents that fit exactly into a particular person's individual heart valves, for instance, or titanium plates that precisely replace damaged bones in faces, or knee implants, or teeth. And sometimes a 3D printed model of a patient's body part is used by surgeons for practice. As one cardiac surgeon explained,

> With current imaging techniques, surgeons have a fair idea as to what to expect before going to operate, but many times they have to 'explore' the heart at surgery to really find out the exact malformation and then plan the

[23]Andrew McAfee and Erik Brynjolfsson, *Machine, Platform, Crowd: Harnessing Our Digital Future* (W.W. Norton, 2017). See the discussion on 3D printing at pp. 105–107.

[24]"You Can Now Buy a 3D-Printed Home—Here's a Look Inside," CNBC, February 25, 2021, available at https://www.cnbc.com/2021/02/25/you-can-now-buy-a-3d-printed-home-heres-a-look-inside.html, accessed August 27, 2021.

[25]*Machine, Platform, Crowd: Harnessing Our Digital Future*, p. 106.

[26]"Lessons from the Maker Movement," *MIT Sloan Management Review*, March 27, 2018, at https://sloanreview.mit.edu/article/lessons-from-the-maker-movement/, accessed August 26, 2021.

operation at the spur of the moment. With the advent of 3D printing, one can do a CTA scan [Computed Tomography Angiography] of the heart with its three-dimensional reconstruction, which can then be fed into the 3D printer and a model of the malformed heart can be created. The surgeons can then study this model and even cut slices into it to plan the exact operation they will perform and save valuable time during the procedure itself.[27]

Affordable customization via 3D printing also allows industrial manufacturers to save costs by 3D printing spare parts and replacement items on demand. At one 63-year-old transmission manufacturing plant owned and operated by Ford, two engineers used a couple of 3D printers they obtained on their own initiative at a retail store to create replacement parts for assembly lines that regularly broke down, saving the company many hours of assembly line time and millions of dollars in costs.[28] The same 3D printers were capable of producing virtually *any* required items at the plant. During the COVID-19 crisis, for example, the assembly-line facility was briefly closed, before being re-opened as an essential business and requiring all workers to wear masks. A problem quickly developed, however, as workers complained about the comfort of the masks, with the straps hurting their ears after several hours of use. “So we immediately went into producing these straps as soon as we got back,” one of the engineers reported. As the crisis continued, the engineers heard that workers with long hair had complaints about the original strap design on the masks because their hair would get tangled up. “So we made another design. . .It’s smooth and flat on the back, so their hair doesn’t get tangled up in it.” To enable better flexibility, the mask straps were printed at a thickness of just 1 millimeter.[29]

Affordable customization via 3D printing allows industrial manufacturers to save costs by 3D printing spare parts and replacement items on demand.

Customizing physical products can yield a competitive advantage provided that the enterprise remembers each customer’s unique specifications and interactions. But because 3D printing technology converts a digital file directly into a physical object, the file is a complete representation of the object, and the file itself can be transmitted at light speed from one location to another, or to any number of other places, with the result that customized physical objects are soon likely to become more analogous to data and information. For the customer-strategy enterprise, this dramatic, technology-driven shift in the nature of production means that it will be each

[27]Syed Tasnim Raza, “Use of 3D Printing in the Medical Field,” Edge, available at https://www.edge.org/response-detail/26708, accessed August 27, 2021.

[28]Brent Donaldson, “Ford Is Saving Millions through 3D Printing (But Maybe Not How You Think),” *Additive Manufacturing*, July 21, 2021, available at https://www.additivemanufacturing.media/articles/additive-manufacturing-and-3d-printing-are-two-different-things, accessed December 13, 2021.

[29]Ibid.

customer's individual specifications and interactions that create the most value. By personalizing physical products, in other words, 3D printing can facilitate the creation of Learning Relationships with customers, but it will still be the customer's own personal needs and preferences that cement the enterprise's relationship with that customer.

By personalizing physical products, 3D printing can facilitate the creation of Learning Relationships with customers.

CUSTOMIZATION OF STANDARDIZED PRODUCTS AND SERVICES

When the executives of a company believe they can sell only standardized products, or easy-to-duplicate services, they may lament their inability to participate fully in the strategic payback of the customer relationship revolution. But to address this issue properly we should start by re-examining the chart in Exhibit 1.3 (from Chapter 1). This chart shows the two dimensions of competition—how many customers with a particular need that a company can reach (product-centric competition), and how many needs the company can address for a specific customer (**customer-centric** competition). And as the chart shows, while a product-centric enterprise tries to reach more customers who have some specific need, a customer-centric enterprise tries to increase the number of *needs* it can address for each individual customer it reaches. This is why share of wallet is inadequate to describe the customer-strategy enterprise's objective. The enterprise doesn't just focus on what share of a customer's current spending goes to satisfying an individual need; instead, the customer-centric enterprise, pursuing a *share of customer* objective, focuses on *every* need that a customer might have, and tries to increase not just the volume, but also the *number* of needs it can meet for the customer.

Often a company that may not see a way to customize a specific product can still customize what they offer to a customer by expanding the number or variety of needs they are meeting for that customer. In this way, even companies that cannot customize a specific product can still customize what they offer to a customer by first meeting a greater share of that customer's needs. A company with a commodity product or service can increase customer loyalty both by improving the overall quality and comprehensiveness of the customer experience, and by building Learning Relationships. It may be possible, for example, for a company to modify the product, add features to it, or combine it with other products. Or, in addition to its standardized product, an enterprise might be able to sell various additions, supplements, or ancillary services that enable a customer to receive more personalized attention, making it possible for their *collaboration* with the firm to benefit them.

The real key for an enterprise trying to find ways to tailor its products and services for individual customers is to visualize the product in its broadest possible sense—not simply as a physical product or one-time service, but as an object (or a service) that solves a problem, meets a need, or plays some role in the customer's existence. One widely cited Clayton Christensen article in the *Harvard Business Review* suggested, for instance, that we ought to think of products as being hired by customers to do a job.[30] So the task is to ask yourself, "What job is our customer trying to get done here," and then "How can we make that job easier for a customer to do, or cheaper, or faster, or better?" This is where a strict adherence to the discipline of differentiating customers by their *needs* will pay off. What a customer needs and what they buy are often two different things. But if an enterprise has a full understanding of the customer's own need, then it can often devise customized services or products to meet that need. Meeting the customer's need is the service being performed by the enterprise, and the product itself is the means for delivering that service, or for doing that job.

> Even companies that cannot customize a specific product can still customize what they offer to a customer by first meeting a greater share of that customer's needs.

We should think of this product-as-service idea in terms of three successively complex levels in the set of needs a customer is trying to meet (see Exhibit 10.3):

EXHIBIT 10.3 Expanded Need Set

CORE	PRODUCT-SERVICE	EXPANDED NEED SET
• Configuration • Size, fit, style • Features • Timing, frequency	• Billing, invoicing, cost control • Packaging, palletization • Logistics, delivery • Promotion, communication • Service operations	• Related products and services • Strategic alliances • Collaborative opportunities • Value streams

1. The *core product* itself includes its physical nature, if it is an actual product, or its component services and executional elements, if the core product is actually a service. Customizing the core product could include:
   - Product configuration
   - Features or capabilities
   - Fit and size
   - Color, design, style
   - Timing or frequency

[30]Clayton M. Christensen, Scott Cook, and Taddy Hall, "Marketing Malpractice: The Cause and the Cure," *Harvard Business Review* 83, no. 12 (December 2005): 74–83. (See Chapter 3.)

2. The *product-service bundle* includes all the services and features that naturally surround the core product. Customization of the product-service bundle could include:
   - Invoicing, billing, and cost management (i.e., helping the customer manage or control costs)
   - Packaging and palletization of the products
   - Promotion and marketing communication
   - Help lines and product support
   - Other additional services
3. And then there is what we call the **expanded need set,** which includes other product or service features that could meet related or adjacent customer needs, enhancing or expanding the customer's original set of needs. Activities undertaken to customize an expanded need set could include:
   - Offering related products or services
   - Forming strategic alliances with other firms serving the needs of the same customers
   - Providing the customer with opportunities to collaborate in product or service design
   - Offering **value streams** of services or benefits following the actual sale of a product or service (more on value streams later in the chapter)

In addition to the services and operations that naturally accompany a core product, most products and services can easily be associated with a customer's other, related needs. When a customer buys a car from a car dealer, for instance, they will likely need automobile insurance, loan financing, a good mechanic, and, possibly, a carwash subscription. Catering to an expanded need set means providing extra services to meet the customer's broadest possible set of needs. The deeper the understanding an enterprise has with regard to a particular customer's needs, the more likely that enterprise will be able to cement a Learning Relationship with the customer, earning the customer's loyalty not simply out of gratitude but also because it has become more convenient, more efficient, and perhaps even less costly for the customer to remain loyal. As long as they are certain their own interests are being protected, the customer will trust the enterprise with a greater and greater share of their business.

Think of this simple example: A grocery store certainly can't customize its store or the products in its stores to meet the preferences of individual customers. Everyone who goes into a store will experience the same store and see the same products. But grocery stores, drugstores, and other retailers have been able to customize their discounts and other offers to match the individual shopping needs of each customer. As mentioned in Chapter 5, the UK grocer Tesco started its Clubcard program, launched in 1993. And as of 2020, Tesco's program had more than 19 million members in its home country.[31] Each quarter these 19 million customers are sent literally millions of

[31]Tesco PLC 2020 Annual Report, available at https://sec.report/otc/financial-report/272297, accessed September 11, 2021. The Clubcard program also operates in Ireland, the Czech Republic, Slovakia, Hungary, and Poland.

different mass-customized discount and coupon offers, based on each individual customer's history and profile. So while Tesco's stores are absolutely the same for every customer entering them, the prices its customers pay for their products, and the promotional offers they receive, are all different. Within about ten years of its inception, the program had increased annual sales for Tesco by nine figures in British pounds.

Today, it's hard to find any retail chain or large independent retailer anywhere that doesn't offer some sort of loyalty program, designed not so much to buy customer loyalty with points, but to secure it by providing relevant, mass-customized discounts, based on a customer's past purchases. These discounts are provided either through the mail or (more commonly) at the till, or (even more commonly) via a mobile app. And to increase convenience, many online and brick-and-mortar pharmacies coordinate prescriptions so a household only has to order or pick up prescriptions once every 30 or 90 days.

As an enterprise broadens the definition of a customer's need and continually expands the need set, the product offering being considered will develop more features and nuances—qualities that will make customization more beneficial to the customer because different customers are likely to prefer different features. Remember that the more differences customers have in terms of their needs, the more benefit each customer will realize by engaging in a Learning Relationship. So the more an enterprise can expand the set of needs it is addressing for a customer, the more likely it will be to find those differences among its customers. Thus, when customers have more uniform needs, as is particularly true of companies selling commodity-like products and services, the customer-strategy enterprise should try to expand the need set, so that customers can be seen as more diverse in the way they individually define their needs.

Simply improving the general quality of the customer experience, delivered in basically the same way to all customers, can be competitively advantageous in the short term, but usually it won't yield a competitive advantage over the long term, because competitors will inevitably work to match such a general improvement. Instead, by customizing its offering a customer-strategy enterprise is working to improve the customer experience for *one customer at a time*. And this improved customer experience will be based on a collaborative, increasingly unique Learning Relationship with each customer, securing a long-term competitive advantage with respect to that individual customer that is based on a more and more detailed relationship ***context***.

In the final analysis, any enterprise that faces difficulty mass-customizing its basic products or services should seek to expand its customers' need set, looking for service and communication opportunities that will allow it to build in mass customization. Some of the things an enterprise can consider when it is looking for ways to customize a basic, commodity-like product would include:

- Configuration of the product or service
- Financing, invoicing, preauthorization, and payment terms
- Bundling of multiple products or services
- Packaging, delivery, logistics, and provisioning
- Repair, maintenance, calibration, and metrics

- Training, coaching, development, worker education
- Connecting or communicating with the product

One company illustrating this kind of thinking is SPAR, a €37B chain of 13,500 grocery stores serving 14.5 million consumers in 48 countries around the world.[32] Most of the stores displaying the SPAR brand name are owned and operated independently, so these retailers are SPAR's true customers. Besides uniting them all under the same brand name, SPAR's primary role for these outlets is to function as their B2B wholesaler, providing most—but not all—of the grocery products the stores sell to their consumers. And, as independent owners and operators of their own stores, SPAR's customers are free to take additional products from other wholesalers, so one of SPAR's most important business goals for each of its customer relationships is to maintain and increase its share of customer. In SPAR Austria, the company has begun preconfiguring its wholesale deliveries to each retail store in the same order in which the items are shelved *in that store*. So as the stock clerk rolls the trolley down the aisle at their store, they can effortlessly find the next items for the store's shelves, simplifying the process and saving considerable time and effort. Importantly, because each store has its own shelving plan, what SPAR has done by preconfiguring its deliveries is that it has customized the service of delivering its grocery products to each retailer (so put this in the category encompassing packaging, delivery, logistics, and provisioning).

In the category of connecting or communicating with the product, consider Evonik Industries (formerly Degussa Chemicals), a German specialty chemicals company. In the United States, Evonik sells a number of specialty chemicals that are used for improving the performance characteristics of concrete, for example. Most of Evonik's customers are construction firms and concrete producers with multiple, independently managed locations, and at each location where concrete is mixed, the chemical tanks for the additives are maintained by the site manager, who is responsible for ordering new chemicals when needed. One problem that plagued customers was when site managers forgot to monitor a chemical tank's level, and the customer would have to delay a mixing because it hadn't reordered the chemical in time. So Evonik developed a remote tank-monitoring system that uses wireless sensors to monitor tank levels and relay the data to a website accessible both to Evonik and the customer. Now the company can anticipate when replenishment is needed by each of its customers, reminding them when necessary, and ensuring that their chemicals are never inconveniently out of stock.[33]

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[32]SPAR company website, available at https://spar-international.com/, accessed August 15, 2021.

[33]Much of this discussion comes from Mark Vandenbosch and Niraj Dawar, "Beyond Better Products: Capturing Value in Customer Interactions," *MIT Sloan Management Review* 43, no. 4 (Summer 2002), 35–42. Vandenbosch wrote about Master Builders in 2002, but they changed their name in June 2004 to Degussa Admixtures. As cited in Don Peppers and Martha Rogers, Ph.D., *Return on Customer: Creating Maximum Value from Your Scarcest Resource* (2005).

As **cloud technology** and IoT continue to gain steam, the need to connect or communicate with the product will inevitably become stronger and ever more powerful for customer-centric competitors. Ordinary, "dumb" products are destined to become "smart," and as a result they will be more customizable. Moreover, the company that manufactures a product is destined to know and remember more and more about each customer who uses it—including how the customer uses it, when, and with what result.[34]

VALUE STREAMS

Some companies believe they have nothing to offer their customers to lead them to want relationships. When an enterprise is selling a commodity-like product, as we've seen, expanding the need set will help it find the leverage to strengthen its relationships with individual customers, who otherwise won't be as likely to want to participate in any sort of relationship beyond a single purchase transaction. And some products—even complex ones—may involve very long sales cycles, with infrequent or nonexistent repurchase likelihoods. How many times, for instance, will a consumer buy a new sofa for their living room? Or how frequently will a business customer contract to build a new multi-story headquarters building?

But there are *two* ways to generate more customer value after a one-time sale: Find another customer for the product you sold, and then another and another, to generate more and more single transactions. Or—much better—find a related stream of products and services you could offer in order to get a greater share of customer from each of the customers you've already acquired.

In other words, consider creating a stream of value behind the actual product sale. Often a value stream can be created for infrequently purchased products based on some type of follow-on service after the product sale. A furniture retailer could create a value stream behind its infrequently sold products by offering a regular annual upholstery cleaning service, for instance. This sort of subscription service would not only earn the retailer a little more revenue on each product, but it would also provide a regular schedule for reestablishing contact with the customer, maintaining the relationship. Or perhaps the retailer could offer the first cleaning without charge, and after visiting the home to perform a cleaning it could offer a more comprehensive service for several different items of furniture, most of which the retailer hadn't sold itself. Or it could sell the customer items of furniture that go with the original purchase, given the customer's total room arrangement. A clothing store could offer a dry cleaning or repair service for the clothing it sells. Customers who buy their suits from the store and pay an extra fee could have all of their dry cleaning, pressing, laundering, tailoring, and sewing done for the first year, perhaps. In each of these hypothetical cases, the enterprise would be increasing the revenue generated from a customer by expanding

[34]Michael E. Porter and James E. Heppelmann, "How Smart, Connected Products Are Transforming Companies," *Harvard Business Review* 93, no. 10 (October 2015): 96–114.

the customer's need set, and in the process it would be building an iterative, ongoing Learning Relationship with the customer.

> There are two ways to generate more customer value after a one-time sale: Find another customer for the product you sold, and then another and another, to generate more and more single transactions. Or find a related stream of products and services you could offer in order to get a greater share of customer from each of the customers you've already acquired.

A relatively new technology development, *cloud computing,* has generated a far more consequential opportunity for value streams during just the last 20 years or so, and has given enterprise software vendors reason to suddenly find religion when it comes to the importance not just of getting more customers, but of keeping them and growing them. In 1999, if a medium-to-large business customer wanted to install a new CRM system (or any other enterprise computing solution), then it had to buy it from a company like Siebel Systems, or SAP, or Oracle, then hire a system integrator to help configure and install it, a process that could take a year or more, with a cost that could run into millions, because the customer might also have to procure its own computer servers and other equipment on which to host the software for its workers to use. In addition, implementation projects like these were notoriously difficult to bring in on time and within budget. In fact, a large software and system implementation was often facetiously said to follow its own special Rule of Two, because "it will take twice as long and cost twice as much as you plan. And you'll have to do it two times." Moreover, once you committed to such a system implementation, there was no going back. If problems developed, or if you changed your mind, tough. You already had an immense stake in the process, and it would be seriously difficult to unwind it.

Today, however, a large enterprise client can gain access to a new software solution via cloud computing for much less money and hassle, because the software itself will run on the vendor's own servers. In fact, if you want to give your entire sales force access to an up-and-running enterprise CRM application today, as one industry expert said, you can literally go to the Salesforce website, "provide a credit card, get a login, and be putting accounts, contacts, and opportunities into the system in less than an hour."[35]

Salesforce offers its software via the **software as a service (SaaS) business model**, a model now used by virtually every business software vendor (and many consumer software vendors). SaaS products are delivered via a proliferating array of cloud technology platforms, including Amazon Web Services, Microsoft, and others, and today the very largest and most complex enterprise software solutions are very rarely sold in large, million-dollar increments. Instead, the customers for these

[35]Nick Mehta, Dan Steinman, Lincoln Murphy, *Customer Success: How Innovative Companies Are Reducing Churn and Growing Recurring Revenue* (Hoboken, NJ: Wiley, 2016), Kindle loc. 723.

software products subscribe to them, on a monthly or perhaps quarterly basis. By relying on cloud computing, in other words, the SaaS model has replaced these million-dollar, one-time-only financial commitments with value streams.

CUSTOMER SUCCESS MANAGEMENT

(See also Chapter 13.)

Among business customers, the SaaS model is highly popular because it doesn't require a company to install and integrate any big mainframe or server machines, or to do any upfront programming, or to keep up with the many updates required for maintenance, security, and software-modification purposes. With a Wi-Fi–connected smartphone or laptop, any sales executive, production manager, HR executive, or newspaper editor can remain fully functional, even at home, at Starbucks, or nearly any other gathering place.

> Value streams eventually lead to supplemental revenue streams for the enterprise. A customer is willing to pay for the ancillary product or service because it is valuable to *them*. But, meanwhile, the enterprise will be strengthening its ongoing relationship by exchanging information with the customer, as the value stream is delivered.

Importantly, if your company sells via the SaaS model, the dynamic of your relationship with a client has entirely changed, because the sale itself is no longer the most important goal. Instead, because your customer is *subscribing* to your software, rather than having had to invest a small fortune and then spend many months implementing and integrating it, if they want to quit your program for any reason they can simply stop paying their subscription fee. In other words, rather than the pipeline management, relationship development, and closing skills required to discover a sales opportunity, carefully nurture it, and then close the sale, the key to your business's profit now is to improve customer retention and growth, and to gradually increase your monthly recurring revenue.

To help you measure, manage, and improve client retention and growth, a new category of software has sprung up to help with **customer success management** (**CSM**). As a discipline, customer success management was pioneered by Salesforce,[36] for the simple reason that their highly successful new SaaS business model required it. CSM starts with the premise that a SaaS software vendor can easily track exactly how its clients are using its software on a day-to-day, hour-by-hour basis—because, of course, a SaaS client accesses the software on the vendor's own computers. So by observing how a client is or is not using its software, and what they are doing with it, a SaaS vendor can help the client improve their results and be more successful with the program. This is definitely in the vendor's interest too, because if a client isn't seeing much success with the program it can quit the service just as easily as it started.

[36]*Customer Success,* Kindle loc. 437.

CSM companies like Gainsight, Totango, and others, convert data about how a client is using a SaaS vendor's software into an array of dashboards, analytic insights, and prompts to help the vendor's own customer success (CS) managers educate and motivate each client, so the client can achieve the best results with the software product they are subscribing to. The customer success manager, operating at the vendor, relies on real-time data showing who at a customer has used the company's software or product, how frequently they've used it, how effectively, and over what period. Which departments and employees at the client are using the software, how frequently are they logging in, and what are they doing once they do? What could the biggest users teach others about how to get better outcomes and results? What mistakes are being made, and what practices might lead a client to achieve more success with the product? And above all, how much does it cost the vendor to procure yet another dollar of annual recurring revenue (ARR)?

Relying on this data, the vendor's CS managers can then undertake single-customer initiatives, multi-customer campaigns, and other actions designed to ensure that each customer achieves more business success with the product they're subscribing to, and that the vendor's ARR continues to increase. But to accomplish this goal the CS manager must usually enlist the help of product engineers, sales executives, distribution channel folks, marketing analysts and others within the vendor, because the actions recommended for a customer will often involve making tweaks to a product, modifying sales offerings, or doing other things that aren't strictly within the CS manager's own purview. And in various CSM forums, discussion groups, and case-study presentations, the constant need to coordinate and collaborate is one of the most frequently emphasized management issues. Over time, customer success data will flow not just to CS managers themselves, but also to many others within a vendor's organization, creating a rising general awareness of individual customer problems and issues. And for the most competitively successful vendors, this rising awareness is likely to drive a bottom-up, self-organizing effort to act in the interests of customers, one customer at a time. After all, why should a product engineer have to wait for some specific customer-success initiative, for instance, before taking action based on data showing that one of the company's product features is cumbersome to use, or rarely beneficial?

This represents a sea change in the way B2B software companies go to market. All the challenge used to be in the hunt, as a vendor pursued a large company and worked night and day to get it to agree to an expensive and time-consuming installation. Once the contract was finally signed and the installation began, however, the customer was pretty much locked in. Getting out of the relationship was just as difficult as buying into it, if not more so. Being successful with the product—that is, getting good business results with it, became the client's problem, not the vendor's. But today, rather than big one-time purchases, these large software capabilities are purchased largely by monthly subscription, and as with any subscription product, the most important **key performance indicator** for the vendor is not how many new customers it can acquire, but how long it can keep those customers and how big it can grow them.

This is why customer success has become such a critical business function. When the purchase process is a continual, every-month decision, any problem can be fatal to the relationship, and the single most important metric for the *vendor* is the degree of business success a *customer* is experiencing with the vendor's product. Success is even more important, to a business customer, than satisfaction! Guy Nirpaz, CEO of Totango, pointed this important strategy out to us during a meeting in his office, when he said one of the key differences between selling in B2B as opposed to B2C is that, in the B2B world, success always trumps satisfaction. To illustrate the point more persuasively, he drew a matrix (Exhibit 10.4) with the level of customer satisfaction along the vertical axis and the level of customer success on the horizontal axis. He said that of course everyone would prefer to be in the upper-right quadrant, with high customer satisfaction as well as high business success. And no one would want to be in the lower left, with low satisfaction and low success.

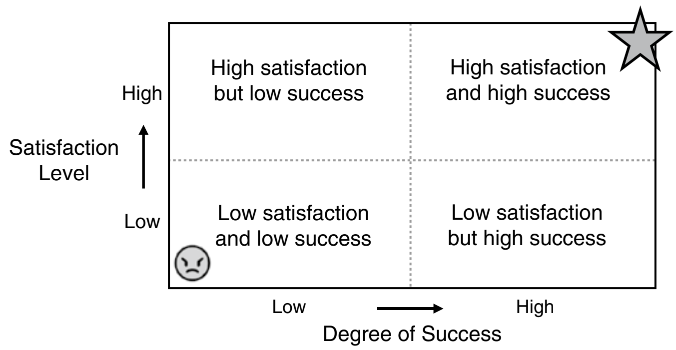

EXHIBIT 10.4 What Would a Business Choose: Satisfaction or Success?

But which quadrant would be preferred if the upper right were not possible? Would a company be happier with high customer satisfaction but low business success? Or with low customer satisfaction but high business success? If you have to think about the right answer to this for more than one second, then you've never held a position of authority in a for-profit business, because the objective in every case will be high business success, *even if* customer satisfaction has to be sacrificed. Simply put, when a business customer is achieving good business results with the product, it is likely to stay loyal longer, buy more, and cost less to serve. Nothing is more important to any business than that the business itself succeed. So the key question for customer success managers is whether the customer is able to achieve the business results it wants with the software. Once a company starts selling its product as a service, Michael Porter said, "The goal of salespeople becomes customer success over time, instead of just making the sale. That involves creating 'win-win' scenarios for the customer and the company."[37]

[37]Michael E. Porter and James E. Heppelbaum, "How Smart, Connected Products Are Transforming Companies," *Harvard Business Review,* October 2015, available at https://hbr.org/2015/10/how-smart-connected-products-are-transforming-companies, accessed August 27, 2021.

It should come as no surprise that so many companies have established formal customer success management functions, particularly in the B2B SaaS category. Because in the days of selling a large, one-time-purchase enterprise software package to a business customer, the most important task for the vendor was getting the customer to sign on the dotted line, *now please*¸ committing once and for all to the high expense and serious effort required to bring that software package live and make progress with it. But today, when they are selling a value stream to a business customer, the most important task for the vendor is to ensure that the customer continues to *succeed* with that value stream, so that it continues to have value. (See Chapter 13 to see how CSM affects the management of the sales department within the customer-strategy organization.)

The Challenger Model

Moreover, the fact that a business customer will always choose success over satisfaction leads to another very important lesson about the CSM discipline: Sometimes client success can be facilitated by client dissatisfaction, or by making the client uncomfortable.

> Sometimes client success can be facilitated by client dissatisfaction, or by making the client uncomfortable.

Near the beginning of his marketing career, Don worked for the highly creative ad agency Chiat/Day, famous for ground-breaking advertising campaigns such as Apple's legendary Superbowl commercial "1984" that launched the Macintosh computer, and years later was named by both *Advertising Age* and *TV Guide* as "the greatest commercial of all time."[38] The late Jay Chiat, the agency's founder, always encouraged his executives to push a client to the absolute limit of their tolerance, because genuinely breakthrough creative messaging would be far more memorable and effective. He was fond of saying that no idea is truly creative unless "it makes the blood drain from the client's face."

In a similar and more updated vein, to be effective, a customer success manager must use the data and insight available to challenge the customer with new thinking and bring them new ideas that might upset the existing way of doing things, in order to make it possible for the customer to achieve more success—in effect, sacrificing customer satisfaction to achieve customer success. Often a business customer will be so focused on the way they've always done things that they'll have difficulty imagining new opportunities, so the expertise that a customer success manager brings to the table with respect to the product's capabilities can be a valuable body of knowledge. Innovation and change are fundamentally subversive activities in any existing organization

[38]Steve Johnson, "What You Didn't Know about Apple's '1984' Super Bowl Ad," *Chicago Tribune*, February 2, 2017, available at https://www.chicagotribune.com/entertainment/tv/ct-apple-1984-ad-myths-ent-0205-20170201-column.html, accessed August 18, 2021.

and challenging the status quo will often lead to some dissatisfaction, if not outright annoyance, on a client's part. But posing an unwelcome challenge to the status quo is sometimes the best way to improve your client's success.

One years-long study involving how thousands of B2B sales reps performed, as rated by their sales managers and **cross-correlated** against 44 different **attributes**, found that by far the most successful kind of salesperson was a type the study authors labelled a challenger, someone who understands the customer's business well, but who debates with and pushes a client, and often shows the client a different view of the world.[39] This sort of salesperson, the study's authors suggest, is better able to address the client's needs and sell solutions to the client's problems, which is a far more effective approach in today's modern, highly complex and information-based economic system. And there's no better way to approach the task of ensuring that a SaaS client continues to be successful with the software they are subscribing to. In the words of the study's authors, "If you truly want to build a 'customer-centric' organization, then you're actually going to have to build an insight-centric organization—a commercial enterprise specifically designed to generate new-to-the world insights that teach customers to think differently not about your products and solutions, but about their business."[40]

We've already seen that the SaaS business model, based on selling a value stream rather than a one-and-done product, has led to the development of a whole new management discipline, customer success management, designed to enable competitive B2B businesses to support and improve their customer relationships, one customer at a time. But as the IoT connects a wider variety of ordinary products and services to the web and becomes a more pervasive aspect of consumer lives, we can expect a similar development even among B2C companies.

In February 2019 Nike introduced a self-lacing, smart athletic shoe, the Adapt BB. It came with its own smartphone app, for both iOS and Android. The left and right shoes could each be independently tightened or loosened via just the swipe of a finger, or by talking into the app on your phone or your Apple watch. Unfortunately, however, the Adapt BB shoes were plagued with software problems from the very beginning. A mere four days after their release, Ars Technica published a story detailing how the Android version of the shoes' app failed repeatedly and often simply shut down entirely.[41] It's highly likely that Nike's customer experience team (if it had one) didn't have the same level of hands-on involvement in the development and testing of this new product as its software team had. And it's certainly not the only smart product that's ever had problems, nor will it be the last. But it does raise an interesting issue with respect to what kind of customer relationship will characterize products in the

[39]Matthew Dixon and Brent Adamson, *The Challenger Sale: Taking Control of the Customer Conversation* (Portfolio, 2011).

[40]Ibid., Kindle loc. 2693.

[41]Ron Amadeo, "Nike's Self-Lacing Sneakers Turn into Bricks after Faulty Firmware Update," Ars Technica, February 21, 2019, available at https://arstechnica.com/gadgets/2019/02/my-left-shoe-wont-even-reboot-faulty-app-bricks-nike-smart-sneakers/, accessed August 27, 2021; and Nike, "What is Nike Adapt," available at https://www.nike.com/adapt, accessed August 19, 2021.

future, as the Internet of Things becomes all-encompassing, and even consumer products are sold as value streams. As increasing numbers of consumer products get connected to the net, the manufacturers of those products are going to have to figure out how to ensure their consumers' success with the products in much the same way SaaS businesses now do, with respect to their clients.

CULTURE RULES

Mass customization, as we have discussed throughout this chapter, involves configuring a product or service by digitally combining a number of different modules representing premanufactured, or preconfigured, components. The business processes that result in a product or service being rendered for a customer in a certain way, or the boosters, filters, and other algorithms that render different online or in-app interactions with different customers, can also be thought of as modules to be combined as the enterprise mass customizes the individual customer experience. And the instructions are business rules that an enterprise follows in configuring different processes so as to *treat different customers differently*. Moreover, because it is done in a mass-customized way, the company is essentially *automating* these processes in order to render its products and services more cost-efficiently.

But while mass customization makes a lot of intuitive sense, aren't there still some situations that won't be covered by an enterprise's various modules and business rules? What happens when a customer presents some problem or need for which there is no valid, preconfigured set of solutions that can be rendered in a cost-efficient way? An enterprise can automate the contact report a sales rep has to file, or it might be able to 3D print that spare part, but no smartphone app can look into a client's eye and judge whether the time is right to push for the sale or to ask another question first. And likewise, no enterprise can write a business rule that requires employees to delight customers. The employees themselves have to *want* to do that. The secret sauce behind treating different customers differently, and maximizing the value they create for an enterprise, is the enterprise's **culture**—the unwritten rules and unspoken traditions that define how employees actually approach their jobs. This is what guides employees when there is no pre-configured module, no existing policy, and no applicable business rules. Culture is what employees do when no one's looking.

This is a very important topic, and we will be addressing it in more depth in Chapter 14.

> Culture is what employees do when no one's looking.

TECHNOLOGY'S REAL RAINBOW: COLLABORATIVE LEARNING RELATIONSHIPS

The payoff for enterprises that engage in customization is twofold. In most cases, by employing automation and business rules to mass-customize its products or the delivery of its services, the enterprise actually can reduce its unit production costs, on an all-in basis, essentially because it will only make those goods that customers will have already bought. More important, however, customization will enable the enterprise to engage in a *collaborative* Learning Relationship with each customer.

Instead of expecting a customer to use what *they* know about a company to figure out what they should buy, the **customer-focused** enterprise uses what *it* knows about the customer to figure out what they genuinely need. In the process, such an enterprise increases the number of transactions it gets from a customer, makes it progressively easier for that customer to come back to that enterprise for purchases and service, and likely increases the profit per transaction.

Our story of managing customer experiences and relationships in the interactive era now takes a turning point. We have laid the foundation of relationship theory and provided a comprehensive examination of each of the four tasks of the IDIC methodology. We have shown the importance of Learning Relationships and the sensitive issues related to privacy protection. We have peeked at the technical tools that help to accelerate the relationship management process and reinforced how technology does not, and should not, manage customer relationships alone.

In Part III (beginning with Chapter 11), we begin to look at what it means to manage the customer relationship process. We discuss the challenges an enterprise faces in measuring and maintaining a customer-based initiative and look at the quantifiable metrics associated with managing customer experiences and **Return on Customer**. We delve into the science of **customer analytics** as a method to predict each customer's behavior and anticipate their needs so they will be treated the way they want and remain a customer. Finally, we show how managing an enterprise that grows through building customer value requires a number of different infrastructure changes that will need to be addressed by managers who fully understand and support the underlying concepts we have been discussing so far—and so much more that we have yet to discuss.

Part II: Food for Thought

1. You're the marketing director for a small chain of retail stores with a long and proud history, but your company is now finding it difficult to compete with Amazon and other digital rivals. You do have a (relatively new) e-commerce offering that seems popular, and it now accounts for nearly 30% of overall sales, but you'd also like your company to be able to relate to customers more individually, as they shop in retail stores. Unfortunately, you don't even know the identities of these shoppers, because they simply come into your outlets and buy things (or not), and then leave. Some of your best salesclerks know and remember a few high-value customers personally and, as a result, these customers seem to be more loyal. How could you go about identifying your retail customers so that you can track their purchases and interactions in your stores, and how would you use their identities to improve the customer experience and generate more business, both online and in-store?
2. Now let's get specific: If you ran a simple storefront business—say, a hardware store—how might you identify your individual retail customers, in such a way that you could track each customer's patronage with you, over time? If you were to take over management of the store, and there was no database or other record of regular customers, how might you identify at least your most valuable, regular customers?
3. When you order ahead at Starbucks, using the company's mobile app, Starbucks has identified you as a customer. The company's computers can tell what your usual order is and prompt you. Does this feel like it threatens your privacy? Or does it feel like it streamlines your experience? Why? Does it make Starbucks worth more or less to you?
4. If you worked at a consumer packaged goods company and sold your products through groceries, drugstores, and convenience outlets, how might you go about identifying at least some of the individual consumers who go into these stores and buy your products? Might there be a way you could entice your customers to come to your website and identify themselves?
5. What will encourage customers to agree to be identified and recognized? Consider the answer for several different kinds of companies.
6. Why is it not enough to consider average customer value?
7. How often should actual value be calculated? Potential value? Why?
8. Search the internet for a company that has successfully "fired" customers in the past. If you were facing a detractor—someone who said that it's wrong to treat different customers differently—how would you defend "firing" customers in this reported or even a hypothetical instance?
9. What policies are successful and what policies are likely to create mistrust? What are likely to be the best measures of actual and potential value for each of the listed customer bases? How would you confirm that your answer is right?

Would the company likely be best served by proxy or statistical/financial value analysis?

- Customers for a B2B electronics components distributor
- Customers for a dry cleaner
- Customers for an automobile manufacturer; for an automobile dealer
- Customers for a chemical supply company
- Customers for a discount department store
- Customers for a large regional supermarket chain
- Customers for a long-haul trucking company
- Customers for Disney World; for Six Flags; for Club Med
- Customers for CNN; for HBO (Caution: They're different. CNN sells viewers to advertisers while HBO sells programming to viewers.)
- "Customers" for a political campaign; for the American Cancer Society; for NPR (formerly National Public Radio); for Habitat for Humanity

10. For each of the companies listed in Question 9, what's the next step? How does a company use the information about customer value to make managerial decisions?
11. Amazon tries to find products for customers and uses data to deduce individual customer needs and predict what they will need next. How does the product maker compete?
12. What else should be added to the list of data bullet points on pages 137 and 138?

    What additional ways are there to assess a customer's potential value as referenced on pages 143 and 144? Why has more progress been made on customer value differentiation than on customer needs differentiation?
13. If it could only do one, is it more likely that a customer-oriented company would rank all of its customers differentiated by value or differentiate all of its customers by need? Why?
14. Is it possible to meet individual needs? Is it feasible? Describe three examples where doing this has been profitable.
15. For each of the listed product categories, name a branded example, then hypothesize about how you might categorize customers by their different needs, in the same way our example companies did in this section of the book. Unless noted for you, you can choose whether the brand is business (B2B) to consumer (B2C):
    - Automobiles (B2C)
    - Automobiles (B2B, i.e., fleet usage)
    - Air cargo (B2B)
    - Cosmetics
    - A mobile phone carrier
    - Zoom
    - Microsoft (B2C)
    - A retail cannabis store

What problems might occur if an enterprise participates in customer dialogues but its own information and data systems are not integrated well? Do you remember any personal experience in dealing with a company or brand that could not find the right records or information during your interaction with it? How did this make you feel about the company? Did you feel the company was less competent? Less trustable?

What are some of the explicit bargains companies have made with you in your role as a customer to get some of your time, attention, or information?

How does the European book club mentioned in Chapter 8 ("Complaining Customers: Hidden Assets?") actually *know* it was the calling program that led to 6% fewer dropoffs and 8% more sales per member? Might it not have been the book selection that year? Or the economy? (Hint: It really did know it was the calling program, but *how*?)

16. When you plan to buy a product and want to investigate its benefits and drawbacks, whose advice do you seek? Do you think the advertiser will tell you about the drawbacks, or just the benefits? If you are trying to evaluate the product by researching it online, do you have more confidence in it if the seller makes other customers' reviews available? What if you read a negative comment? Might you still buy the product?
17. You've been appointed as the new chief marketing officer (CMO) for a large packaged-goods company. Your CEO has decided that your company will be the premier relationship company in your industry.
    - What could that mean?
    - How will you execute that?
    - What will you use as data collection tools?
    - What role will interactivity play in your plans?
    - What role will email play? Mobile devices? Social networking platforms?
    - Be as specific as you can.

    Now answer the same questions for the following companies:
    - An automotive manufacturer
    - A natural gas company
    - A retail shoe chain
    - A company that makes pneumatic valves for construction
    - The U.S. Navy
    - Other kinds of organizations (you decide)
18. Do you know anyone who has created and played a game of their own creation using Roblox? If you have done so, have you ever played a Roblox game created by someone else?
19. You're holding a Delta ticket to Anchorage, but the last leg is on Alaska Airlines. When you have a problem with that last flight of the journey, Delta disavows any responsibility, even though the ticket and flight number are branded Delta. What went wrong here and how can it be fixed?

20. Interaction in any of its forms, and in either direction is almost always visible to customers. Can you think of any instances in which interaction is invisible? Have you ever noticed that a lot of companies respond very slowly to an email query or complaint, and much faster on Twitter or Facebook? Why is that? Could it backfire?
21. Will a company need prior research to build a Golden Question that yields high predictability? Why or why not?
22. Who owns a customer's information?
    - Who should profit from it?
    - How would that work?
23. Is anonymity the best solution to privacy?
24. What is the difference between privacy and data security, and how should that difference affect the way we use customer data?
25. Compare the situation of Big Business versus Big Brother having detailed information about you.
26. On the topic of privacy, the real commercial questions are these:
    - What do we need to know to serve a customer better and make them more valuable to us?
    - What information do we really need to know that?
    - Once we get that information, how do we balance distribution at the front lines with the need to protect a customer's privacy?
    - What are the limits in how we will share or distribute data?
    - How will we protect and secure the data?
    - How do we build privacy and trust into our profitability strategies?
27. What greater assets do any company, online or off, have to dangle in front of other companies than the private data of thousands, or even millions, of customers? Do the rules change when a company is bought out or goes bankrupt? What happens to a company's privacy pledge when there no longer is a company? And what guarantee is there that the new owner of your data will honor the same privacy standards as the former owner?
28. How will Lego practice mass customization? To think about mass customization for Legos, consider:
    - Who are the customer types for Lego? (Think retailers, B2B.) Who are the MVCs? The most growable customers (MGCs)? The below zeros (BZs)? (See Chapter 6.)
    - What are customers buying when they buy Legos? (Hint: It's not toy building bricks.)
    - If customers buy packages of Legos to resell, what else do they need? What is their expanded need set?
    - What is the opportunity to lock customers into a Learning Relationship and build share of customer for Lego?
    - Is there any opportunity, ever, at all, for Lego to build Learning Relationships with any end user? How and why?

29. If mass customization is such a good idea, why don't we see more of it in the marketplace right this minute?
30. Name half a dozen examples of mass customization or expanded needs sets in the enterprises where you do business.
31. Imagine the 3D photography tied to 3D color printing that allows the creation of individualized tabletop sculptures of customers themselves, their children, and their pets. Although the product has immediate commercial promise, the real question is how a company as well as a customer could benefit from having this data stored about individuals. What are some ancillary applications?
32. You're the newly hired marketing director at West-Drug, a regional drugstore chain of 150 stores. You have a loyalty program with several thousand members, who account for about two-thirds of your sales.

    In a market research project, you survey more than 3,000 randomly chosen consumers in your area, including West-Drug's customers and those of your principal competitors (CVS, Rite Aid, and Walgreens). You learn that West-Drug's average customer satisfaction rating among all consumers is 3.1 on a 5-point scale, while your competitors have average ratings of 4.2, 4.3, and 4.7.

    Digging further, you see that your average satisfaction score is low primarily because West-Drug's proportion of very low 1 and 2 ratings is roughly twice as high as that of your competitors. From this you deduce that West-Drug must have a much higher number of plainly dissatisfied customers than your competitors do. What steps would you take to begin improving the overall reliability and quality of West-Drug's customer experience?

33. You are the new chief marketing officer for PDQ Golf, a network of 15 publicly accessible driving ranges throughout the state. Every week, each of your driving ranges serves 1,000–2,000 golfers, who pay by the hour. Most of your regular customers bring their own clubs, but about a third of your customers choose to rent clubs from PDQ Golf. All renters need their own sizes (they can choose from 12 sizes, including children's sizes), and about 10% of the renters need left-handed clubs. You also operate a bar and grill at every driving range, and a golf shop for shirts, caps, gifts, and accessories. The merchandise, snacks, meals, and drinks you sell account for almost 50% of your overall revenues.

    You do your best to accommodate all your customers, but you have no idea who they are, which ones are more valuable, which ones might need more particular services, or what they buy in the store or the bar and grill. Your customers simply come in, pay for the range and for any equipment or products they need, and whatever food or drinks they consume from the bar and grill.

    - How might you go about identifying your customers so that you can remember them from interaction to interaction?
    - Once you're successful at identifying all or most of your customers, how might you rank them by their value to you?
    - And how might you differentiate your customers by their needs?

34. Geek Squad (founded in 1994) was bought by Best Buy in 2002, and ever since then it has served as a service arm for the consumer electronics retailer. Its computer and electronics service people are based at every Best Buy retail location. Geek Squad is also deployed to help customers install, maintain, and operate computers, TVs, home theaters, connected appliances, audio systems, and the like. A significant portion of Best Buy's computer purchasers consist of small and medium-sized businesses (SMBs), ranging from independent freelancers to multimillion-dollar firms selling accounting services, consulting, retailing, light manufacturing, and other services.

    What different *needs* would you expect Best Buy's different SMB customers to have for Geek Squad services?

    As an example, accounting firms and lawyers, who deal with more valuable, personal, and sensitive information, and would need extra help with anti-hacking protections and other services to maintain data security.

35. You run a grocery distribution company. Your big customers are the independent store operators who use your brand on their storefronts and take delivery of your grocery products. You want to earn a higher share of each of these customers' business done with you. What can you do to *collaborate* with your customers and lock their loyalty in?
36. You run a toxic-waste disposal company. Your big corporate clients are in a dozen different locations, all around the country. It's a dirty business, and who really wants to talk to you about sewage and biohazards? You want to earn a higher share of each customer's business. How might you collaborate with your customers and lock in their loyalty?
37. Suppose you own and operate a local carwash, and you have about 20 employees who rotate shifts, polishing, vacuuming, cashiering, and so forth. Customers drive their cars to your carwash, and order and pay for the wash that they want (standard, deluxe, supreme, wheels-only, etc.). After paying, they drive their cars up to the entrance, ride through the wash, wait for the towel drying workers to finish, and then drive away. You know some of your customers must be far more valuable than others, in terms of their frequency and their wash options, and you want to single them out for even better service.
    - What could you do to identify your MVCs?
    - And what might you do for them, if you could identify them?
38. You are the vice president of marketing for Agilent Technologies. They sell test and measurement equipment to B2B clients, including things like chromatography, mass spectroscopy, and instruments for clinical, biological, and other purposes. Some of your clients are extremely large and still have growth potential (super-growth customers), but they can often be demanding, and frequently hammer your prices down to levels that are not profitable or just barely profitable.

What are some strategies for improving your relationships with these kinds of customers so that they might be more profitable for your business?

39. Your firm is a packaged-dessert maker with limited ad budget, and you sell through supermarkets and convenience stores. As a packaged goods company with a limited range of items, you have to respect your distribution system. In the short term you will concentrate on creating relationships with the stores and store chains that carry your product. However, in the long run you want to identify more of your end-user consumers and to create practical, ongoing relationships with the most valuable of them. What are some ways you can build your business without undermining your important relationships with your primary distribution channel, the stores and store chains?

PART III

Making It Happen

CHAPTER 11

Measuring and Managing to Build Customer Value

We've long felt that the only value of stock forecasters is to make fortune tellers look good. Even now, Charlie [Munger] and I continue to believe that short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grown-ups who behave in the market like children.

—Warren Buffett

Customer relationships cannot be installed; they must be adopted. And building customer value requires process, organization, technology, and **culture** management. It has been a shift in strategy after 100 years dominated by **mass marketing**. The management of **customer experiences** as a way to get a greater share of each customer's business and to build the **value of the customer base** is a journey, not a destination.

Our story of managing customer experiences and relationships in the interactive era now takes a turning point. We have laid the foundation of relationship theory and provided a comprehensive examination of each of the four tasks of the **IDIC methodology**: **identify**, **differentiate**, **interact**, and **customize**. We have shown the importance of developing **context** in **Learning Relationships** and the sensitive issues related to privacy protection. We have peeked at the technical tools that help to accelerate the relationship management process and reinforced how technology does not, and should not, **manage customer relationships** alone.

Beginning here with Part III, we will look at what it means to manage the customer relationship process. We discuss the challenges an enterprise faces in measuring and maintaining a customer-based initiative and look at the quantifiable metrics associated with managing customer experiences and **Return on Customer** (**ROC**). We delve into the science of **customer analytics** as a method to predict each customer's behavior and anticipate their **needs** so they will be treated the way

(*continued*)

they want and remain a customer. Finally, we show how transforming into an enterprise that grows through building customer value requires a number of different infrastructure decisions that will need to be addressed by managers who fully understand and support the underlying concepts we have been discussing so far—and so much more that we have yet to discuss.

> Customer relationships cannot be installed; they must be adopted.

Traditional marketing measures such as response rates, cost per thousand (CPM), gross ratings points (GRP), and awareness levels help a company understand how successful a "campaign" has been or how successful or efficient a particular message is, on average, in reaching a target market. But when using interactive technologies and dealing with customers one at a time, the key task most marketers face is *how* to optimize the enterprise's behavior around individual customers rather than products. Optimizing the enterprise around a customer is the problem confronted whenever a firm is trying to decide how to design a website, how to define objectives and scripts for a contact center, or how to frame the selling strategy for a face-to-face meeting with a customer. The question being asked in these situations isn't, "What's the best overall message for this particular product, when talking to everyone?" but "What's the best message for this particular customer, during this particular interaction?" As we learned in the chapters on IDIC (Chapters 4–10), the **customer-centric** competitor hopes that by optimizing the enterprise's behavior around a particular customer during a particular interaction or event, the firm will be able to maximize the value created by that customer. This includes not only the short-term, current-period value created by immediate product sales or costs generated, but also the long-term value created by changes in the customer's predisposition toward the brand.

Customers create long-term value because they have memories.[1] Each customer's decision whether to buy from a business today will be based at least partly on their memory of any past experience they've had with the firm, or perhaps on their impressions of it based on their friend's past experience. The important thing is that every time a customer has an experience with any business, their intention or likelihood of buying from that business in the future is liable to change. Nice experience? Likely to buy more later. Might even talk about the brand with a friend or online. Bad experience? Likely not to buy much in the future. Also might criticize the brand to a friend or to a bunch of people online.

[1]This discussion originated in Don Peppers and Martha Rogers, *Rules to Break and Laws to Follow: How Your Business Can Beat the Crisis of Short-Termism* (Hoboken, NJ: John Wiley & Sons, 2008) and *Return on Customer: Creating Maximum Value from Your Scarcest Resource* (New York: Currency/Doubleday, 2005), here updated for 2022.

Although this is not a textbook on accounting or economics, nevertheless it's important to remember that the actual economic value of any business enterprise can be measured in terms of the discounted net present value (**NPV**) of the future stream of cash flow that the enterprise is expected to generate. So when a customer's likelihood of buying in the future changes, or when their likelihood of sharing their experience with a friend changes, the company's likely future cash flow also changes—which means that the company's actual economic value goes up or down as a result of the customer's changing frame of mind. This is the long-term component of the value that customers create. (See our introductions to Return on Customer in Chapter 2 and customer **lifetime value (LTV)** in Chapter 6.)

For the overwhelming majority of companies, this kind of value creation (or, sometimes, value destruction) is not captured in the financial statements. Note, however, that the customer experience driving an increase or decrease in the enterprise's value occurs in the present. Although the firm may not realize the cash effect for days or weeks or months, the value itself is created or destroyed today, with the customer's current experience. Moreover, this is happening whether marketers at the enterprise think about it or not and whether they try to measure it or not. Even though the financial systems of most firms don't recognize the long-term value constantly being created or destroyed by the individual current experiences of their customers, the financial metric that we introduced in Chapter 6, customer lifetime value (LTV), is specifically designed to capture it. To reprise the concept, a customer's LTV is defined as the net present value of the future stream of cash flow attributable to that customer. It therefore directly represents the long-term financial benefit of a customer's continuing patronage. When the customer becomes more predisposed to buy from the enterprise, their LTV will increase. When the customer becomes less enamored with the enterprise's brand, their LTV will decrease. As a result, the increases and decreases in a customer's LTV can be thought of as the direct, dollars-and-cents quantifications of the long-term value created or destroyed in particular customer interactions.[2]

[2]The work in this area is way too lengthy to try to list it all here. V. Kumar has been one of the leaders in the work on measuring the profitability of customers and calculating lifetime value. See V. Kumar and Bharath Rajan, "Chapter 28: Customer Lifetime Value: What, How, and Why," in *The Routledge Companion to Strategic Marketing*, Bodo B. Schlegelmilch and Russell S. Winer, eds. (Taylor & Francis, 2020); Sarang Sunder, V. Kumar, and Yi Zhao, "Measuring the Lifetime Value of a Customer in the Consumer-Packaged Goods Industry," *Journal of Marketing Research* 53, no. 6 (2016): 901-21; V. Kumar and Werner Reinartz, "Creating Enduring Customer Value," *Journal of Marketing* 80, no. 6 (2016): 36-68; and V. Kumar, *Profitable Customer Engagement: Concept, Metrics, and Strategies* (New Delhi: Sage, 2013) for chapters on customer lifetime value, customer referral value, customer influence value, customer knowledge value, and how to integrate all of them. Also see V. Kumar and Werner Reinartz, "Customer Analytics Part I" and "Customer Analytics Part II" in *Customer Relationship Management: Concept, Strategy, and Tools*, 89–141 (Heidelberg: Springer, 2012); and Morten Holm, V. Kumar, and Carsten Rohde, "Measuring Customer Profitability in Complex Environments: An Interdisciplinary Contingency Framework," *Journal of the Academy of Marketing Science* 40, no. 3 (May 2012): 387–401. Finally, see V. Kumar and Anita Pansari, "Aggregate and Individual Level Customer Lifetime Value," in *Handbook of Research on Customer Equity in Marketing*, eds. V. Kumar and Denish Shah, 44–75 (Cheltenham, UK: Elgar, 2015).

Companies have to strike a balance, because they need to create both short- and long-term value.

However, there is a certain tension between encouraging customers to create value in the short term (through immediate sales) and encouraging them to create value in the long term (through changes in the customer's predisposition). Focusing on either task can undermine the other. If a firm markets too aggressively in order to build up current sales, it will almost certainly damage a customer's long-term value—maybe by cannibalizing sales it would have made in the future anyway, or perhaps by irritating the customer into not wanting to receive further communications or not even wanting to do more business. But by the same token, if a company smothers a customer in great service in order to maximize the future business they do with the firm—well, great service isn't free either, and the funds required today to provide this service reduce whatever short-term value the customer might create. Therefore, companies have to strike a balance, because they need to create both short- and long-term value.

Unfortunately, for most businesses, the temptation to maximize the short term is nearly irresistible. Publicly held companies may have the excuse of investor pressures, but even nonpublic companies will succumb to the short-term temptation if they allow themselves to forget about the way customers really create value. An endemic problem among businesses is the fact that the traditional measures of financial success drive short-term thinking and actions, and these measures just do not account for all the ways customers actually can create shareholder value. Reconciling the conflict between current profit and long-term value is one of the most serious difficulties facing business now. Failing to take a properly balanced approach not only penalizes good management practices but also undermines corporate ethics by encouraging managers to steal from the future to fund the present. Often companies end up destroying value unintentionally—or worse, they know they are destroying value but feel they have no real choice about it. At the extreme, a firm might even resort to overpromising or tricking customers out of their money, in order to maximize short-term profit. Of course, doing this almost certainly hampers future sales and destroys long-term value by eroding the trust that customers have in the firm.

Balancing between such extremes in order to maximize overall value creation is not a new or revolutionary idea. As early as 1996, in an innovative and forward-thinking *Harvard Business Review* article, Bob Blattberg and John Deighton suggested that a firm should apply "the **customer equity** test" to balance marketing expenditures between customer acquisition and customer retention efforts.[3] The very concept of brand equity, which was a widely used metaphor during the heyday of mass advertising, was based on the idea that a brand's value could be built up over time, with

[3]Robert C. Blattberg and John Deighton, "Manage Marketing by the Customer Equity Test," *Harvard Business Review* 74, no. 4 (July–August 1996): 136–144.

appropriate messaging, and that this store of value could become a genuine asset for driving competitive success.[4]

A white paper from Peter Mathias and Noel Capon of Columbia Business School considers the implications of managing customers for three "quite different outcomes: maximizing revenue in the near term, maximizing profitability in the short to intermediate term, and optimizing the asset value of customer relationships— customer relationship capital—over the long term."[5] The paper suggests that salespeople traditionally have been held accountable for short-term revenues, but as more organizations have come to emphasize key account management over the last decade, the metric of success has shifted perceptibly from customer revenue to customer profitability. To be successful in the future, say the authors, a firm will have to "take the long view" and "maximize the net present value (NPV) of future profit streams from these customers." See Zeithaml et al. for a review of three decades of customer value research.[6]

Of course, even when executives understand the value of long-term planning, many say pressure from boards and shareholders forces them to act for short-term gains. According to a 2020 McKinsey survey of executives:

- Of the survey respondents, 70% said that, to meet short-term financial goals, their companies' executives would take actions that do not enhance long-term growth.
- Executives at companies trying to meet short-term financial targets by taking actions that create no long-term value said that their companies achieve worse financial outcomes than others.
- Respondents said these companies are only 50% as likely as peers to realize more organic revenue growth, and 27% less likely to generate higher levels of ROIC (return on invested capital).[7]

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[4] Roland T. Rust, Valarie A. Zeithaml, and Katherine N. Lemon, *Driving Customer Equity: How Customer Lifetime Value Is Reshaping Corporate Strategy* (New York: Free Press, 2000). Also see Roland T. Rust, "Seeking Higher ROI? Base Strategy on Customer Equity," *Advertising Age* 78 (2007) (36): 26–27. Accessed May 22, 2021. Rust makes the case: "Think of customer equity as the discounted profit flows summed across all of a firm's customers. If you remember Finance 101, that is almost exactly the definition of the value of the company. That is, customer equity is a very good marketing proxy for the value of the firm, and in fact there are a number of studies that show that customer equity is usually quite close to the firm's market capitalization."

[5] Peter F. Mathias and Noel Capon, "Managing Strategic Customer Relationships as Assets: Developing Customer Relationship Capital," Velocity, *Strategic Account Management Association* 5 (Q1, 2003): 45–49.

[6] Valarie A. Zeithaml, Verleye Katrien, Hatak Isabella, Koller Monika, and Alexander Zauner, "Three Decades of Customer Value Research: Paradigmatic Roots and Future Research Avenues," *Journal of Service Research* 23, no. 4 (2020): 409–432, doi:http://dx.doi.org/10.1177/1094670520948134.

[7] Ariel Babcock, Sarah Keohane Williamson, and Tim Koller, "How Executives Can Help Sustain Value Creation for the Long Term," McKinsey & Company, July 22, 2021, available at https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/how-executives-can-help-sustain-value-creation-for-the-long-term, accessed August 23, 2021; see also Rebecca Darr and Tim Koller, "How to Build an Alliance against Corporate Short-Termism," McKinsey & Company, January 30, 2017, available at https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/how-to-build-an-alliance-against-corporate-short-termism, accessed May 23, 2021.

In an earlier McKinsey study:

- Of the respondents, 79% felt especially pressured to demonstrate strong financial performance over a period of just two years or less.
- In addition, 44% said they use a time horizon of less than three years in setting strategy.
- However, 73% said they *should* use a time horizon of more than three years.
- Finally, 86% declared that using a longer time horizon to make business decisions would positively affect corporate performance in a number of ways, including strengthening financial returns and increasing innovation."[8]

Let's say executives get the go-ahead from their board—there's still the question of how to measure intangible assets like customer equity over the long term.[9] Charles Tilley notes, "Eighty percent of the market value of companies now lies in intangible assets. Yet many accounting practices and processes do not reflect this shift."[10] So, much of what passes for long-term strategic planning ends up focusing on metrics like cost assessment rather than revenue flow, because they're a lot easier to predict and manipulate. Companies can't control customers, but they can control costs! But as Roger L. Martin points out, although focusing on ways to influence customers can seem risky and unpredictable, it's crucial, because "over the longer term, all revenue is controlled by the customer."[11]

Determining the appropriate measurements to be used in quantifying the results of a company's marketing efforts has always been a challenging task, and to many it seems to have been made doubly difficult by the complexity of customer-specific marketing initiatives that new interactive technologies make possible. The very culture at many firms is intertwined with more traditional measures of success—or what we might call ***legacy metrics***: quarterly product

> It shouldn't be surprising that companies often find it challenging to supplement legacy metrics with updated measurements designed around capturing the values that individual customers create, one customer at a time.

[8]Dominic Barton and Mark Wiseman, "Focusing Capital on the Long Term," *Harvard Business Review* 92, no. 1/2 (January/February 2014): 44–51.
[9]Thorsten Wiesel and Bernd Skiera, "Customer Equity Reporting," in *Handbook of Research on Customer Equity Marketing*, eds. V. Kumar and Denish Shah (Cheltenham, UK: Elgar, 2015): 466–482.
[10]Charles Tilley, "Reporting for the 21st Century," in *Perspectives on the Long Term*, eds. Dominic Barton and Mark Wiseman, pp. 84–89.
[11]Roger L. Martin, "The Big Lie of Strategic Planning," *Harvard Business Review*, January– February 2014, available at https://hbr.org/2014/01/the-big-lie-of-strategic-planning, accessed August 27, 2021. Also see Roger Martin, "It's Time to Accept That Marketing and Strategy Are One Discipline," Medium.com, April 19, 2021, available at https://rogermartin.medium.com/its-time-to-accept-that-marketing-and-strategy-are-one-discipline-17f0140521c9, accessed October 26, 2021.

sales; cost of goods sold; number of new customers acquired; earnings before interest, taxes, depreciation, and amortization (EBITDA); return on investment (ROI); return on equity (ROE)—the tried and true. It shouldn't be surprising that companies often find it challenging to supplement such legacy metrics with updated measurements designed around capturing the values that individual customers create, one customer at a time.

It is precisely because customers create both long- and short-term value that the customer-centric competitor will be well served to think of individual customers as being similar to financial assets—assets that are generating some cash flow now and are likely to continue generating cash flow for some time into the future. Each customer, in other words, represents a bundle of likely future cash flows—costs and revenues tied to that particular customer's most likely future behavior.

The asset value of a customer is the customer's LTV. Consumer marketing firms with databases of transactional and other customer records can use statistical modeling techniques to forecast their customers' future behaviors and then calculate the LTVs represented by those behaviors. This is not an exact science, however, and no matter how sophisticated the computer modeling becomes, it will never be completely accurate, for the simple reason that predicting the future never can be completely accurate. (Of course, it must be noted that the accepted calculations of the tried and true have limitations in accuracy too. See Chapter 6.)

However, many would argue that using predictive models to forecast future customer behavior is not substantively different from, and not inherently any less accurate than, using similar statistical models to forecast future economic variables, such as the supply and market demand for a particular product or service. In any case, the basic principle that a customer's asset value should be thought of in terms of the future cash flows they represent is very useful, especially when we consider how this asset value goes up and down on a daily basis with the customer's current experience.

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The problem is that while LTV is a known and accepted concept in marketing circles, few marketers and even fewer finance people fully appreciate its real implications. Customers have memories and free will, so (unless we're talking about the utilities monopoly) the treatment they receive from an enterprise today has a significant impact on the value they can be expected to yield for that enterprise not only today but also in the future. If a customer can be thought of as a financial asset, then changes in the value of this asset—changes in the customer's LTV—are important. When a customer's opinion of a firm improves or deteriorates, based on their experience with the firm today, their LTV goes up or down, and the amount of this increase or decrease in LTV is real economic value that has been created or destroyed as a result of the customer's experience in the present. In this light, changes in the LTV of a customer are every bit as important, financially, as the current-period sales or costs attributable to that customer and captured on financial statements.

Consider this analogy: Suppose a business has some physical asset, perhaps a warehouse full of spare parts. Then suddenly the asset is rendered worthless by a disaster. Suppose a hurricane wipes out the warehouse, and the firm isn't insured for the loss. If that were to happen, generally accepted accounting principles (GAAP) would require the firm to write down the value of that asset, and this quarter's income would be reduced by the amount of the write-down. Now think again about the customer's asset value.

Suppose, instead of a hurricane wiping out a warehouse full of spare parts, there is instead some kind of **customer service** snafu, with the result that a very valuable customer becomes angry and upset with the firm. Because of this, their LTV plummets to zero (or even below zero, because they might communicate their bad feelings about the firm to their friends!). Didn't the company's value decrease when that happened? Surely, its future cash flow will decline if that customer's opinion is not turned around again, right? Of course, the accounting treatment for this kind of customer event is quite different from that prescribed for the destruction of a physical asset carried on the balance sheet—but for now, we won't focus on the accounting issues but on the simple reality of the economic loss to a company represented by an unresolved customer complaint.

> By definition, all the revenue you will ever generate will come from the customers you have now and the ones you will have in the future.

The fact that a customer's asset value (or LTV) will increase or decrease with their current experience, because they'll remember that experience later, means that a customer-centric enterprise has to account for the value it is creating from customers in a different way from the way a product-centric enterprise accounts for the value created by its products. Products don't have memories, while customers do. Note that how a company treats parts and supplies today will not affect the future cost of these supplies, or the profit to be earned from the products created with them. But how a company treats customers today will definitely affect the future profits likely to be generated by those customers.

Today's accounting courses don't often acknowledge customers as significant financial assets. But in the nonaccounting real world, customers are the only genuine value-creating assets any business has. As we said in Chapter 1, the only reason a business exists at all is to create and serve customers. Customers create, on the most basic level, virtually 100% of any enterprise's value. Customers define a business as a business. And it ought to be clear to the most casual observer that a customer's experience with a company, its products, or its brands has an economic impact that goes beyond the current financial period. Any company that spends advertising money to improve its brand image is explicitly acknowledging this fact. Such a firm is investing money based on the assumption that customer intentions have a financial value. If it can affect those future intentions today, then it hopes to see the cash effect tomorrow.

When it comes to understanding how Learning Relationships based on trust create financial value for a business, there are basically two approaches to the issue: a simple, philosophical approach and a quantitative, analytical approach. Both start with customers, for one simple reason: By definition, all the revenue you will ever generate will come from the customers you have now and the ones you will have in the future. (*Take note: If it pays you money, it's a customer*. Brands, products, patents, logos, sales regions, and marketing campaigns do not pay money to a firm; only customers do.) The simple approach is to state your company's value proposition as a straightforward quid pro quo:

1. You want each customer to create the most possible value for your business.
2. On the whole, a customer is likely to create the most value *for* you at about the point they get the most value *from* you.
3. The customer gets the most value from you when they can *trust* you to act in their own interest.

Some companies—especially those that have grown up in the interactive age—have so internalized this view of the customer as a value-producing financial asset that it affects their whole philosophy of business. Amazon's Jeff Bezos says his firm would rather spend on free shipping, lower prices, and service enhancements than on advertising. "If you do build a great experience, customers will tell each other about that," he says.

In fact, Bezos clarifies that "if you're long-term oriented, customer interests and shareholder interests are aligned. In the short term, that's not always correct." He is saying here that he cares about shareholders and that's *why* he cares about Amazon's long-term share price.

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CUSTOMER EQUITY

> Take away a profit-generating customer, and the value of a firm declines. Improve the cash flow expected from a customer, and the firm's value increases. This is true whether such a change in the firm's value *is* or *is not* measured or reported.

Products, brands, stores, bank branches, patents, information technology systems, marketing promotions and campaigns—even the best employees—do not pay money to any organization. Only customers—by definition—generate revenue. And if customers are the only genuine source of value creation for a business, then all the customers an enterprise has (or that it will ever have in the future) must be responsible for creating 100% of that enterprise's shareholder value. This is the basic idea behind the concept of *customer equity*. As a term, *customer equity* is often used as a way to describe the sum of all the lifetime values of some group or segment of individual customers. The total value of such a group of individual customers is the group's customer equity. However, at the enterprise level, when referring to the entire customer base, the term must include not just the lifetime values of all the customers the enterprise currently has, but all the customers it will have in the future, as well. Because customers create all value for any business, by summing the LTVs of an enterprise's current *and* future

[12] "Jeff Bezos on Leading for the Long-Term at Amazon," HBR IdeaCast, ed. and interviewer Adi Ignatius, *Harvard Business Review*, January 3, 2013, available at https://hbr.org/podcast/2013/01/jeff-bezos-on-leading-for-the, accessed August 27, 2021.

In the interview, Bezos said: "I do not follow the stock on a daily basis, and I don't think there's any information in it. Benjamin Graham said, 'In the short term, the stock market is a voting machine. In the long term, it's a weighing machine.' And we try to build a company that wants to be weighed and not voted upon. When things get complicated, we simplify by saying what's best for the customer? And then we take it as an article of faith if we do that, it'll work out in the long term. So we can never prove that. In fact, sometimes we've done price elasticity studies, and the answer is always we should raise prices. And we don't do that because we believe—and again, we have to take this as an article of faith—we believe by keeping our prices very, very low, we earn trust with customers over time, and that that actually does maximize free cash flow over the long term."

customers, we are calculating the actual economic value of that enterprise, as a going concern.[13]

Importantly, future customers are an even more vital part of the value of any rapidly growing enterprise. Thus, if all of a company's cash flows come from its customers, then the sum of all current and future customers' LTVs is the same thing as the economic value of the firm (i.e., the NPV of the firm's future cash flows). Take away a profit-generating customer, and the value of a firm declines. Improve the cash flow expected from a customer, and the firm's value increases. This is true whether such a change in the firm's value *is* or *is not* measured or reported.

> One of the hazards of short-term thinking is that even a firm with high current profitability may find that it is not "banking" enough customer equity to sustain its future financial success.

The term *customer equity* can describe the effectiveness of customer strategies and implementation because it is primarily determined by the total value of the enterprise's customer relationships. For a customer-centric competitor, customer equity can be thought of as the principal corporate asset being tended. One of the hazards of short-term thinking (i.e., of marketing efforts designed to produce current-period sales without much attention being paid to customer LTV) is that even a firm with high current profitability may find that it is not banking enough customer equity to sustain its future financial success.

Not that long ago Dell got into financial trouble, as its earnings failed to keep up with expectations. For years, thanks to its groundbreaking direct-to-consumer **business model**, the company had been the only major personal computer manufacturer making any money, with profit margins a full 10 points higher than most of its rivals. But according to *BusinessWeek*, "Rather than use that cushion to develop fresh capabilities, Dell gave its admirers on Wall Street and the media what they want: the highest possible [short-term] earnings."[14] The result was that Dell failed to maintain its

[13]However, the way in which a firm adds lifetime values together to get the customer equity of a group of customers will depend on the actual LTV calculation being used. If a firm uses a fully allocated cash flow figure, incorporating all fixed and variable operating costs, then LTVs can simply be arithmetically summed to get customer equity. Often, however, it can be more useful to use marginal contribution when calculating LTV, in which case unallocated costs would have to be added back into customer equity, as individual LTVs are rolled up into larger and larger groups of customers. This may sound like a complex accounting problem, but the truth is it's just ensuring that costs and revenues are neither omitted nor double- counted when summing customer LTVs to derive customer equity.

[14]Nanette Byrnes and Peter Burrows, "Where Dell Went Wrong: In a Too-Common Mistake, It Clung Narrowly to Its Founding Strategy Instead of Developing Future Sources of Growth," *BusinessWeek*, February 19, 2007, pp. 62–63.

profitability and in 2007, the original chief executive officer (CEO), Michael Dell, had to be brought back to take over again and try to restore the company to its former luster. Then, within just a few months, the company announced it would have to restate four years of earnings results because "unidentified senior executives and other employees manipulated company accounts to hit quarterly performance goals."[15] The company bought back its own stock and went private again in order to have the luxury of focusing on customers and innovation for the long term.[16]

Some companies have tried to improve their stock value by trying on new, short-term strategies, but, as illustrated by JC Penney's disastrous results, it's crucial to test first what customers want.[17] JC Penney, a bulwark of American retailing for nearly a century, has been bought out by mall owners and faces a death spiral, based on short-term, quarterly focus.[18]

In the early 1990s, a close colleague of ours in the advertising industry related a story to us about having developed a unique idea for improving the level of customer service provided by cable television companies. Based in New York City, he and a business associate had met personally with senior marketing officials at the two cable operators operating in that city (Cablevision and Time Warner Cable), along with another cable operator providing service in Connecticut. Each of these companies was regularly derided by customers for inattentive service, late or often missed service appointments, and a generally uncaring attitude toward their customers. As our friend told the story, at each of these three different business meetings, as they were perhaps halfway through describing their proposal for improving customer service and building customer loyalty, someone from the other side would interrupt, saying something like, "You don't get it, do you? We're a monopoly. . ." These executives' point was, to paraphrase a widely popular movie line, "Monopolies don't need no stinkin' customer service." Companies that got their start as legislated monopolies, even if they are soon plunged into the unsure waters of business competition, have frequently found it difficult to shed their attitude that customers are merely obstacles lying between them and a profit.

Monopolies work just fine for their owners—until any competition or new technology comes along. Blockbuster made a fortune on late fees, until Netflix simply changed the business model, eliminating late fees and Blockbuster.

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[15]Byrnes and Burrows, "Where Dell Went Wrong."

[16]Michael Dell, "Going Private Is Paying Off for Dell," *Wall Street Journal*, November 24, 2014, available at http://www.wsj.com/articles/michael-dell-going-private-is-paying-off-for- dell-1416872851, accessed February 11, 2016.

[17]Jim Aisner, "What Went Wrong for JC Penney?" *Harvard Business School* Working Knowledge, August 21, 2013. https://hbswk.hbs.edu/item/what-went-wrong-at-j-c-penney, accessed August 27, 2021.

[18]"JCPenney Is Getting a New Start in 2021, But Its Old Problems Remain," PYMNTS.com, January 6, 2021, available at https://www.pymnts.com/news/retail/2021/jcpenney-is-getting-a-new-start-in-2021-but-its-old-problems-remain/, accessed August 27, 2021; Phil Wahbe, "J.C. Penney faces a tough road ahead as it mulls bankruptcy protection," May 15, 2020, available at https://fortune.com/2020/05/15/jc-penney-bankruptcy-chapter-11/ accessed May 23, 2021.

Short-term gain, long-term loss.

Dell certainly wasn't the first business to suffer because it tried to maximize quarterly earnings and profit, and it won't be the last. U.S. automakers succumbed to a similar problem when they failed to plan for how newly available Japanese imports might alter consumers' tastes in cars. Consumer electronics manufacturers in the United States made the same mistake with respect to their Pacific Rim competitors. Retailers that ignored the significance of Walmart's new business model have yet to catch up. Most semiconductor manufacturers failed to embrace very large-scale integration (VLSI) chip technology when it replaced transistors, and their business was taken over by new entrants like Intel and Hitachi. Even without the acceleration of COVID-19, online shopping has become the norm in many categories where it was once unimaginable. In industry after industry, companies that remain focused exclusively on current sales and profit falter primarily *because* they are focused exclusively on current sales and profit.

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Many executives recognize that their company's obsession with short-term results is fundamentally destructive but feel powerless to do anything about it. Others feel equally strongly that if they just focus relentlessly on immediate sales and profit, then the long term will be okay. This is a false assumption because the investment community's obsession with short-term performance is irrational and destructive. Just before the recession of 2008, William Donaldson, former chairman of the Securities and Exchange Commission (SEC), commented, "With all the attention paid to quarterly performance, managers are taking their eyes off of long-term strategic goals."[19] And we don't have to look any further than the financial meltdown and Great Recession of 2008–2009 to see the consequences of rampant, unchecked short-termism.

Years later,, SEC Commissioner Daniel M. Gallagher bemoaned the same issue, blaming the demands of individual and institutional investors.[20] But not all investors think short-termism is a good investment; Larry Fink, chairman and CEO of BlackRock, the world's largest money manager, believes corporate leaders have a greater duty to "the company and its long-term owners" than to "every investor or trader who owns their companies' shares at any moment in time," and promises support to companies whose corporate leaders follow this model.[21] As this book goes to press, the

[19]Joseph McCafferty, "The Long View," *CFO*, May 1, 2007, pp. 48–52.

[20]Daniel M. Gallagher, "Activism, Short-Termism, and the SEC: Remarks at the 21st Annual Stanford Directors' College," June 23, 2015, available at https://www.sec.gov/news/speech/activism-short-termism-and-the-sec.html, accessed August 27, 2021.

[21]Larry Fink, Letter, reposted on *Business Insider*, April 14, 2015, https://www.businessinsider.com/larry-fink-letter-to-ceos-2015-4, accessed August 27, 2021.

focus is still on balancing long- and short-term goals. A joint report from Baker McKenzie and the World Economic Forum identified some key issues related to achieving balance, noting that obligatory quarterly reporting alone was not the primary reason for short-termism, but rather a lack of alignment between directors' and shareholders' legal duties, and a shifting balance of power between boards, management teams, shareholders, and other stakeholders.[22]

Customer-centric firms, because they deal more carefully with the issue of customer value creation, are naturally more oriented to balancing long- and short-term goals. Indeed, the very idea of using a customer-centric program to improve, say, customer satisfaction and loyalty is based entirely on generating future profits as a result of providing good service currently.

The difficulty comes in convincing the board that long-term investment in customers and customer engagement is a good idea for shareholders. The average tenure of a chief customer officer (CCO) is only about 26 months,[23] and most CCOs with above-average tenure report it took them three-to-five years before they could "clearly demonstrate the significant value that they had offered to the company." In the first year they typically spend a lot of time putting out customer fires, then they begin to focus on key customers and what they want out of the relationship with the company and how to address customer needs and balance them with requirements of the business. In fact, for many CCOs, their position is a public nod to a stated interest in customer experience, but in reality they are not central to decision making. According to Blake Morgan, author and former director of the Chief Customer Officer Council, "Too many companies still give customer experience lip service. They do this by appointing a Chief Customer Officer or CXO. By hiring or promoting a Chief Customer Officer, or Chief Experience Officer, the company makes it publicly seem like they understand customer experience and are working toward improving it, but this is often only a public gesture."[24]

And yet, she emphasizes, the time frame when thinking of how to measure and build customer equity is years, not quarters.[25]

[22]Beatriz Pessoa de Araujo and Adam Robbins, "The Modern Dilemma: Balancing Short- and Long-Term Business Pressures," Harvard Law School Forum on Corporate Governance, available at https://corpgov.law.harvard.edu/2019/06/20/the-modern-dilemma-balancing-short-and-long-term-business-pressures/, accessed October 26, 2021.

[23]"Classifying Chief Customer Officers," Chief Customer Officer Council, available at http://www.ccocouncil.org/site/classifying-chief-customer-officers.aspx, accessed August 30, 2021. "The CCO role is the most fragile in the C-suite, with an average tenure of approximately 26 months, with some notable exceptions on either side of the average."

[24] Blake Morgan, "The Case against a Chief Customer Officer," *Forbes*, January 5, 2020, available at https://www.forbes.com/sites/blakemorgan/2020/01/05/the-case-against-a-chief-customer-officer/?sh=14770d56181c, accessed August 24, 2021.

[25] Blake Morgan, "What Does a Chief Customer Officer Actually Do?" *Forbes*, September 21, 2015, podcast interview with Curtis Bingham, Founder and Director, Chief Customer Officer Council, available at http://www.forbes.com/sites/blakemorgan/2015/09/21/drivingcustomerengagementpodcast/#1a81b0417629, accessed August 24, 2021.

This trend to thinking long-term was predicted decades ago. An article in *Fortune* magazine pointed out that many customer-centric firms concentrate on raising their returns on specific **customer segments** and that this results in a "rerating" of a company's profits/earnings ratio, as Wall Street "decides that the company can sustain [its] profit growth for years into the future."[26]

In 2014, CVS Pharmacy announced that it would no longer sell cigarettes or tobacco products in any of its 7,600 nationwide stores. The second largest U.S. pharmacy estimated it stood to lose $2 billion annually from the loss of tobacco sales, but CEO Larry Merlo, a 58-year-old former pharmacist, said, "Cigarettes have no place in an environment where health care is being delivered. This is the right decision at the right time as we evolve from a drugstore into a health-care company." The move clearly required CVS to rethink the balance of short-term profits and long-term value of the company.[27]

Knowing that removing cigarettes does not necessarily mean people will quit smoking, CVS also launched a "uniquely personalized" smoking cessation program that involves all its stores, its 900 MinuteClinics, and its "leading administrator of drug prescription benefit coverage." CVS has also made online resources available and is partnering with the American Cancer Society and service providers in local communities.

> From its launch on Sept. 3, 2014, through December 2014, CVS pharmacists counseled more than 67,000 patients filling a first prescription for a smoking cessation drug or prescription nicotine replacement therapy (NRT), and consulted with thousands more smokers seeking advice about over-the-counter NRT products. Purchases of over-the-counter NRT products that assist smokers trying to quit increased by 21 percent in that timeframe compared to the previous four months. And, customers picked up 2.3 million tobacco cessation brochures at CVS/pharmacy and thousands of "Last Pack" encouragement toolkits, reaching millions of additional smokers with education, information and support.[28]

A year later, CVS Health conducted a study into the effects of its decision to stop selling tobacco after one year. In states where CVS/pharmacy has greater than 15% market share, there was a 1% decrease statewide in cigarette pack sales over the

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[26]Larry Selden and Geoffrey Colvin, "Five Rules for Finding the Next Dell," *Fortune*, July 12, 2004, p. 104.

[27]Timothy W. Martin and Mike Esterl, "CVS to Stop Selling Cigarettes," *Wall Street Journal*, February 5, 2014, available at https://www.wsj.com/articles/SB10001424052702304851104579363520905849600, accessed August 30, 2021; and R. P. Siegel, "CVS Sets Example by Taking the High Road on Tobacco Sales," Triple Pundit, May 13, 2015, https://www.triplepundit.com/story/2015/cvs-sets-example-taking-high-road-tobacco-sales/57916, accessed August 30, 2021

[28]Siegel, "CVS Sets Example by Taking the High Road on Tobacco Sales"; see also CVS Website, cessation hub: http://www.cvs.com/quit-smoking/index.html. The website offers support for quitters with ask a pharmacist and visit MinuteClinic options, a survey to determine level of dependence, success stories, info on nicotine replacement, tips, and more.

8 months since CVS removed tobacco from its stores, amounting to 95 million fewer packs. There was a 4% increase in the sale of nicotine patches in the month following the removal.[29] Key to this discussion was the reaction by analysts and investors. ISI Group analyst Ross Muken wrote in a note to investors:

> The ultimate economic impact on CVS/Caremark will not be known for some time but financial analysts have been supportive of the change. We believe the move will be viewed as a positive long-term decision by CVS/Caremark, despite the near-term profit drag, as it paves the way for increased credibility with both healthcare consumers and payers.

Nevertheless, the moment the decision was made, CVS lost $2 billion in revenue, but the analytics community still supported the decision for having long term value.[30] Five years later, CVS still supported smoking cessation, does not sell tobacco products, and declares they have quit tobacco for good.[31] During that first five years of ending their sales of tobacco and supporting cessation, CVS Health's market cap grew from $93.81 billion to $118.24 billion.[32]

A classic customer equity success story is that of Verizon Wireless, the mobile phone company. During the four-year period from the end of 2001 through the end of 2005, this firm, which was at the time a joint venture between Verizon and Vodafone, dramatically increased its customer equity. According to publicly reported figures, the company earned $21 billion in operating income in those four years while growing its customer base from 29.4 million handsets in use to 51.3 million. This kind of acquisition story is the kind that makes headlines and was touted as a great reason to invest in Verizon. But during the same period, Verizon Wireless quietly reduced its monthly **customer churn rate**, or **turnover**, on postpaid retail (contract) customers from 2.6% to 1.1%.

A back-of-the-envelope calculation[33] would show that partly because of the reduced customer turnover rate, Verizon Wireless's customer equity grew by around $20 billion during this period. In other words, Verizon Wireless actually created nearly twice as much shareholder value as was reflected in its income statements during these four years. About half of this increase in customer equity was attributable to the new customers acquired; the other half came from the increased average LTV of all its

[29]"We Quit Tobacco, Here's What Happened Next," CVS Health, September 2015, http://www.cvshealth.com/research-and-insights/cvs-health-research-institute/we-quit-tobacco-heres-what-happened-next, accessed February 12, 2016.
[30]Robert Glazer, "CVS Lost $2 Billion with 1 Decision—Here's Why They Were Right," Forbes, April 21, 2020, available at https://www.forbes.com/sites/robertglazer/2020/04/21/cvs-lost-2-billion-with-1-decision-heres-why-they-were-right/?sh=530df80d689c, accessed August 24, 2021.
[31]"Tobacco-free For Five Years," CVS Health, available at https://cvshealth.com/news-and-insights/articles/tobacco-free-for-five-years, accessed August 24, 2021.
[32]"CVS Health Market Cap," YCharts, available at https://ycharts.com/companies/CVS/market_cap, accessed August 24, 2021.
[33]Peppers and Rogers, *Rules to Break and Laws to Follow*, p. 263.

customers due to the dramatic reduction in customer churn during the period. Consider that the reduction in turnover would have required Verizon to take steps that made it easier to stay a customer—better service, proactive reminders, hassle-free solutions to problems such as a lost phone—all capabilities that could be seen as distracting from the acquisition mission.

Significantly, Verizon Wireless relied on some highly sophisticated (for the time) **predictive analytics** to anticipate and reduce customer churn. The truth is, Verizon Wireless's four-year surge in value creation was probably a one-time event for the company because the more customer churn has been reduced, the harder and costlier it becomes to reduce it further. But other wireless firms throughout the world face opportunities every bit as rich as this, and for the most part they have failed to take advantage of them. In fact, if anything, there is strong evidence that many mobile telecom companies are running in the opposite direction, chipping away at their customer equity as they compete fiercely to acquire new customers at any cost—even when it means acquiring customers with lower and lower LTVs at higher and higher **customer acquisition costs**.[34]

In Chapter 4, we described what a trustable telecom company would look like, and asked the key question: *If customers understood what a trustable company was like, would they be willing to pay more, and how much?*

One survey of health care insurance customers found that they would be willing to pay an average of $25 more a month to do business with a health care insurance company they trust.[35] And in a survey involving more than 2,400 respondents, all U.S. residents and customers at one of the five major U.S. mobile operators—AT&T, Sprint, T-Mobile, U.S. Cellular, or Verizon[36]—began by asking respondents how much they thought their mobile services provider could be trusted. The results found very significant differences on a variety of issues that add up to a great deal of money for a business. Most significantly, *participants said they would be willing to pay about $11 more per month, on average, for a mobile carrier consistently demonstrating a higher level of trustability*.

Let's do the math: If you run a health care insurance company and your customers would be willing to pay you an extra $25 a month, 12 months a year, then for every 10 million customers your company serves, you are face-to-face with a potential revenue increment of some $3 billion! Per year! And for every 10 million telecom customers, a company could add $1.3 billion per year! Three of the major telecoms each had about 70 million customers at the time, so for *each* of them, increased customer

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[34]See *Rules to Break,* pp. 84-86.

[35]For more on the value of trust in health care, see "Measuring the Value of Trust in Healthcare," Peppers and Rogers Group, available at http://dev.worldcongress.com/events/HW12084/pdf/WPPRG_TrustinHealthcare.pdf, accessed August 30, 2021. Peppers & Rogers Group's 2012 Customer Trust in Healthcare study examines the role trust plays in the relationship between health insurers and consumers, and how that trust connects to financial strength.

[36]Thanks to Tom Lacki for his additional insights about the research on trustability and mobile carriers.

equity due to higher levels of trustability could be worth nearly $9 billion. Only a fraction of this would be needed to accomplish most of the trustable actions listed in Chapter 4. The rest would drop to the company's bottom line, improving shareholder value and also customer experiences and loyalty in the long term.[37]

> Each customer is like a tiny bundle of future cash flow with a memory.

So how do we decide how much you can really afford to spend *today* in order to create a better experience for the customer, to build the current and future value of your relationship with them, based on their expected future change in behavior? Trustability is a question we have to answer two ways. The first approach to the question of how trustability creates financial value is a philosophical approach, an inevitable response to technology-driven interconnectivity and the transparency it creates. But the second is a quantitative, analytical approach, and that helps more in our strategic planning and our rewards and reporting. Here's how to think about it: Every business executive knows that customers are financial assets. And, as is the case with any other financial asset, every customer has a certain value, based on the cash flow they can be expected to produce for the business over their lifetime.

In a nutshell, two different kinds of current-period business success are on every company's menu, and it's critical to know the recipe for both:

- Good current profitability, while generating more customer trust and customer equity (have your cake and eat it too); or
- Good current profitability, while eroding customer trust and customer equity (use your cake up so there's nothing left).[38]

But when we examine it closely, building the value of customers through trustability and improved customer experiences is in fact financially attractive for a business even though in many situations it may cost money up front in the form of forgone profits or newly incurred expenses, as many business improvements do. If current-period earnings were the only criterion by which Amazon ever evaluated its financial performance, it would never do anything so irrational as refusing to make a profit from a willing (if forgetful) customer, by reminding you that you previously bought something most people only buy once. But the fact is that when Amazon warns you before you forgetfully buy something you probably don't want, the company gains something far more financially valuable than the profit they could have made off of your forgetfulness. In addition to the increased likelihood that you'll recommend

[37]Our understanding of the difficulties of operating a mobile carrier in a more trustable way came from an interview we did with Peppers & Rogers Group consultants responsible for this client, Ozan Bayulgen and Zeynep Manco, Peppers & Rogers Group Istanbul office.

[38]See our discussion of these issues in Don Peppers and Martha Rogers, Ph.D., *Extreme Trust: Turning Proactive Honesty and Flawless Execution into Long-Term Profits* (New York: Portfolio/ Penguin, revised, 2016), and *Rules to Break and Laws to Follow* (John Wiley & Sons, 2008), pp. 80–84.

Amazon to friends and colleagues, they'll be solidifying your loyalty and continued patronage (after all, you'll now want to buy all your books from Amazon so they can prevent you from accidental repeat purchases, right?).

The clue to understanding why trusted customer relationships can be financially attractive to a firm is recognizing that many of its economic benefits don't come immediately but over time, as returning customers buy more and as a company's solid reputation continues to generate more new business. Quantifying these benefits—including the value of increased customer loyalty, referrals, and additional sales—requires a robust customer analytics capability, as well as a financial perspective that fairly balances short- and long-term results.

Today's most successful firms focus on the long-term value of their customers, and the importance of maintaining their trust and confidence, despite the fact that sometimes the actual economic value can be difficult to quantify. In his portrait of one such forward-thinking firm, *Googled: The End of the World as We Know It*, Ken Auletta tells the story of how its founders approached their IPO (initial public offering):

> Google's two 31-year-old founders were driving the company with a clarity of purpose that would be stunning if they were twice their age. Their core mantra, which was echoed again and again in their IPO letter, was that "we believe that our user focus is the foundation of our success to date. We also believe that this focus is critical for the creation of long-term value. We do not intend to compromise our user focus for short-term economic gain."[39]

"Focus on the user and all else will follow" is still number one on Google's core philosophy of "Ten Things We Know to Be True."[40] As one of the top five companies in the United States, something is clearly paying off for Google, and the question remains open: Will this philosophy continue as the company moves further and further away from founder control?

> It is the customer relationship that links long-term consequences with short-term actions.

Although all of these companies have naturally created controversy, it is still true that to forward-thinking online companies such as Google and Facebook (not to mention Amazon, Apple, Zappos, and other successes), *it is the customer*

[39]The facts about how Google operates were found in Ken Auletta, *Googled: The End of the World as We Know It* (New York: Penguin Press, 2009), p. 111. Please note: The point we're making here is generally true, but ads are ranked according to an AdRank, which is a complex formula that also includes relevance to search keywords and other ads in the list. It's not purely based on user clicks but is primarily so. Confirmed from Alphabet's "Investor Relations" page, available at https://abc.xyz/investor/, accessed August 30, 2021. Regarding ads and how they're ranked, see "Google Ads Help," Google, available at http://adwords.google.com/support/aw/ bin/answer.py?hl=en&answer=6111, accessed August 30, 2021.

[40]"Ten Things We Know to Be True," https://about.google/philosophy/, accessed October 26, 2021.

relationship that links long-term consequences with short-term actions. These companies are following a course of action that is intuitively obvious to them even if it might be difficult to quantify mathematically. Don't forget: Jeff Bezos was monomaniacally focused on Amazon's ultimate success even though the company lost money for 28 consecutive quarters after it was formed.[41]

What Is the Value Today of a Customer You Don't Yet Have?

If customer equity includes the value not just of current customers but also of prospective customers, then prospects must have some value to a firm. A current customer has a lifetime value, but how can a prospective customer possibly have any sort of lifetime value, if a firm isn't doing any business with them, and may in fact never do business with them?

As strange as it may sound, the fact is that a prospective customer does have real economic value for an enterprise, today – even before they become a customer, if they ever do. Hypothetically, for instance, consider two firms, Firm A and Firm B, each of which has a thousand customers, and each of these customers has an estimated **actual lifetime value** of $1,000. So this means that each firm's thousand current customers have a combined value of $1 million together. But now suppose that Firm A has also identified 1,000 prospective customers, each of whom has some probability of becoming an actual customer next year, while Firm B has no identified prospects at all. Obviously, Firm A must be worth more than Firm B, but *how much more*?

As long as there is some probability that a prospect will become a valuable customer to an enterprise, then the prospect *already* has an economic value to the firm today—an expected value. And what is that expected value? Very simply put, the LTV of a prospective customer is equal to their LTV if they were to become a customer, multiplied by the *probability* they will become a customer.

Suppose, for instance, that Firm A realistically expects to achieve a 4% conversion rate from its pool of prospects every year, meaning that every prospect has about a 4% likelihood of becoming a customer with a lifetime value of $1,000 next year, and then a 4% likelihood the next year, and the next, and so forth. So in addition to the $1,000 lifetime values of our 1,000 existing customers—lifetime values that span the average customer's tenure of, say, 10 years —*next* year Firm A will likely have an *additional* 40 customers, with their own lifetime values of $1,000—40 customers who joined the firm from its pool of prospects that year. And the year after that Firm A will have still another 40 new customers, and the year after that, and so forth.

What this means is that each of Firm A's prospective customers has a current value, today, that can be represented as 4% of $1,000 in LTV received one year from now, plus 4% of $1,000 received two years from now, and three years from now, four years, and so forth—because each prospect has just a 4% chance of becoming a customer in any one of these future years.

[41]Launched in 1994, Amazon posted its first quarterly profit on December 31, 2001. "Amazon Posts First Profit," *Communications Today* 8, no. 16 (January 24, 2002): 1.

(*continued*)

Moreover, no matter how good Firm A's analytics and methodology are, these predictions of LTV and of likelihood of conversion are still just estimates, because no one, not even the smartest textbook authors in the world, can predict the future. Moreover, the further into the future Firm A goes with its assumptions about the behavior of any customer or prospect's behavior, the less confidence it can have in its prediction. So to account both for this declining confidence as well as the time value of money itself, Firm A chooses a relatively steep annual discount rate of 20%—reducing all of its economic values by 20% for each additional year in the future being calculated.

So, every prospect in Firm A's pool of prospects is worth a current value that can be calculated by adding up its values for every year in the future:

Year 1: \$1000 LTV × 4% likelihood × 80% time discount = \$32.00

Year 2: \$1000 LTV × 4% likelihood × 64% time discount = \$25.60

Year 3: \$1000 LTV × 4% likelihood × 51% time discount = \$20.48

Year 4, 5, 6, 7, etc.

These numbers (\$32.00, \$25.60, \$20.48, etc.) actually comprise an infinite series, but each number declines further, and by using ordinary high school math, we can calculate the sum of this infinite series with the following equation

$$\text{Average } \mathit{LTV\ per} \text{ prospect} = \$32.00 \div 20\% = \$160.00^{a}$$

So, Firm A's 1000 prospective customers, each have an actual lifetime value of \$160. This means that Firm A's customer equity is \$1,160,000 – which is \$1 million for the 1000 current customers it has, and another \$160,000 for the value of the 1000 prospective customers it has.

It's important to note that a firm can increase its customer equity (i.e., its financial value, as a going enterprise) by tinkering with any of the inputs to this set of equations. It can:

- Increase the LTV of any current customer.
- Increase the number of current customers.
- Increase the LTV of any prospective customer.
- Increase the number of prospective customers.
- Increase the likelihood that any prospective customer will become a customer.
- Increase the accuracy of its estimates (reducing the discount rate).

In addition, our highly simplified example omitted a key point, having to do with customer differences. To simplify our calculations we assumed that all of Firm A's customers and prospects were identical in terms of their lifetime values, but this

(*continued*)

of course would be untrue for almost any real-world enterprise. As we learned in Chapter 6, customers are almost always different in terms of their values, with some companies' customer bases having a very steep **value skew**, while others have a relatively shallow value skew.

So in thinking about how to maximize the value created by prospective customers, as a group, a firm can choose two completely separate strategies:

1. It can focus its efforts on trying to acquire those prospects that would have higher actual lifetime values if they become customers; and
2. It can focus on increasing the likelihood that a prospect will become a customer.

When, for instance, an enterprise conducts a free seminar for prospective customers, the prospects who elect to attend that seminar will almost certainly increase their likelihood of becoming customers, which is the purpose the enterprise has in mind for conducting the seminar in the first place. And when a consumer-marketing enterprise offers free samples to prospective customers, the ones who respond to the offer are more likely to become customers, as are the smartphone users who download the company's app. Because every enterprise needs to know whether it makes sense to run a seminar for prospects or to give samples away, it must assess the current value of the customers it doesn't yet have. Increasing the value of prospective customers is a legitimate and time-honored business activity.

A prospect is simply a customer with whom the enterprise has a 0% share of customer.

But what about when a prospect becomes a customer? Each of Firm A's customers had an LTV of $1000, so when Firm A converts a prospect to a customer, doesn't that mean it is increasing its customer equity by $1000?

In a word: No. Since the prospect was already worth $160 to Firm A, the net increase in value from making that prospect into a customer was only $840. Think of it in terms of a new customer with a $1000 LTV being activated, while at the same time a *prospect* with a $160 LTV is being deactivated.

Another way to think about it would be in terms of **unrealized potential value**. Technically, each of Firm A's prospective customers already has an actual lifetime value of $160, and an additional unrealized potential value of $840. We could easily think of a prospective customer as simply a customer that has a great deal of as-yet-unrealized growth potential—a real customer, but one with whom we so far have a **share of customer** of 0%.

So our mission, as a business, is to realize some of that unrealized potential, by using our actions to change the prospect's otherwise expected future behavior.

[a] *Purists' note:* The exact calculation would adjust the 4% probability down slightly each year, because the probability of a prospect becoming a customer in Year 2 is 4% times the 96% probability that they didn't already become a customer in Year 1, and so on.

CUSTOMER LOYALTY AND CUSTOMER EQUITY

The CVS and Verizon Wireless discussions clearly illustrate the fact that customer loyalty is likely to play a large part in any enterprise's effort to maximize the value its customers create. Executives frequently cite the problem of improving customer loyalty as one of the key reasons for embarking on a customer-centric initiative to begin with. This is because for many businesses, even small increases in average customer loyalty can have quite significant effects on their financial results in the long term. But because customer loyalty doesn't create nearly so much short-term value as it does long-term value, the most useful way to analyze the impact of an improvement in customer loyalty is usually to examine its impact on a firm's underlying customer equity.

This was exactly the approach taken by Sunil Gupta and Donald Lehmann.[42] In an important classic study, Gupta and his colleagues examined the financial reports of five different publicly held companies—Ameritrade, Amazon, Capital One, eBay, and E*TRADE—in order to try to estimate each company's customer equity. Then they calculated the impact on each firm's customer equity of changes in different marketing variables, including the average cost of new customer acquisition, the average profit margin, and the average customer retention rate, or loyalty.

What they found was quite remarkable, as shown in Exhibit 11.1, which compares four of the five companies:

- If the cost of new customer acquisition is reduced by 10%, customer equity values of these firms will increase by between about 0.5% and 1.5%

EXHIBIT 11.1 Effect of Increasing Customer Value on Acquisition Cost, Margin, and Retention

	Customer Equity ($b)	Percentage Increase in Customer Value for a 10% Improvement in		
	Base Case	Acquisition Cost	Margin	Retention
Amazon	2.54	0.51%	10.51%	28.34%
Ameritrade	1.45	1.19%	11.19%	30.18%
eBay	2.11	1.42%	11.42%	30.80%
E*TRADE	1.89	1.11%	11.11%	29.96%

Source: Sunil Gupta and Donald Lehmann, *Managing Customers as Investments: The Strategic Value of Customers in the Long Run* (Philadelphia: Wharton School Publishing, 2005).

[42]Sunil Gupta and Donald Lehmann, *Managing Customers as Investments: The Strategic Value of Customers in the Long Run* (Philadelphia: Wharton School Publishing, 2005). See also Elliot Shin Oblander, Sunil Gupta, Carl F. Mela, Russell S. Winer and Donald R. Lehmann, "The Past, Present, and Future of Customer Management," *Marketing Letters* 31, no. 2/3, (Sep 2020): 125-136. This paper overviews customer management research, from its historical origins to its recent developments and recommendations for future research, with an emphasis on novel data sources, online marketplaces, and new technologies as well as privacy and fairness considerations.

- If product margins are raised by 10%, the customer equity levels of the firms will go up by roughly the same 10%.
- But if customer loyalty is increased 10%, then the customer equity levels of the firms improve by roughly 30%.

> Measure what matters.

A 10% boost in customer loyalty for these companies, in other words, increases their overall value, as companies, by about 30%! Traditionally, everyone talked about the importance of acquisition, but retention is how you build the value of the company. Because it costs more to get a new customer than to keep one, and because retention improves customer equity by three times as much as acquisition, then it's important to measure retention in order to drive a greater focus on customer experience and relationships. In other words, measure what matters.

Gupta and his colleagues had to use publicly reported financial data, and they limited themselves to analyzing five companies with fairly straightforward and easily modeled business structures. Each of the firms sells directly to end-user customers, for instance, so there were no complicated channel or distributor relationships to consider, and each has a high concentration of repeat customers who do business frequently. But the implications of this study still should be applicable to more complex businesses with more complicated business models.

In any business, customer retention may or may not be the most appropriate variable to try to evaluate. Customer values can change in many ways. Customer attrition or retention is like an on-off switch, but in most categories, customers should be thought of more in terms of volume dials. Increasing the amount of business your customer does, or at least avoiding a reduction in the business they do, could be a much more useful objective in many cases. A survey of the behaviors of more than 1,000 U.S. households across a variety of industries concludes that while reducing defection definitely represents an opportunity for most businesses, there is far more financial leverage in simply increasing the amount of business done by customers, or avoiding *reductions* in the volume of business done.[43]

Jill Avery at Harvard details four mistakes companies commonly make about acquisition, retention, and churn.

1. Companies don't measure the real cost of churn because of the natural time lapse between failing the customer and the churn, which is often six to eight months later.

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[43]Aurélie Lemmens and Sunil Gupta, "Managing Churn to Maximize Profits," *Marketing Science* 39, no. 5 (Sep. 2020): 956; Scott Neslin, Sunil Gupta, Wagner Kamakura, Junxiang Lu, and Charlotte Mason, "Defection Detection: Improving Predictive Accuracy of Customer Churn Models," *Journal of Marketing Research* 43, no. 2 (May 2006): 204–211. This project was funded by the Teradata CRM Center at Duke University. For the survey of U.S. households, see Stephanie Coyles and Timothy C. Gokey, "Customer Retention Is Not Enough," *Journal of Consumer Marketing* 22, no. 2/3 (2013): 101–105.

2. Companies don't look at churn as a behavior on the part of the customer that is a response to behavior on the part of the company, but unfortunately look at churn as a number.
3. Companies think there is a magic number for churn: But different numbers are acceptable for different business models.
4. Companies don't realize that churn is really an acquisition problem. If a company determines which customers will be the most valuable and the most likely to engage, churn will go down because the company has brought in and kept customers to whom your company has the most value and who have the most value to your company.[44]

Customer loyalty itself is not always easy to define. If a consumer who considers themself loyal to a particular retail brand of gasoline is to stop at a different brand's filling station because it is more convenient at a given time, have they become less loyal than they were? When a business that buys all its office furniture from a particular contractor decides to put the next set of furniture purchases out to bid, is that defection?

Most companies end up creating a practical definition of retention for their customers that includes two features.[45] Unless the customer has a single, subscriber-like relationship with a company and clearly leaves, retention is rarely considered an all-or-nothing variable. Thus, at an initial level, retention tends to be defined progressively—from downgrading behavior, to inactive status, to no longer being a customer. For some firms, a downgrading pattern itself is an indicator of increased risk of loss. For example, a cable customer with premium channels and many pay-per-views each month may downgrade to just basic cable, or even to local broadcast only, until they completely defect to streaming.

At a second level, any definition of retention must also **recognize** the multiple relationships that a customer may have with a firm in terms of products that span business units. Customers who terminate a relationship in one area—paying off a home mortgage with a bank, for instance—may or may not retain a strong and active relationship in other areas, such as retail banking, investments, and credit. And marketers can't come to grips with this phenomenon at all unless they take an enterprise-wide view of each customer, across all business units and channels.

Although any lost customer is a real loss, understanding the nature of the loss will help to manage the costs of trying to reactivate customers or even to win them back.

[44]Amy Gallo's interview with Jill Avery, "The Value of Keeping the Right Customers," *Harvard Business Review*, October 29, 2014, available at https://hbr.org/2014/10/the-value-of-keeping-the-right-customers, accessed August 30, 2021. See also Aurélie Lemmens and Sunil Gupta, "Managing Churn to Maximize Profits," *Marketing Science* 39, no. 5 (September 2020): 956.

[45]Thanks to Dr. Linda Vytlacil, formerly at Carlson Marketing Group and now Professor of Data Analytics at John Brown University, for this discussion of how to think about customer retention, attrition, and defection.

It's important, first, to distinguish between customer attrition and customer defection. Attrition almost always results from a circumstance outside the direct control of a business—an elite business traveler retires, an office-supplies buyer declares bankruptcy, a retail customer moves to another territory. Defection, by contrast, is a customer loss that might have been mitigated, because the customer is clearly choosing to move part or all of their business to the competition (e.g., a landline customer choosing to drop their land service in order to go mobile only.) By distinguishing defection from attrition, we can isolate the drivers of each behavior and invest where we are likely to earn the highest ROC.[46]

There is also the question of tenure. In any population of customers, those most likely to defect will be the first to do so. Thus, the longer any particular group of customers has remained in the franchise, the less likely any of them are to defect in any given time period. Stated another way, the average annual retention rate among any population of customers will tend to increase with time.[47] When we talk in general about "improving retention," we have to be quite careful, because the least loyal customers are always the newest ones. The easiest way for almost any enterprise to improve its *average* retention rate would simply be to stop acquiring new customers altogether! Again, resolving this problem requires a metric that can balance immediate profits and costs against the long-term value being created or destroyed.

In the final analysis, regardless of whatever behavior change a company can effect in its customer base—whether it is an increase in purchasing or a reduced likelihood of attrition—all of the financial results are captured in the LTV and customer equity numbers. The only question is how accurately the LTV equations have been constructed and modeled.

Forecasting customers' future behaviors and estimating their financial impact will never be simple, but with the customer analytics and statistical tools now available, it's not exactly rocket science anymore either. Some straightforward actions contribute to increases or decreases in an enterprise's customer equity:

- Acquire more customers.
- Acquire customers who are more valuable to begin with (i.e., acquire customers likely to have higher LTVs).
- Increase profit per customer.
- Reduce servicing costs per customer.
- Sell customers additional products or services.
- Reduce the rate of customer attrition.
- Increase the propensity of customers to refer other customers.

[46]We often hear about *replacing* a customer who has defected, but this is a fallacy. A company can never truly replace a customer it wanted to keep. If it acquires another customer, it could have had two.
[47]You'll find a more thorough discussion of customer "vintages" in Don Peppers and Martha Rogers, Ph.D., *Enterprise 1to1: Tools for Competing in the Interactive Age* (New York: Currency/ Doubleday, 1997), pp. 365–366.

- Add social and influence value—willingness to rate products and services, participation in **social media**, etc.
- Improve willingness to recommend **(Net Promoter Score [NPS])**.[48]

Many of these actions will generate results that can be measured in the current period, even though their primary effect is to alter how customers buy in the future. These are some of the **leading indicators** of LTV change, and we will return to this topic later in this chapter.

But first, we need to answer a bigger question. If customer-centric companies concentrate on maximizing the value that their customers create, and these customers create value in both the long and the short term, is there a single, overall metric that could help an enterprise gauge the efficiency with which its customers are creating value?

RETURN ON CUSTOMER

Note: For a complete discussion of ROC, see also Chapter 2. ROC is pronounced are-oh-see.

Whenever companies engage in untrustable behavior, we usually find a nearly manic obsession with short-term financial results and almost total disregard for longer-term financial implications. Short-termism generates many dysfunctional and even self-destructive business practices, as profit-oriented companies dismiss the long-term consequences of their actions in order to generate current-period profits—profits that feed the bonus pool, pump up the stock price, and meet analysts' expectations. Short-termism is characterized by unadulterated self-interest and directly conflicts with trustability, but it is still easily the most pervasive and destructive business problem on the planet.

In one survey of 401 chief financial officers (CFOs) of large, publicly traded companies in the United States, 78% confessed that they would be willing to give up actual economic value for their firms if that was necessary in order to hit the quarterly numbers.[49] In another recent study, Ling Harris et al. reported that organizations facing

[48] Net Promoter Score (NPS), developed by Satmetrix Systems, Inc., Bain & Co., and Fred Reichheld, is a popular measure of the difference between customer satisfaction and dis- satisfaction based on a customer's willingness to recommend a product, company, or brand to a friend. See also Fred Reichheld and Rob Markey, *The Ultimate Question 2.0: How Net Promoter Companies Thrive in a Customer Driven World* (Cambridge, MA: Harvard Business Review Press, 2011).

[49] We found the survey fascinating: Emery P. Dalesio, "Executives Sacrifice Shareholder Value to Please Street," Associated Press State & Local Wire, February 9, 2004. "Three-quarters of business executives admit they massage earnings reports to meet or beat Wall Street expectations and would sacrifice shareholder value to keep earnings on a smooth upward slope. . .The study of 401 senior financial executives by researchers at Duke University and the University of Washington found that 55 percent would delay starting a project to avoid missing an earnings target. Four out of five executives said they would defer maintenance and research spending to meet earnings targets. The preference for smooth earnings growth instead of even slight variations is so strong that 78 percent of the surveyed executives would give up economic value in exchange, the study said."

pressure to manage earnings sometimes fill high-level accounting positions with "dark personalities," who are willing to push ethical boundaries.[50]

Short-termism like this emphasizes the selfish aspect of free-market competition, without allowing room for the empathetic, nonselfish side of most people's nature. Elinor Ostrom, the first woman to win the Nobel Prize in Economics, has suggested that "when we assume people are basically selfish, we design economic systems that reward selfish people."[51] Obviously, there's no longer any question that a free-market system is much more efficient and fair than any state-controlled system could ever be, but the "greed is good" philosophy that animates so many is testimony to the fact that it offers its biggest rewards to the most selfish people.

The truth is, however, that short-termism only reigns supreme at most businesses because *the financial metrics we apply to business are not economically true measures of success*.[52] They never have been, and they haven't substantially changed since being introduced at the beginning of the Industrial Age. The way most businesses "do the numbers" to document their financial performance focuses entirely on the past—that is, on the most recent financial period. Most companies' financial reports to shareholders include absolutely no consideration of the way the most recent performance has either helped or harmed a firm's prospects for generating future profits, leaving this detail to the stock market analysts and others to figure out. Yes, a good business will track customer satisfaction or maybe even NPS or customer lifetime values. Ultimately, though, these figures *should* have more effect on how earnings are calculated. Unfortunately, earnings from the most recent financial period remain the Supreme Performance Metric, the **key performance indicator** (**KPI**) to beat all other KPIs.[53]

Managers sometimes take comfort in the sophistication and precision of their short-term financial metrics, ignoring the long-term effects simply because they can't be as precisely defined. But this is like the classic joke about the person who loses their car keys late one night and looks for them near a street corner, even though they lost the keys half a block away. When a police officer asks the obvious question—-*Why?*—the person glances up at the streetlamp illuminating the corner and says, "Because the light's better here."

[50]Original study found at Ling L. Harris, Scott B. Jackson, Joel Owens, and Nicholas Seybert, "Recruiting Dark Personalities for Earnings Management," *Journal of Business Ethics*, March 2021, 1–26.

[51]Elinor Ostrom quoted in Clay Shirky, *Cognitive Surplus* (New York: Penguin Press, 2010), p. 111.

[52]Most companies report and reward based on historic numbers and leave prediction and projection to others. Steven Pinker suggests that our understanding of time is severely limited, psychologically, and that this is evident purely from the structure of language itself. After all, when time is expressed grammatically in most languages, there are only three real tenses: the here and now, the future unto eternity, and the history of the universe before now. Moreover, he says, because the human experience of time is entirely subjective, "it speeds up or slows down depending on how demanding, varied, and pleasant an interval is." Steven Pinker, *The Stuff of Thought: Language as a Window into Human Nature* (New York: Viking, 2007), p. 190.

[53]If you want to extend your examination of how KPIs are often used, see Gretchen Morgenson and Joshua Rosner, *Reckless Endangerment: How Outsized Ambition, Greed, and Corruption Led to Economic Armageddon* (New York: Henry Holt/Times Books, 2011) for an outstanding narrative of the entire mortgage mess that led to the recession of 2008.

The simple fact about business metrics: If you aren't measuring the right things to begin with, you're not going to get better results by measuring them more accurately. Said another way, when your headlights aren't on, the best rearview mirror available isn't likely to improve your driving.

> When your headlights aren't on, the best rearview mirror available isn't likely to improve your driving.

Nowhere was this no-headlights philosophy more evident than during the run-up to the 2008 Global Financial Crisis, a disaster brought about by rampant, overconfident short-termism. Short-term metrics and incentives, when they are applied to businesses based on current-period financials, almost inevitably end up promoting the interests of commission seekers, bonus-earning senior managers, and short-term investors. Usually, this is directly counter to the legitimate interests of a company's shareholders, not to mention its customers, employees, partners, and other stakeholders.

So how do we measure better in order to make the most of the customers we have, and will have—the customers who are, by definition, a company's only source of revenue? *If it is in a company's own economic self-interest to be trustable,* then how should that company measure and report its value if it is building customer equity through trusted Learning Relationships and the better customer experiences that result? And what if a company's short-term actions increase current numbers but decrease future value at the same time? Companies cannot simply ignore the reputational damage they would do to themselves if they were to resort to spamming or rampant telemarketing. And, as interactivity accelerates, and trustability becomes even more important, it won't just be spamming that damages a reputation.[54] Untrustable activities will cause genuine economic harm to a business, and its cost is likely to dwarf whatever short-term profits a business might have been able to generate. While economics may not be everything, when it comes to operating a profit-making company with a payroll to meet and shareholders to satisfy, it's *almost* everything. It's extremely important to realize, therefore, that while acting in a customer's interest will sometimes require a company to incur a short-term cost, it will nearly always be economically beneficial for the firm in the long run. So how can we calculate how much a firm can invest in building customer value to support short-term profits and increased long-term value?

It has never been possible to succeed for long with a business that offered substandard product quality or uncompetitive pricing. A business might generate extra profits for a brief period by cutting back on quality or raising prices above the norm, but as customers acquire the information needed to compare one company's offerings with others, it is inevitable that lower-quality, higher-price companies will lose out to higher-quality, lower-price competitors.[55]

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[54]There's a lot of information out there about spam. See, for instance, "Home," BarracudaCentral, available at http://www.barracudacentral.org/index.cgi?p=spam, accessed August 30, 2021, which calculates spam percentages daily. On May 23, 2021, this site calculated the percentage of spam worldwide as 84.4%.
[55]Whitney MacMillan, chairman emeritus of Cargill, makes the case for the critical value of building social capital within your company and offers a proven formula for how to do it. See Whitney MacMillan, "The Power of Social Capital," *Harvard Management Update* 11, no. 6 (June 2006): 1–4.

To begin with, a company has to consider that customers, even if numerous, are finite in number. A company can make more products but cannot manufacture more customers. If customers are a scarce productive resource—imposing a constraint on a company's growth—then it would make sense for executives to track how efficiently they use this scarce productive resource to create value. When an enterprise wants to track the efficiency with which it deploys capital to create more value, it uses some metric such as return on investment. ROC (pronounced *are-oh-see*) is a metric directly analogous to ROI and specifically designed to track how well an enterprise is using customers to create value.[56]

ROC can provide a company with financial bifocals—a single lens through which it can see its earnings from customers clearly, whether these earnings are up close and immediate or in the more distant long term. To understand the ROC metric, start with a simple analogy. Imagine that last year you bought a stock for $100, and during the year you received a dividend payment of $5, while the stock price climbed to $110 by the end of the year. Your total ROI for the year would have been 15%. You put up $100 initially, and the total new value created amounted to 15% of that initial investment. If, however, the stock price had fallen $10 during the year, from $100 down to $90, then your total ROI would have been a negative 5%, and even though you received a $5 dividend, you would have suffered a net loss overall.

Now apply that thinking to customers. Suppose you begin the year with a customer who has an estimated LTV of $100, and during the year you make a profit from the customer of $5. By the end of the year, let's suppose your predictive modeling calculation shows that the customer's LTV has increased to $110. In that case, your ROC for the year would be 15%. But this measurement of the economic performance of a particular customer will capture not just the sales you generate from the customer during the year but also the change, if any, in the customer's value to your business—LTV, that is, or the value of their likely future purchases, recommendations to friends, and so forth, as modeled in your customer database.

To understand why ROC is important, go back to the stock purchase for a minute, and imagine that the only information you have is how much the dividend is. You can't see whether the value of the underlying stock is increasing or not, or maybe decreasing. In that case, even though the actual value of the stock will be going up and down all the time, you really can't say how well your investment is doing. So far as you're concerned, as long as the dividend continues or increases, you seem to be doing just fine, but the truth is that without also knowing how the underlying stock price is changing, it's impossible to say whether you're really creating value or not. If you had a stockbroker who wouldn't tell you, you'd fire that stockbroker.

The fact is that many companies are content to measure, carefully and sometimes with maniacal precision, their current sales from customers, without ever noticing, or measuring, or demanding to know how much the customer equity lying underneath the current numbers has gone up or down. But because customers are a scarce resource for businesses, when a company doesn't try to measure how much of that resource is being used up to create its current numbers, it is getting an incomplete picture of its financial performance.

[56]Don Peppers and Martha Rogers, "Return on Customer: A Core Metric of Value Creation," *Customer Strategist* 2, no. 1 (March 2010): 30–39.

Return on Customer = Total Shareholder Return

Total shareholder return **(TSR)** is a precisely defined investment term that refers to the overall return a shareholder earns from owning a company's stock over some period of time.[a] According to one financial authority:

> *Total Shareholder Return represents the change in capital value of a listed/ quoted company over a period (typically one year or longer), plus dividends, expressed as a plus or minus percentage of the opening value.*[b]

This definition is based on what a shareholder's actual cash flow would be if they were to buy the stock at the beginning of the period and sell it at the end. The shareholder gets cash dividends during the period, and by the end of the period there may also have been some up-or-down change in the capital value of the stock itself. In a perfect world (economically speaking, that is), a publicly traded firm's market-driven capital value would equal its discounted cash flow (DCF) value, corrected for the effects of its capital structure. Of course, there's no way to prove or disprove this because no one really knows what any company's discounted cash flow is going to be in the future. Nevertheless, it's widely accepted that the market price of a public company's stock at any point in time should generally reflect the marginal investor's best guess as to the company's discounted future cash flow.

To understand the argument that ROC equals TSR, start with the premise that all revenue and costs created by any company's business operation[c] must come from its customers at some point, directly or indirectly. If the discounted cash flow value of an operating business is created entirely by customers, then its discounted cash flow is composed of a whole lot of individual LTVs. All the firm's current and future customer LTVs added together (i.e., its customer equity) will therefore equal its total discounted cash flow. As a result ROC equals a company's current-period cash flow, plus the change in its discounted cash flow value during the period, expressed as a percentage of its beginning discounted cash flow value.

In other words, ROC is simply a different route to prospective TSR—a method that breaks the economic value of a business into smaller and smaller customer-specific units, all the way down to specific, individual customers. ROC calculations don't rely on changes in share price, but if a firm's shares are publicly traded then stock price can still provide an important additional reference point for validating the firm's total customer equity.

A final note about shareholder return: The formal definition of TSR may refer only to publicly traded companies, but all companies have shareholders. Whether shareholder return is calculated in order to flesh out an SEC filing or just to decide how much everybody gets paid this year, and whether shareholder meetings take place on the 68th floor, at the investment company's office, or around the kitchen

(*continued*)

table, shareholder return is the most fundamental metric of value creation for any kind of business.

Both shareholder return and ROC apply to every company that needs a bookkeeper.

[a] When we talk about shareholder return, we're really talking about the rate at which an enterprise is creating value for its owners.
[b] The definition of TSR came from Value-Based Management.net, at https://www.valuebased-management.net/methods_tsr.html, accessed August 23, 2021.
[c] In considering a firm's business operation, we are purposely disregarding capital structure and thinking only of the firm's actual business as a business.

Source: Updated from Don Peppers and Martha Rogers, Ph.D., *Return on Customer: Creating Maximum Value from Your Scarcest Resource* (New York: Currency/Doubleday, 2005), pp. 15–16.

A firm can calculate ROC for a particular customer, if it has reliable information about that customer's LTV, change in LTV, and profit for the period, or it can calculate ROC for a particular group or segment of customers, as well. If the firm calculates its ROC with respect to its total customer equity, the result will be mathematically the same as its TSR during the period. (See the box "Return on Customer = Total Shareholder Return.") Remember that a firm's customer equity is virtually the same thing as the value the firm has as an operating business. Therefore, ROC equals TSR.

Return on Customer = Total shareholder return

Suppose we try to estimate ROC and use it to begin tunneling a path through the mountain of a company's financial performance. At the same time, the company's accountants begin tunneling toward us from the opposite side of the mountain, trying to estimate the firm's TSR (based on its discounted cash flow value as a going concern). The mathematics suggest that we should meet at roughly the same place in the middle. Because ROC = TSR, a company can be truly happy with its ROC only if it exceeds its cost of capital, because only then is the firm actually creating value, overall, for its shareholders. (Obviously, if an investment doesn't earn a return greater than a firm's cost of capital, the firm is better off not making the investment at all. Whenever a firm creates net new shareholder value, this is because its total shareholder return has exceeded its cost of capital by at least a tiny margin for some period of time.)

Therefore, when a firm's ROC for some marketing initiative is less than its cost of capital, whether it is calculating ROC for the whole company or for some smaller subset of customers and prospects, it would be better off not undertaking the initiative. No value is created for a business when TSR is lower than the cost of capital, and because ROC = TSR, no value is created for a firm when ROC is less than the cost of capital either. Even though a firm may be showing a current-period profit from some set of customers, if its ROC for those customers is less than its cost of capital, then it isn't benefiting its shareholders, because not enough customer equity is being generated.

Many companies that show little growth or hard-fought, tepid earnings are actually not creating net new shareholder value at all but simply harvesting the customer LTVs they already have in the bank. If an enterprise wants to grow and continue to grow, it has to ensure that every sales, service, and marketing initiative will yield an ROC greater than its cost of capital. That way, even as it is realizing earnings in the current period, it will also be building enough new customer equity to support future earnings.

Analyzing a company's ROC at the enterprise level can help clarify its financial prospects in ways that traditional financial statements aren't likely to reveal. To help you visualize this, Exhibit 11.2 shows an array of five different hypothetical companies divided into three categories, depending on whether each company is creating value, destroying it, or merely harvesting it.

Companies 1 and 2 in this exhibit are **value creators**. For these two companies, the combination of short- and long-term value created by their customers is occurring at a rate that is almost certainly higher than their cost of capital. In each case they are ending their year with higher customer equity than they started with, so they can expect to grow their earnings in future years as well. Although it's clear each company is creating net new value for its shareholders, in Company 2's case, this net new value is being created despite the fact that the firm's current profits are actually negative.

EXHIBIT 11.2 Are You Creating, Harvesting, or Destroying Value?

	Company 1	Company 2	Company 3	Company 4	Company 5
Customer equity at beginning of year	$1,000	$1,000	$1,000	$1,000	$1,000
Customer equity at end of year	$1,200	$1,200	$1,020	$950	$900
Change in customer equity during the year	$200	$200	$20	(–$50)	(–$100)
Profit during the year	$50	(–$50)	$30	$50	$50
Total customer value created	$250	$150	$50	$0	(–$50)
Return on Customer	25%	15%	5%	0%	(–5%)
	Value Creators		**Value Harvesters**		**Value Destroyer**

Source: We are indebted to the insights of Taylor Duersch and other members of Carlson Marketing's Decision Sciences team, now a part of Groupe Aeroplan, for helping us to clarify the role that customer equity plays in future earnings. Taylor Duersch is now a vice president at Sam's Club.

Companies 3 and 4, however, are what we would call **value harvesters**. They are simply treading the financial water by harvesting customer profits that already have been "put in the bank" in the form of customer equity. Their ROC is not negative, but it is clearly below their cost of capital. Although each is earning a current profit, neither one is replenishing its customer equity enough, so it's unlikely that either of these companies will be able to achieve much growth in future years. They may continue to report lukewarm, increasingly difficult profits for the time being, but sooner or later, their customer equity will no longer be sufficient to sustain a profit at all. Technically, they may not be destroying shareholder value yet, but if these firms were people, they would be living off their savings.

As a **value destroyer**, Company 5 is in the worst situation of all, with ROC below zero. True, the company has scraped out a profit this year, but this profit was achieved only by stealing even more from the future. One can imagine a car manufacturer offering the deepest-ever discounts in order to prop up the fourth quarter's numbers. In the process, it saddles itself with a saturated market and customers trained to wait for more discounts, creating a much more difficult problem when it comes to making next year's numbers. Company 5 is on the skids, whether this is revealed in its current financial statements or not. It may be reporting a profit to shareholders. But shareholders who dig deeper will see that this firm doesn't have the operating and financial strength necessary to sustain this level of earnings for long. What this firm is really doing is "eating itself" and reporting the meal as a profit.

Using Up Customers

We know a multiline insurance company in the United States we'll call Company X. It sells auto, property, and life insurance through a network of its own agents, each having the authority to sell any of the company's products. Some of these products generate more profit than others. Life insurance, as one example, tends to sell at a higher margin and is less subject to fraud, when compared to auto insurance. To protect agent profitability and maintain order within the distribution channel, Company X doesn't allow any of its own agents to solicit clients from any of its other agents. So once an agent lands a new customer, no other agent from that company can ask that customer for additional business.

The problem is that for a variety of reasons—background, predisposition, expertise—some agents simply don't sell all of Company X's insurance products with equal enthusiasm and effectiveness. Consider an agent who has a fine track record for recruiting new auto insurance customers but then rarely, if ever, elects to sell any other line of insurance product to customers. They have found that they can build themselves a bigger book of business, faster, simply by concentrating on acquiring more and more auto insurance customers, a task they are is exceedingly good at, rather than spending time and energy learning how to sell property or life insurance, or some other product, to their existing customers. Of course, every new

(*continued*)

customer they recruit won't be buying any other type of insurance from Company X, because no other agent is allowed to solicit, while the agent is unlikely to suggest other products.

In effect, Company X is "using up" a whole customer whenever it sells an auto policy through this agent. If there were an unlimited supply of new or prospective customers, this wouldn't be a problem, but the supply is not unlimited. Even putting aside the fact that a single-product customer has a greater proclivity to wander away to a competitor, the real issue here is that every time the company gets a customer and does not get the most possible value from that customer, the company loses a real monetary opportunity. And it cannot simply make this opportunity up by finding more customers.[a]

With the right metrics and a thorough analysis, Company X might discover that the value this agent leaves on the table with each new customer recruited is more than the value generated by each auto policy they sell. If that were the case, then this particular agent is not creating value for the company at all but destroying it. That's right: Company X may actually be destroying value every time this particular agent recruits a new customer. There are several solutions to this problem. One is to use available software, such as Agency Revolution, to make sure all leads have been followed through, and that additional offers are appropriately made to customers, either through teaming current salespeople or by virtually connecting customers with the right salespeople. In either case, the rewards will be for increasing the value of a customer rather than closing a product sale.[b]

Company X's business has been based on the belief that as long as its sales and marketing effort is effective, it can always acquire more customers from somewhere. But this is a false assumption. Instead, to make the right decisions as a business, you must always take into consideration the population of customers and prospective customers truly available to you. After considering the whole population of customers and prospects, your job is to employ that population to create the most possible value for your firm.[c]

Because customers are scarcer than other resources, using up customers is more costly than using up other resources.

If you let this thought sink in for a minute, you'll realize that it requires us to adopt a perspective on a business that will lead us to make different decisions. Evaluating your business model, or your company's various sales and marketing and other activities, from the standpoint of return on investment or payback ratio or some other financial metric, is important, but it's even more important to evaluate every action you take based on how many customers you have to *use up* to achieve the financial results you want.

Because customers are scarcer than other resources, using up customers is more costly than using up other resources.

(*continued*)

[a] Sometimes companies use up customers with technology. Jill Dyché, author of several excellent books on customer data coordination and management, explains how CDI (customer data integration) would help distinguish between John Smith (the very valuable customer) and John Smith Jr. (the deadbeat) so we don't turn down the former for a high-profit loan. Getting the process right is as important as getting the philosophy and the compensation right.
[b] Peter Manchester, "Why the Insurance Industry Needs to Rethink Its Value Proposition," Ernst & Young, July 15, 2020, available at https://www.ey.com/en_us/innovation-in-insurance/why-the-insurance-industry-needs-to-rethink-its-value-proposition, accessed December 14, 2021; and Yoann Michaux, "Four Ways Insurance Companies Are Improving Their Customer Experience," IBM Smarter Business Review, May 18, 2021, available at https://www.ibm.com/blogs/services/2021/05/18/four-ways-insurance-companies-are-improving-their-customer-experience/ , accessed December 13, 2021.
[c] Manchester, "Why the Insurance Industry Needs to Rethink Its Value Proposition."

Source: Adapted and updated from Don Peppers and Martha Rogers, Ph.D., *Rules to Break and Laws to Follow: How Your Business Can Beat the Crisis of Short-Termism* (Hoboken, NJ: John Wiley & Sons, 2008), pp. 43–45. Updated 2021.

From the figures in Exhibit 11.2, it should be clear what kind of company represents the best value for an investor, although to a large extent savvy investors will have already discounted each firm's stock price to reflect its growth prospects. Nevertheless, if a firm succeeds in converting itself from one class to another—say, from value harvester to value creator—this will likely have a major impact on its economic value as an operating business. As investors uncover this information, the firm's stock will almost certainly be revalued in a significant way.

The Verizon Wireless situation we discussed earlier in this chapter resembles Company 1's situation in the exhibit. The firm produced good earnings while simultaneously accumulating even more customer equity. We calculated Verizon Wireless's ROC in each of those four years, and it averaged a whopping 68% annually. Stated differently, each year during the period we analyzed, Verizon Wireless created enough total new value to equal about two-thirds of its value as an operating company at the beginning of that year.

Yes, such a high ROC for four years running represents a remarkable spurt of value creation, but the way to think about it is that each year Verizon Wireless was revaluing its entire customer base, steadily improving the overall value of its business. Its success in customer retention was building up the company's customer equity account to a level that could support even higher earnings.

Estimates for Verizon's competitors during the same period revealed ROC measures ranging from only 19% to below zero. Even if all of the companies, including Verizon, offered investors about the same *current* returns, which company would you rather invest in? Or work for? Or acquire? Or be the customer of?

Tracking customer LTV allows a firm to calculate ROC in a variety of situations, sometimes in order to decide what the best course of action is and sometimes simply to avoid self-defeating business decisions that generate unanticipated (or unmeasured) costs. At many firms, for example, customer acquisition programs are evaluated simply on the basis of the quantity of new customers acquired rather than on their quality (i.e., their expected LTVs and growth potential). Profit optimization programs often look at cost savings without considering customer retention issues. And retention programs designed to reduce churn might do so by maintaining marginally profitable customers or even unprofitable ones.

These are, in fact, the self-defeating criteria by which many telecom companies evaluate their own actions. Because they don't track changes in customer LTVs, they have no real understanding of the overall value they are creating or not creating with their everyday tactical decisions. For the most part, many telecommunications firms seem to have an indiscriminate hunger simply to win any new customers they can and to avoid losing their current ones, no matter what the LTV economics are in either situation. These firms are making decisions designed to maximize their current-period earnings, and it's possible that they actually are doing so. The problem, however, is that this may undermine their companies' long-term viability. They actually may be destroying more value than they are creating.

According to one group of industry experts writing at the time of the previous Verizon example, many if not most telecom firms have seen the average LTV within their customer bases decline quite significantly in recent years:

> *Some [telecom companies], for example, have tried to reduce churn by offering discount plans and other incentives—but ended up retaining customers they would have been better off losing and making formerly marginal customers unprofitable. Others have tried to contain the surge in unpaid bills by tightening credit limits on new applicants but are now turning away many customers who would have been profitable.*[57]

In essence, according to this authority, this is an example of a whole industry full of companies that are essentially strip-mining their base of customers and prospects to feed their current-period results. As they continue with these policies, it becomes harder and harder to pump up the current period, while at the same time the customer environment is becoming increasingly polluted with uneconomic offers and unprofitable programs. It is anyone's guess as to whether telecom firms are actually *willing* to sacrifice the future in their increasingly desperate effort to prop up the present, or they simply are *unaware* of what they are really doing, because they don't have the right customer-centric metrics in place.

[57]Adam Braff, William J. Passmore, and Michael Simpson, "Going the Distance with Telecom Customers," *McKinsey Quarterly* 4 (2003): 83–93.

Measuring, Analyzing, and Utilizing Return on Customer

ROC is a decision support tool for executives and can help an enterprise evaluate the total costs and benefits of its actions with regard to specific customers or groups of customers, taking into account both short-term and long-term costs and benefits. To do this, the ROC metric includes whatever profit or loss is attributable to a customer in the current period (the short term), as well as any change in that customer's lifetime value during the projected period (the long term). When used appropriately, ROC can thus reveal and combat the short-termism that plagues so many of the metrics and incentives that today's enterprises commonly use to evaluate the financial costs and benefits of their various customer-facing actions.

As we stated previously, the ROC can be calculated by adding together whatever profits have been earned on a customer in the current year, plus any change in that customer's lifetime value during the year, and then dividing that total by the customer's total lifetime value at the beginning of the year. We can write this as an equation, in the following form:

$$\mathrm{ROC} = \frac{P_0(\mathrm{LTV}_1 - \mathrm{LTV}_0)}{\mathrm{LTV}_0}$$

where:

P_0 = profit (or loss) attributable to a customer in the current year
LTV_0 = the customer's LTV at the beginning of the current year
LTV_1 = the customer's LTV at the end of the current year[58]

ROC analysis presupposes that an enterprise is actively estimating its customers' lifetime values, based on financial modeling that takes into account a customer's past behaviors, interactions, and transactions, and uses that information to predict the customer's future behavior. This prediction, of course, is simply an estimate, but it should be based on the behaviors that other, similar customers exhibited in the past, when faced with similar circumstances, or in similar situations.

Sophisticated, computer-based analytical studies involving things such as customer segmentation, profiling, churn modeling, propensity modeling, response modeling, and cost analysis, are the tools with which an enterprise could estimate the future behavior of a customer at a certain time—based, of course, on what is already known. Although technological advances in recent years and the increasing speed of computing tools make the statistical modeling effort relatively easier, most of the work still involves ensuring that the right **attributes** are collected accurately, reflecting relevant customer behaviors and appropriate values within the model. But no matter how sophisticated the analysis, making these decisions will necessarily involve a great deal of judgment and sometimes creativity as well.

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[58]This equation was first used in Don Peppers and Martha Rogers, "Return on Customer: How Marketing Actually Creates Value," *Marketing Review St. Gallen* 28 (2011), pp. 14–19.

Customer Lifetime Values: Practical Considerations

We have defined a customer's lifetime value as the "net present value of the future financial **contributions** attributable to a customer, behaving as we expect the customer to behave—knowing what we know now, and with no different actions on our part."

It should be obvious that a customer's lifetime value is impossible to know with any certainty, for the simple reason that it involves the future behaviors of a live, thinking being, living in a volatile world. Only a mind reader would be able to predict that being's personal decisions in advance, and the best futurists can't predict everything that will happen. That having been said, it is nevertheless true that *LTV is a real, actual number*. It is not merely a conceptual idea. To prove it, think about choosing some customer from an enterprise's distant past—say, 20 years ago. From the historical records of that customer's patronage over the next 20 years, the customer's LTV to the enterprise as of 20 years ago can easily be calculated, and with precision.

The question for today's marketer is how best to employ the LTV concept to make decisions that are good in the long term, not just in the short term, by guessing correctly at the "future financial contributions" that a particular customer or set of customers are most likely to generate. A good analogy for this would involve investors trying to guess at the future cash flows that might be generated by a share of stock or a bond. Investors buy and sell such securities to each other based on their differing *guesses* about the amount of cash flow that each security will generate in the future, and then discounting that cash flow back to the present to get its net present value. But while no investor can ever know for sure what cash flow will in fact be generated in the future, there is an active market of investors with a wide range of insights and perspectives trading various securities back and forth, creating a market that rewards good guesses, penalizes bad guesses, and generates a "fair market price" at any given point of time for every publicly traded security.

As with LTV, the "future cash flows to be generated" by any publicly traded security cannot be known in the present, but these future cash flows still represent a *real number*, not merely a conceptual idea. It is the true economic value of a security, and it is a quantity that eventually *will* be known, although it cannot *yet* be known, and so it must be guessed at. And these guesses are what fuel the very concept of a stock market.

The economist Fischer Black, one of the authors of the famous Black-Scholes equation for valuing stock options, wrote that he would consider a stock market to be efficient if a firm's stock price were always between 50% and 200% of its true economic value. In other words, if the true economic value of a company's future cash flows would set its stock price at $100, Black would consider the stock market to be efficient as long as it didn't value the company's shares below $50 or higher than $200. This is a pretty wide margin of error, even given the fact that no one can truly know the future, but Black's point was that it would still be sufficient to enable investors to make informed decisions about the reasonableness of their investments.[a]

(*continued*)

This margin of error might not be a bad guide for evaluating customer lifetime values, either. While practitioners sometimes talk about customer lifetime values as if these "future financial contributions" from individual customers could somehow be precisely calculated or accurately predicted, the hard truth is that they can't be, not even with all the calculating power in the universe. On the other hand, as with stock markets, if an enterprise's estimate of customer LTVs is no less than 50% nor more than 200% of the actual, it is undoubtedly accurate enough to facilitate better business decisions, based on a clearer view of reality than that which would be presented by relying entirely on short-term metrics and ignoring reasonable estimates of the value of customers' future behaviors.

Simply acknowledging that a customer's lifetime value is a real number, even though it can't be known in the present, can provide useful ways for the marketer to communicate with the budgeting and finance departments with respect to the investments an enterprise makes in advertising, sales incentives, and customer experience improvements. And when we also acknowledge that LTV is impossible to know precisely, we can easily make a case for developing and using the kinds of **proxy variables** described in Chapter 6.

[a] *Rules to Break and Laws to Follow*, p. 37. In his 1986 Presidential Address to the American Finance Association, Fischer Black said, " . . . we might define an efficient market as one in which price is within a factor of 2 of value, i.e., the price is more than half of value and less than twice value." Fischer Black, "Noise," *Journal of Finance* 41, no. 3 (July 1986), https://doi.org/10.1111/j.1540-6261.1986.tb04513.x, accessed October 26, 2021.

At one large Canadian bank, **customer portfolio managers** are evaluated and rewarded in a way that mandates their continued interest in building short-term revenue as well as long-term customer equity. If you were the portfolio manager for a group of customers (who likely don't know of your existence), you'd be the gatekeeper for communications from the bank to each of those customers. It would be your job to figure out how to eliminate roadblocks to doing more business with each of those customers, and—by taking the customers' point of view based on analysis and insight—to maximize the value created by each of those customers. You wouldn't allow the mortgage people, say, to send everybody in your portfolio a mass mailing, but rather would insist that messages be sent only to those who'd find it relevant. At the end of the quarter, you would be rewarded based on two measurements:

1. How much profit did the bank make on your portfolio of customers this quarter?
2. As of this quarter, what is the three-year projected value of the customers in your portfolio?

This two-part compensation model guarantees that you will not be tempted to do anything that will make money in the short term but jeopardize long-term customer equity—no hidden fees, no service cuts valued by customers, nothing that will reduce the long-term number. Unless both numbers are good, you won't get a bonus.

LEADING INDICATORS OF LTV CHANGE

Once a firm is practiced enough in analyzing LTVs to begin monitoring how changes in LTV are caused, it can begin to apply the ROC metric to manage its marketing initiatives and its overall business more productively, focusing on the most important factors in improving its customers' LTVs. If customer loyalty is the dominant factor in an enterprise's customer equity calculation, then improving customer loyalty will be key to success. If profit on value-added service is the dominant variable, then services should be emphasized. Making the right business decision will depend on the current performance of a firm's LTV parameters and on the effort required to influence the improvement of these parameters. Improving on a metric where performance is already high is generally more difficult (and costly) than focusing on an area with more room for improvement. Once Verizon Wireless had reduced its monthly churn from 2.6% to 1.1%, for instance, it will not be possible to duplicate that reduction, and the firm likely will have to find other ways to increase its customer equity if it wants to sustain such a high ROC.

ROC requires an enterprise to predict future customer behavior changes using currently available information. In essence, a company's analytics program must identify and track the leading indicators of LTV changes. The question is, what data are available today to forecast up or down movements in a customer's LTV?

The predictive modeling process involves two basic steps. The first step involves devising an equation for LTV that includes whatever transactional records or other data are available on customers' actual past spending (and other measurable behaviors, such as visits to the website or social media platforms, trackable referrals, complaints, etc.). It's best if there are several years' worth of transactions, but often a company will have to make some assumptions based on business judgment or sampling. Such records might include, for instance, each customer's purchases every year, the margin on those purchases, and the number of years the customer has done business with the firm. Essentially, the company is using the computer to go back through historical customer records and make the actual calculations of LTV for as many individual customers as possible.

The second step is to identify the most predictive currently available variables with respect to the LTVs calculated in the first step. If we start by calculating LTVs for individual customers using historical records, we then comb back through all the information we have about those individual customers in order to pick out **correlations** and relationships with their individual LTVs. The data to be used should include proxy variables such as purchase transactions to the extent possible but might also include complaint and service records, demographic (**B2C**) or firmographic (**B2B**) information, needs-based research, or even information on customer attitudes—essentially, any information at all that can be obtained in a customer-specific form, with respect to the customers whose LTVs already are calculated.

In the end, the objective is to generate a second equation for LTV, but this will be an equation that uses currently available data to predict an individual customer's LTV rather than using transaction data to calculate it retrospectively, as is the case for **recency, frequency, and monetary value (RFM)**, which is often used by database marketers. One large consumer service business devised a predictive model for LTV based on 10 years of customer transaction records. The company first ran a statistical analysis to see what independent variables most affected a customer's likelihood of returning, because likelihood of returning seemed to be the most important single factor in determining LTV. Using the findings from this analysis, the company created an equation for predicting the future revenue from each customer. This formula was not limited to transactional records but included outside variables as well, such as the general level of consumer confidence in the economy at large. Each customer's future contribution was estimated by applying historical margin to their predicted future revenue.[59] As one of their executives explained:

> *For a very high level summary of the LTV calculation, we ran a regression to see what independent variables affect a [customer's] likelihood of returning. We then used the coefficients of the successful variables to create a formula for predicting future revenue for each [customer]. At least one of these was external—something like consumer confidence. Finally we applied the historical contribution of each [customer] to get to future contribution. Our LTV calculation contains only future expected contribution. We applied the formula to historical customer data to get LTV from previous years.*

In the end, in addition to **descriptive data** (sometimes called *demographic data*),[60] the company's LTV model used such variables as the first type of service purchased, the average rate paid, and how recently the last service was purchased.

The variables driving any firm's LTV model can be thought of as the leading indicators of LTV change. The model won't ever be perfect, because predictions never are. There always will be problems having to do with the availability of data, analytical issues, and other obstacles. But reliability will improve with experience, as a firm learns to collect, monitor, and weight the information more and more accurately. The leading indicators of LTV change fall into four general categories, and the goal of each is better understanding of future value:[61]

1. ***Lifetime value drivers***. These are the elements of the LTV equation itself—the actual components that determine how much value the customer creates for the company, over time.[62] They will include loyalty and share of customer

[59]The information from the large consumer service business is proprietary but was documented for us in an email from a colleague sent to the authors, including the executive statement we've been allowed to share.
[60]See Chapter 7.
[61]See footnote 2 in Chapter 6 for a more complete review of customer lifetime valuation.
[62]While LTV has a lot to do with purchasing behavior and intent, as well as other facts about customers, the influence a customer has over the preferences and purchases of others becomes more and more important in this mix.

(as well as potential share of customer) but will also include cross-selling rate (number of company products used by the customer), as well as influence on other customers, through **word of mouth** and influence through social networks.[63] According to Dustin Hawley:

Plain and simple, social media influencers have a profound effect on their followers. And those effects directly relate and contribute to the purchasing journey of today's consumers. As the world continues on its path of technological advancement and social media continues to grow at a blistering pace, influencers will have gain more and more power over their audiences, and that means power over their purchasing decisions. Understanding this influence is essential in constructing your marketing tactics and overall branding strategy. And utilizing these resources while they are still essentially in their infancy can put you leaps and bounds ahead of your competition. If you still don't believe that social media personalities have substantial influence over the purchasing decisions of their audience, and today's consumer base in its entirety, be prepared to watch your competitors pass you by.[64]

2. ***Lifestyle changes***. When a customer takes a new job, or gets pregnant, or retires, or gets married or divorced—when their lifestyle or personal situation undergoes a substantial change, the LTV may also be affected. Demographic information and vital statistics can often be obtained from third-party databases, independent of a company's own transactional and other records. Age and health may figure very prominently, but should be considered in the context of other factors. The data must be clean and accurate. Business customers, too, go through stages and lifestyle changes. When a business becomes less profitable or more profitable, its buying behavior will likely change. When a privately held business goes public, or when a company acquires another firm, its behavior will change.
3. ***Behavioral cues***. The number of contacts initiated, the services or products contracted, the number of complaints or comments submitted, and payments made or not made are all examples of behavioral cues.

   Suppose a business has a satisfied consumer customer spending $100 a month, with an estimated LTV of $10,000. Now suppose this customer calls in to complain about a faulty product or an episode of bad service. The call center rep handles the complaint professionally. As a result, the customer not only remains satisfied but actually writes a complimentary letter to the firm and tweets to friends and followers. It is highly likely that this customer's LTV will have increased dramatically with that transaction. The transaction created actual value for the company right then, even though the firm hadn't yet collected any cash as a result of the customer's increased propensity to buy or to

[63]For an insightful look into how online and face-to-face word of mouth (WOM) relate, see Ed Keller and Brad Fay, *The Face-to-Face Book: Why Real Relationships Rule in a Digital Marketplace* (New York: Free Press, 2012).

[64]Dustin Hawley, "How Do Influencers Contribute to the Purchase Decision Process?" available at https://www.viralnation.com/blog/how-do-influencers-contribute-to-the-purchase-decision-process/, accessed May 23, 2021.

recommend it to friends. In point of fact, the firm actually might have incurred a current-period cost to satisfy the complaint.

4. ***Customer attitudes***. These include such things as satisfaction level, willingness to recommend your company or products, and likelihood of buying from you again. A customer's attitudes have a strong influence on their future behavior. Attitudes are not observable behaviors but moods and points of view that can be accurately assessed only via surveys or fielded market research. They are important, however, because they influence behavior, so to the extent a firm tracks such attitudes, it should be able to make informed judgments about changes in its customer equity.[65] At its core, Fred Reichheld's Net Promoter Score (NPS), discussed in Chapter 6, is based on the idea that a customer's willingness to recommend a product to a friend or colleague is directly correlated with the customer's own satisfaction with the product and with the future sales the product will generate from that customer. Some authorities have achieved moderate success in correlating customer satisfaction levels with market value.[66] The degree to which a firm is perceived to pay attention to its customers also affects customer attitudes and willingness to do business with it in the future. One classic study, jointly led by Roper Starch Worldwide and Peppers & Rogers Group, showed that among bank customers who rated their banks as providing good customer service, an ability to treat a customer as a distinct individual (such as providing a personal contact, sending only relevant messages, and anticipating the customer's needs) made a significant difference in that customer's future intentions. Of those who rated their banks high on customer service but low on such relationship capabilities, 26% stated that they

[65]Customer attitudes, like other soft (nonfinancial) measures, were once the epicenter of a controversy. On one side were those who believed that customer attitudes, brand value, employee turnover, and other nonfinancial measures would prove to be clear predictors of future performance. On the other side were those who maintained that a lot of what we believe, including that customer satisfaction adds value and reduced employee turnover reduces costs, was simply folklore. See Allan Hansen, "Nonfinancial Performance Measures, Externalities, and Target Setting: A Comparative Case Study of Resolutions through Planning," *Management Accounting Research* 21, no. 1 (March 2010): 17–39; and Robert Bruce, "Non-Financial Measures Just Don't Add Up," *Financial Times*, March 29, 2004, p. 10. But more recent studies tend to support the predictive value of attitude or emotional loyalty. See Rich Karlgaard, *The Soft Edge: Where Great Companies Find Lasting Success* (San Francisco: Jossey-Bass, 2014); Vincent O'Connell and Don O'Sullivan, "The Influence of Lead Indicator Strength on the Use of Nonfinancial Measures in Performance Management: Evidence from CEO Compensation Schemes," *Strategic Management Journal* 35, no. 6 (June 2014): 826–844; and Donna M. Booker, Dan L. Heitger, and Thomas D. Schultz, "The Effect of Causal Knowledge on Individuals' Perceptions of Nonfinancial Performance Measures in Profit Prediction," *Advances in Accounting* 27, no. 1 (June 2011): 90–98.

[66]See "CFI Group: Research Links Customer Satisfaction to Stock Returns," Business Wire, July 5, 2012, https://www.businesswire.com/news/home/20120705005269/en/CFI-Group-%20Research-Links-Customer-Satisfaction-Stock, accessed August 30, 2021; also see Ellen Garbarino and Mark S. Johnson, "The Different Roles of Satisfaction, Trust and Commitment in Customer Relationships," *Journal of Marketing* 63 (April 1999): 70–87. These researchers found that for low-relational customers, satisfaction is a better predictor of future behavior, but for high- relational customers, trust and commitment are more important.

were likely to switch away at least one product in the next year. By contrast, among those who rated their banks high on customer service *and* relationship capabilities, just 1% stated any intention to switch products.[67] This astounding contrast is a strong endorsement for a customer relationship's benefits in retaining customers, at least when it comes to retail banking, and we've seen similar findings in the telecommunications industry.[68]

The key to ensuring that customer attitudes serve as a useful tool in tracking real-time LTV changes is to identify the correlations between a customer's current attitude—or change in attitude—and their actual behavior in the future (observable behaviors such as new purchases, repurchase, referrals, complaints and interactions, service calls, etc.). Measuring a customer's *change* in attitude would be particularly helpful for businesses that don't have the advantage of a sizable volume of customer transactions.

Reminder: It's not necessarily the wisest policy to pester customers directly for data, but it's always smart to capture whatever interactions and transactions occur naturally during the course of business. The more transactional data points a firm has with respect to its customers, the more opportunity it will have for using the data to deduce the future behavior of particular customers or groups of customers within its customer and prospect base.

STATS AND THE SINGLE CUSTOMER

To maximize ROC, an enterprise has to gain some practice in using LTV as a tool and in tracking how it changes over time. It can never be known exactly how much an investment in acquisition will yield, or how to measure retention precisely over an extended period, or how much additional business actually will be stimulated by a particular offer. Yet from empirical observations an analyst eventually will be able to deduce how LTV is likely to be influenced by various drivers and by the attitudes of customers. The big challenge will be to fashion the company's strategies not just to maximize this quarter's sales or "new customers added" but rather to maximize the

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[67] For more about the Roper Starch and Peppers & Rogers Group study, see "Customer Relationship Management in Financial Services: A National Perspective," Roper Starch Worldwide, CNO-385, September 2000. For an in-depth description of the research, see Jonathan Brookner and Julien Beresford, "One to One in Retail Financial Services: New Strategies for Creating Value Through Customer Relationships," Peppers & Rogers Group and LOMA (Life Office Management Association, Inc.), 2001.

[68] Jeffrey Prince and Shane Greenstein determined that switching a bundle would keep 40% of customers from switching phone/cable/Internet service, "Does Service Bundling Reduce Churn?" *Journal of Economics & Management Strategy* 23, no. 4 (Winter 2014): 839–875. In another article, David Myron notes that "bundling two services usually reduces customer churn by 25 percent. Bundling a third product reduces it by an additional 13 percent, and a fourth product reduces churn by an additional 6 percent." "Telecoms Focus on Services, Not Price, to Reduce Churn," *Customer Relationship Management* (May 2004).

rate at which the enterprise is creating overall economic value, in the long term as well as the short term.

Of course, statistical analysis has its limits. In a group of a million consumers, a statistical model can predict aggregate behavior, such as a likely response rate or attrition rate, with reasonable accuracy. Such models can detect behavior patterns that tend to indicate some future actions, such as defection, providing the manager with an ability to intervene. They can also be used as benchmarks. But reduce the size of the overall group being analyzed, and the stability of these statistical calculations begins to break down. At the level of the individual customer, even the most sophisticated statistical models are subject to a great deal of randomness and noise.

However, once a company does drill all the way down to the level of an individual customer, it can make direct, one-to-one contact, and this kind of interaction will always trump statistical models. If a firm has really good, up-to-date, reliable data about an individual customer, and if those data are based on direct interaction with the customer, then it should be able to predict the customer's behavior much more precisely than it could if the customer were simply one customer within some statistical cluster. For this reason, direct interaction with customers will provide an enterprise with the most useful and reliable leading indicators of those customers' future behavior.

For a company serving just a few hundred B2B customers, statistical models are rarely as useful as the objective judgments of the sales and account managers closest to the customers. These judgments, too, are just educated forecasts, but they can be made more reliable and accurate by adhering to a standardized set of criteria. Has a contract been proposed? Is there a standing purchase order? Do we provide the back-end maintenance as well as product installation? Is the relationship characterized by partnership and **collaboration**? Can this customer refer other customers to us? Have they done so in the past? Judgments made on the basis of such objective but nonquantitative criteria are critical to making educated decisions about customer LTVs. They help get a firm as close as possible, as objectively as possible, to understanding the actual values of individual customers.

This provides us with a good place to remind the reader that although traditional KPIs have been used since the beginning of the Industrial Revolution, give or take, they are not—if we really examine them closely—completely accurate either. We have all *agreed* they are accurate, and agreed they are fair, and agreed they are logical—and even predictive. ROC is a way to maximize long-term value and also hit short-term targets. Put another way, it is a way to hit short-term targets without sacrificing long-term value.

The metrics associated with managing customer relationships can provide invaluable insight into the profitability potential of the enterprise's customer base and the viability of the enterprise's new customer-strategy business processes. The customer-centric enterprise does, however, have to concern itself with other measurements and analyzing other pieces of information that are more specific to growing the overall value of each customer. **Treating different customers differently** can entail a detailed analysis of each customer to determine how the enterprise can alter their **trajectory** with the enterprise. Often this analysis can help turn customer information into knowledge the enterprise can use to help customers meet their needs.

The triggers, or predictors, of individual customer action and opportunity usually cannot be seen without detailed analysis. This is the increasingly complex and far-from-intuitive science of *customer-based analytics* and *customer experience analytics*, and having this discipline well represented on an enterprise-wide cross-functional team is critical. Sophisticated statistical models powered by technology can uncover some remarkable and highly predictive patterns. The ability to mine data is so valuable that its precise manifestations can be proprietary within certain companies. In the next chapter, we uncover some of these scientific applications of analytics within the **customer-strategy enterprise**.

CHAPTER 12

Customer Analytics, Martech, Critical Thinking, Data Science, and the Customer-Strategy Enterprise

Get your facts first. Then you can distort them as you please.

—Mark Twain

The triggers, or predictors, of individual customer action and opportunity usually cannot be seen without detailed analysis. This is the increasingly complex and far-from-intuitive science of *customer-based analytics* and ***customer experience** analytics*, and having this discipline well represented on an enterprise-wide cross-functional team is critical. Sophisticated statistical models powered by technology can uncover some remarkable and highly predictive patterns. The ability to mine data is so valuable that its precise manifestations can be proprietary within certain companies. In this chapter, we uncover some of these scientific applications of analytics within the **customer-strategy enterprise**.

Data, information, and analysis have always been important for any marketing professional trying to decide the right level of resource investment and the right course of action. In the pre-interactive age, product-centric mass marketers relied on data and analysis to help identify which types of customers were most likely to buy their product (i.e., how to get more customers).

Now, however, as **customer-centric** marketers focus on the ongoing, **interactive** relationships they have with their individual customers (and prospects), they use the exponentially greater quantity of available data not just to *get* more customers, but to *keep* them longer and *grow* them bigger, individually. They want not just to understand large numbers of customers, overall, but also to uncover the values and **needs** of *individual* customers, one customer at a time. Today's competitors want to use data to deduce the next product or service an individual customer is likely to want to buy and even to hear about, as well as to predict the next behavior the customer is likely to exhibit.

(*continued*)

In this chapter, we will look at the **customer analytics** function and ***martech*** (marketing technology) and learn about the fundamental issues facing customer-strategy companies as they try to derive more analytically reliable insights from such large amounts of customer data. Importantly, we will not be using quantitative methods within this chapter, but we will instead try to equip marketing professionals with enough understanding of the analytics and data science functions to enable them to ask appropriate, intelligent questions of, and to understand the answers provided by, the data scientists and analysts who use more quantitative methods.

Reliable data and good analytical processes are important to any customer-strategy enterprise's success, but—in addition—critical thinking is absolutely indispensable.

Information from and about customers has always been a vital part of business operations, throughout history, even before the computer came on the scene. Before computers, however, there was considerable friction and expense involved in collecting data, storing it, conveying it, and making calculations with it, let alone doing the kinds of massively analytics-intensive activities with customer data that companies now regularly manage. In the pre-computer era, because of the large expense involved in handling and manipulating data, many operations on large data sets were based on simple random sampling.

Consider, for instance, how the airline business operated in the pre-computer age. It was a difficult and time-consuming computational task for an airline to calculate what it was owed by another airline when a passenger connected from that airline. To streamline the customer experience, the airline industry has always permitted passengers to buy their entire airline travel itineraries with one purchase, even when the itinerary involves connections with another airline. The industry negotiated various interline agreements specifying how much of a total fare is due to each different carrier participating in the trip, and a passenger can therefore buy a single ticket from Airline X that involves connecting from X to a flight on Airline Y. When the passenger shows up for their flight segment on Airline Y, however, that airline must bill Airline X for Y's share of the total fare collected by X, as provided by the interline agreement.

Before computers this was an *immensely* difficult task, starting with paper tickets printed in red-ink carbon copies and usually written by hand. The carbon-copy ticket-coupon collected by Airline Y's gate agent had to be sent to Y's headquarters for processing, and it could easily require 10 to 15 minutes of a single accounting clerk's time at Airline Y just to calculate, for that single ticket, how much to bill Airline X for Y's leg of the trip. Then an accounting clerk at Airline X would spend an equal amount of time checking the same data, just to be sure they weren't being overcharged by Airline Y. Multiply this by the *millions* of different flights taken and ticket coupons collected each month, and the computational expense significantly bit into the price paid by the customer.

So the airlines negotiated an agreement among themselves, reducing that expense by some 90%. Rather than performing the accounting calculations on *every* ticket, they simply agreed to do a random sample of calculations on 10% of all tickets collected, and then they billed each other for 10 times whatever amount was calculated for the random sample. Every month, the airline trade association would select a random digit, from 0 to 9, and for that month the tickets with ticket numbers ending in *that* randomly selected digit were the only ones totaled and calculated.[1]

CUSTOMER-SPECIFIC DATA AND LONGITUDINAL INSIGHT

As computers gradually came to play a bigger role in business operations, and even before the interactive revolution that arrived with the internet and World Wide Web, businesses found that they could use computers to make better and better decisions with respect to managing the products and services they sold. They cut costs for inventorying products, they more accurately tracked and forecast sales volumes, and they performed their accounting and finance functions with spreadsheet ease.

But it was in using *customer-specific* data that they were able to begin dipping their toes into the water of the customer-centric revolution. And before the internet, the primary vehicle for collecting customer-specific data was the loyalty program. For a customer, the **benefit** of a loyalty program is in the miles or points, or the discounts and rebates earned by giving their loyalty to the company offering it. But as we said in Chapter 5, over and above the customer's loyalty, a significant and perhaps even more valuable benefit for the company is the data that a loyalty program generates, as it tracks the purchases of participating customers, one customer at a time, across all the company's various products, services, divisions, and functions.

This kind of customer-specific data generates what we might call **longitudinal insight**—that is, insight into individual customers' behaviors, over time. All marketers need longitudinal insight to see how their business is actually affected by the experiences their customers have with their products, but some **business models** won't naturally provide that insight without a tool like a loyalty program because for some businesses such a program is the only cost-efficient way to **identify** customers individually.

With a chain of retail stores, for example, customers come in and buy products, pay for them at the cash register, and leave. Without a loyalty program or some other customer-specific mechanism (for instance, a membership requirement, an app, or a registration of some type), a physical retailer has no practical means to connect a customer's purchases today with what that particular customer purchased yesterday or called about last week.

[1]Don was the director of accounting of a regional airline in 1979, and this is how all domestic airlines operated at that time, when it came to auditing, accounting, and billing for interline flights.

Product Analytics

Let's say a store's merchandising manager wants to decide how to allocate shelf space to various products carried in the store. They'd like to reduce the space given to the least profitable products, while increasing the amount of space allocated to more heavily bought products. To make this decision using product data, they would look at the figures provided by up-to-the-minute point-of-sale (POS) data—computer-tabulated data that comes from scanning product bar codes at every cashier station. With POS data they will know exactly what products are selling at which stores. So let's suppose that the POS data our merchandising manager sees for three different products stocked in one category show this:

EXHIBIT 12.1 Traditional Product Analytics

	Weekly Units	Weekly Spend	Total Stores	Spend per Store
Product A	10350	$ 26,393	267	$ 99
Product B	6300	$ 17,010	210	$ 81
Product C	5100	$ 10,965	166	$ 66

Source: Don Peppers and Martha Rogers Ph.D., 2021

This table of product-only data can be thought of as a snapshot of each week's sales. Based on the data, the merchandising manager can see that Product A is clearly the star performer, with 1½ to 2½ times the volume of the other products being carried. Product C, on the other hand, appears to be the slowest dog in the race, and based on this data they might decide to de-emphasize it, or perhaps even discontinue it altogether.

The problem with a data snapshot like this, however, is that it gives our merchandising manager absolutely no insight into how many of the retailer's *customers* have actually tried each of these products over time, or how happy they've been with them. Rather than a snapshot of sales of *products,* in other words, they would need to view a movie of how *customers* are behaving, over time. They would need longitudinal insight.

Customer Analytics

So now let's suppose that in addition to POS data, the retailer also has access to individual, customer-specific data, as might be provided by a loyalty card, for instance, linking every member's transactions from week to week, month to month. This new data would allow the manager to look beyond product analytics, to customer analytics. And the longitudinal insight that customer analytics provides could help the manager see, at least with respect to the retailer's loyalty card members, how many customers have ever tried these products, as well as the number who have re-purchased. Suppose the new, more complete, table of data, based on customer-specific tracking, looked like this:

EXHIBIT 12.2 POS and Customer Analytics

	Weekly Units	Weekly Spend	Total Stores	Spend per Store	Customer Penetration	Repeat Rate
Product A	10350	$ 26,393	267	$ 99	0.81 %	4.3 %
Product B	6300	$ 17,010	210	$ 81	0.55 %	7.9 %
Product C	5100	$ 10,965	166	$ 66	0.45 %	16.0 %

Source: Don Peppers and Martha Rogers Ph.D., 2021

The first four columns in this table are the very same product-only POS data, but the last two columns show penetration and repeat rate. This information can only be calculated by using customer-specific data. And from this new data, our merchandising manager can see that Product C is not the dog but the star performer! Product C is repurchased by consumers almost four times as frequently as Product A, but revenue per store is low because less than one in 200 of their customers has even sampled it yet.

Rather than discontinuing Product C, the best course of action for our merchandising manager would be to promote it more, perhaps generating additional trials by using the loyalty program to offer a coupon, rebates, or two-for-one deals to those customers who haven't yet bought it even once. After all, the more customers buy Product C, given its repeat rate, the more loyalty and revenue it will generate for the retailer. And if any product were to be de-emphasized or discontinued, our merchandising manager would almost certainly pick Product A, even though that product is the retailer's current best seller. After all, the customer-specific data show such a low repeat rate that discontinuing this brand would disappoint the fewest customers, and may, in fact, serve to prevent customers from being discontented with a product that looked promising, but isn't.

With the same customer-specific longitudinal data, we can also determine how likely the firm's **most valuable customers** are to buy Product C, as well as any of the other products. And this will tell us whether discontinuing a particular product might upset a high number of MVCs, risking their defections.

The power of customer analytics involves the power of customer-specific data and longitudinal insight. With customer analytics, a business can see a whole different dimension to its operations: the customer dimension.

The Many Uses of Customer Analytics

Customer analytics contributes to better sales productivity and lower marketing costs in a number of different ways, in addition to making smarter decisions with respect to the right products to carry, and the priority each should be given. Customer analytics achieves the following:

- Makes it possible to send more relevant information and offers
- Helps to improve shopper-to-buyer conversion rates

- Results in smarter, more relevant (and therefore usually faster and less costly) **customer service**
- Enables a company to offer specific and more targeted cross-sell and up-sell opportunities, which can result in measurably increased sales
- Helps keep customers longer, increasing customer **lifetime value**, profitability, and **Return on Customer (ROC)**
- Reduces interaction time and effort, making information exchange or transactions easier, faster, and more likely
- Uses speech analytics to deliver real-time agent guidance
- Improves the customer's perception of the level of service as a result of relevant messaging during an interaction
- Makes improved service levels for higher-value and high-potential customers possible[2]

Those who use customer analytics, therefore, are not just trying to create an unobstructed view of the customer, but also enabling the enterprise to see things from the customer's own perspective. By delving into a customer's history with the firm, analytical programs can help the enterprise **customize** the way it serves or manufactures a product for a customer to suit that customer's individual needs. In essence, customer analytics helps the enterprise to transform its customer data into critical business decisions about individual customers. Customer analytics software can reveal hidden trends about a customer and compare their behavior to other customers' behavior. Customer analytics can not only play an important role in customer acquisition, by helping the enterprise decide how to handle different prospects differently and predicting which ones are more likely to become the most valuable customers,[3] but also identify which customers are most likely to churn, allowing an enterprise to take preventive action on a customer-by-customer level.

Customer analytics can also provide ***metadata***—information about information—that can help marketers spot characteristics and trends that enhance customer retention and profitability. Furthermore, customer analytics can be a technique for examining the profitability of specific products that individual customers purchase.

In this age of interactivity, **machine learning**, and **artificial intelligence**, customer-strategy businesses rely on ***data mining*** to help develop insights into the

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[2]See Forrester and CallMiner, "The Three Customer Service Megatrends in 2021," available at https://callminer.com/c/the-three-customer-service-megatrends-in-2021, accessed August 25, 2021. See also William M. Saubert, "Using Customer Analytics to Improve Customer Retention," *Bank Accounting & Finance* 22, no. 3 (April–May 2009): 33–38; Brendan B. Read, "Why Performance Analytics Is Important," *Customer Interaction Solutions* 27, no. 2 (July 2008): 24–25; and Kevin Cavanaugh, "Achieving Intelligent Interactions with Analytical CRM," *DM Review* 11, no. 5 (May 2001): 44–47.

[3]D. Anthony Miles, "Statistics Research: Measuring Customer Behavior and Profitability: Using Marketing Analytics to Examine Customer and Marketing Behavioral Patterns in Business Ventures," *Academy of Marketing Studies Journal* 18, no. 1 (September 2014):145-168.

qualities and characteristics of individual customers. SAS Institute defines data mining as "the process of finding anomalies, patterns, and **correlations** within large data sets to predict outcomes."[4] Investopedia describes data mining as ". . .exploring and analyzing large blocks of information to glean meaningful patterns and trends. It can be used in a variety of ways, such as database marketing, credit risk management, fraud detection, spam Email filtering, or even to discern the sentiment or opinion of users."[5]

As the late Frederick Newell pointed out in his classic work on the subject, *Loyalty.com*,

- Analytics helps profile customers so that the characteristics of loyal customers can be identified to predict which prospects are more likely to become the most valuable new customers.
- Data mining can help a company manage customer relationships by determining characteristics of customers who have left for a competitor, so that the enterprise can act to retain customers who are at risk of leaving.
- Analytics helps an enterprise learn the mix of products to which a group of customers is attracted so it can understand what different types of customers most value.

> Customer analytics is not a technology—it is a business process.

"With this knowledge," Newell writes, "we can mine the customer file for similar customers to offer suggestions they are likely to value. Without data and its being analyzed to develop information and knowledge about the way things are happening in the real world, all we have are opinions. Every expert we have talked to gives the same answer: 'Data mining is knowledge discovery.'"[6] Or to put it another way: Customer analytics is not a technology—it is a business process.

Real-Time Customer Analytics

Although data mining is still a term frequently used to describe the customer analytics process, the implied analogy to mining suggests a batch process, with the enterprise searching out nuggets of information, then cashing in by putting these nuggets to use. In the interactive age, however, the reality is that businesses are continuously developing real-time insights into the nature of their individual customers, not only so that

[4]SAS, "Data Mining: What It Is and Why It Matters," available at http://www.sas.com/en_us/insights/analytics/data-mining.html, accessed January 23, 2021. James Goodnight, Founder and CEO of SAS Institute, has said that "Data-driven marketing is not just convenient, but also context-appropriate, allowing brands to respond to a *moment of truth* at exactly the right time."

[5]Alexandra Twin, "Data Mining," Investopedia, September 20, 2020, available at https://www.investopedia.com/terms/d/datamining.asp, accessed January 23, 2021.

[6]Frederick Newell, Loyalty.com (New York: McGraw-Hill Professional Book Group, 2000).

the right marketing campaign or online offering can be created and launched, but also so the customer can be given the correct offer, or the most appropriate customer experience, *right now,* while the interaction is taking place.

Rather than mining the database of customer characteristics and interactions for some statistical correlation or other insight, and then putting it to use, in other words, today's marketers rely more and more on **real-time analytics**—insights that are developed and used while a customer is on the phone, or visiting the website, or standing at the checkout counter.

> Real-time customer analytics are necessary before a customer-strategy enterprise can optimize its real-time interactions with each of its customers.

Today, leading companies integrate the most relevant elements of their customer-analytics algorithms into their actual touch-point applications. If a customer behaves a certain way, then a mathematical algorithm can analyze that behavior and instantly access the most relevant offer or treatment for that customer, after considering everything the enterprise knows or predicts, in real time. Customer analytics enables the enterprise to classify, estimate, predict, cluster, and more accurately describe data about customers, using mathematical models and algorithms that ultimately simplify how it views its customer base and how it behaves toward individual customers.

BIG DATA

Customer data often comes in a structured format—that is, laid out in tables so that it can easily be found in a relational database (e.g., a spreadsheet). A list of customer names, addresses, and account numbers, or a record of the dates and times at which a customer accessed the website, or a record of purchase transactions made and UPC codes bought, or a compilation of complaints made, or refunds issued—all these data can be compiled in relational databases. The values of the tickets Airline A sells, along with the amounts it is billed by Airline B for their share of those tickets, would be structured data, compiled in a relational database.

But as computer technology has progressed, and as the cost of data storage has continued to plummet, more and more unstructured data is also being collected and recorded for future use. Wikipedia defines "unstructured data" as "information that either does not have a pre-defined **data model** or is not organized in a pre-defined manner."[7] Such data might include a YouTube video or a TikTok meme, the voice recording of a phone call, the voice-to-text computer-transcribed record of it, **social media** activity, facial-recognition imagery, or the real-time smartphone location data used for things such as predicting traffic in a traffic app or providing walking

[7]"Unstructured Data," Wikipedia, available at https://en.wikipedia.org/wiki/Unstructured_data, accessed Feb 21, 2021.

directions to the nearest Thai restaurant on Google Maps. In terms of its sheer volume, unstructured data already accounts for some 80% of *all* data being generated and recorded,[8] but with the rising importance of the **Internet of Things** (IoT) and the always-connected products and devices it will be composed of, unstructured data is on the verge of another dramatic—and exponentially increasing—surge.

There is already so much data available to organizations, in fact, and it has become so complex over the years, that analysts have taken to using the term **big data** to describe massive amounts of often unstructured data. According to a 2018 definition, big data "is where parallel computing tools are needed to handle data," and therefore represents "a distinct and clearly defined change in the computer science used."[9]

Viktor Mayer-Schonberger, Professor of Internet Governance and Regulation at Oxford, maintains that big data has distinct benefits because it:

> *. . . refers to things one can do at a large scale that cannot be done at a smaller one, to extract new insights or create new forms of value, in ways that change markets, organizations, the relationship between citizens and governments, and more.*[10]

Consider PriceStats,[11] for instance, a business in the big data space founded in 2010. PriceStats' computers scrape the web constantly to identify the retail prices charged for billions of items around the world, every day. By carefully selecting the best, most representative retailers with both online and offline offerings, the company can reliably report on inflation rates and purchasing power parity in 23 different countries around the world. The result is a *real-time inflation* number every bit as accurate as the official government statistics in those countries—numbers that typically appear two or more months after the fact, and have always been laboriously compiled based on various kinds of random sampling. Moreover, unlike many government agencies, as an independent business with no political agenda, PriceStats has no vested interest in the direction or magnitude of the data it analyzes, with the result that its inflation figures tend to be even more accurate than domestic governments' own inflation statistics. This is an example of how private analytics "serves as a credible outside check on national statistical bodies. For example, *The Economist* distrusts Argentina's method of calculating inflation, so it relies on the PriceStats figures instead."[12]

[8]Devin Pickell, "Structured vs. Unstructured Data—What's the Difference?," G2, November 16, 2018, available at https://learn.g2.com/structured-vs-unstructured-data#:~:text=What%20is%20the%20difference%20between,collect%2C%20process%2C%20and%20analyze, accessed August 25, 2021.
[9]Charles Fox, *Data Science for Transport* (Springer, 2018).
[10]Viktor Mayer-Schonberger and Kenneth Cukier, *Big Data: A Revolution That Will Transform How We Live, Work, and Think* (London: John Murray/Hachette UK, 2013), Kindle location 106.
[11]PriceStats, available at www.pricestats.com, accessed August 25, 2021.
[12]*Big Data*, Kindle loc. 643.

Cleaning and Maintaining Data

For now, let's look at big data about customers. Companies produce large amounts of data through their own wide array of customer-related business processes, including order entry, billing, reservations, complaint handling, product specification, voice of customer (VOC) surveys, online interactions, and sales calls. In addition, companies can watch for mentions and other relevant data in social media and other online sources, as well as online chat and other participation, and they can compile data relevant to understanding their competitive position by watching out for and compiling their competitors' social media mentions as well.

Often, however, even when a firm has the customer analytics resources necessary to unleash the value of its data, it finds that much of its information is dirty (expired, irrelevant, nonsequential, or nonsensible) and needs to be cleaned (eliminated, updated, correlated, and/or refined). Data scientist Stephen H. Yu, President and Chief Consultant at Willow Data Strategy, argues that "more than 80% of data analysts' time goes into fixing and standardizing provided data."[13] He explains the immensely important task of cleaning data this way:

> *. . . databases are filled with inaccurate, inconsistent, uncategorized, and unstructured data. To be useful, data must be properly corrected, purged, standardized, and categorized.*
>
> *Even simple time-stamps could be immensely inconsistent. What are date-time formats, and what time zones are they in? Dollars aren't just dollars either. What are net price, tax, shipping, discount, coupon, and paid amounts?*
>
> *. . . most non-numeric data are not that useful without proper categorization, through strict rules along with text mining. And such work should all be done up front.*[14]

As customer analytics tools and technology become more affordable and easier to use, enterprises are starting to feel competitive pressure to improve their capabilities in terms of managing and extracting benefits from data, and *customer* data is on the frontline of the competitive battle for profitability.[15] The various activities involved in readying customer data for analysis, and the **analysis process** itself, include:

[13]"In Data Analysis, the Right Answers Come Only from Asking the Right Questions," *Adweek*, December 4, 2020, available at https://www.adweek.com/performance-marketing/in-data-analysis-the-right-answers-come-only-from-asking-the-right-questions/, accessed February 15, 2021.

[14]"Understanding What a Customer Data Platform Needs to Be," *Adweek,* May 28, 2020, available at https://www.adweek.com/media/understanding-what-a-customer-data-platform-needs-to-be/, accessed February 15, 2021.

[15]See Hugh J. Watson, Dale L. Goodhue, and Barbara H. Wixom, "The Benefits of Data Warehousing: Why Some Organizations Realize Exceptional Payoffs," *Information and Management* 39 (2002): 491–502, available at https://www.researchgate.net/publication/222006284_The_benefits_of_data_warehousing_Why_some_organizations_realize_exceptional_payoffs, accessed August 26, 2021.

- *Classification,* or assigning instances to a group, then using the data to learn the pattern of traits that identify the group to which each instance belongs.
- *Estimation,* for determining a value for some unknown continuous variable, such as credit card balance or income.
- *Regression,* which uses existing values to forecast what continuous values are likely to be.
- *Prediction,* or using historical data to build a model to forecast future behavior.
- *Clustering,* which maps customers within the database into groups based on their similarities.

Customer analytics is especially useful for consumer marketing companies that collect transactional data through call centers, websites, or electronic points of sale. Banks, credit card companies, telecommunications firms, retailers, and even airlines adopted customer analytics as a vital part of their business operations earlier than other companies, primarily because these sorts of companies tend to generate large volumes of customer-specific information in the natural course of operating their businesses. Now the largest companies in the world are essentially data analytics companies.

Welcome to the Digital World

With the exponentially increasing calculative power of computers, it no longer costs what it used to cost to perform statistical calculations on an entire data set, even if the data set is immense and the computations are complex. Digital technology has virtually eliminated the paper airline ticket, and all the data in the airline ticket-selling and flight-boarding processes now are collected digitally, fed into computers, and have eliminated the need for random sampling when calculating cross-billing amounts. Airlines, of course, are just one instructive example of this digital transformation, which has made similar improvements and efficiencies possible in every industry, but particularly in those industries characterized by large amounts of data. As a result, individual, one-customer-at-a-time information has now become the fuel required to drive the central engine of customer value creation in virtually every competitive business. To the customer-centric organization, data about individual customers are like gold nuggets that if collected and used effectively, can increase the **value of the customer base**—and thus the organization—significantly.

> To the customer-centric organization, data about individual customers are like gold nuggets that if collected and used effectively, can increase the value of the customer base—and thus the organization—significantly.

These days, the cost of collecting, storing, compiling, calculating, and transmitting data is relatively minor, and the dilemma facing most companies is how best to make sense of it: how to *understand* what the data are telling them about their customers. Analytics software, as well as sharp analytical thinking, have become critical components of the customer-strategy enterprise. Professional data scientists and analysts who can operate such software and understand the mathematics behind it are now in great demand. But marketing professionals who can reduce the analytics and numbers into understandable principles and practices are perhaps in even greater demand.

> Simply knowing how to *ask the right questions* of a data scientist is a skill that too few marketers have today.

Having mathematics or statistics training is always beneficial when making decisions based on data, but even more important than knowing how to calculate equations is knowing a few basic principles, many of which don't even require adding a string of numbers. A great many bad decisions have been made based on spurious correlations, false assumptions, poor interpretations, or biases that infect our reasoning when using statistical data. And sometimes these mistakes are even made by quant-jocks.

The mathematical data models that analytical software can produce are, by definition, simplifications of the real world— they represent how different types and cohorts of customers have behaved before and will likely behave again. They enable a company to quantify correlations and to discover otherwise hidden patterns within large sets of customer data. By analyzing historic information and applying it to current customer data, these mathematical models and algorithms can mine the data to predict future events, with varying degrees of accuracy.

No enterprise will *ever* be able to predict perfectly, however, whether a particular customer will buy a certain product, or abandon their shopping cart, or defect to a competitor, because the future is inherently unpredictable (only fortune tellers and stock analysts will say differently). Still, with good analytics an enterprise can assess the *likelihood* that a prediction will come true, or that a particular action on its part will have the predicted result.

What's the Story?

The goal of all analytics efforts, whether they involve customer behaviors, credit scores, medical outcomes, shipping patterns, bird migration habits, or anything else, is to use the numbers and data available to improve our understanding of causes and effects. In **customer analytics**, we want to know what *caused* a particular customer to defect to another brand, or to buy more from us, or to refer a friend to us. We want to know the *reason* why an individual customer abandoned their shopping cart on our website, and we struggle to understand the *explanation* behind our observation that a certain type of customer (as defined by patterns in the data) is, say, more likely to take our product as a subscription service, rather than purchasing it outright. In each case what we are searching for is the "story" that would make sense of whatever pattern we have spotted in the data.

However, even though we are searching for cause-and-effect stories, the correlations and patterns in our data usually do not, in and of themselves, reveal these stories. In statistics, two variables are considered to be correlated when they seem to be related in some way, that is, when there is a measurably less-than-random similarity in their values. The time at which a rooster crows, for instance, is highly correlated with the time at which the sun rises. Note that correlations can either be positive or negative. There is a positive correlation between the quality of grades a person gets in school and the size of their salary as a working adult, while there is a negative correlation between the speed of a train and the time it takes to get to its destination.

Correlation is not causation.

Among statisticians and analysts, however, there's a frequently used saying: Correlation is not **causation**. What this means is that even when two variables are shown to be highly correlated, traditional statistical methods, by themselves, still cannot show which variable caused the other, or even *whether* one actually caused the other. We all know that the rooster does not *cause* the sun to rise, and that the correlation does not provide information about causation. Similarly, we might find a correlation between the volume of breakfast cereal a family consumes and the number of children in the family, but we can safely assume that eating more breakfast cereal does not *cause* families to have more children. In each of these cases, we intuitively know the direction of causation. We *already* know it's the rising sun that causes the rooster to crow, just as we know that larger families are more likely to consume a greater volume of breakfast cereal. This prior knowledge tells the story in our minds, supplying us with a direction of causation. Data analysis might help us to understand the magnitude of the relationship, but we cannot deduce the direction of causation by data mining for statistical patterns alone. We usually get it from our prior knowledge, and in this case such prior knowledge comes from our life and experience as thinking, planning, conscious human beings. Two sets of data can even show a high degree of correlation when *neither* set has any causal relationship to the other whatsoever. For instance, if we were to compare the time of day that roosters crow with the time of day that cereal is consumed, we would see a strong correlation there also, but neither effect has been caused by the other. Instead, they are both the result of some other factor, what statisticians call a confounding factor. In this case, the confounding factor would involve the 24-hour day, and the cultural custom of eating cereal for breakfast (closer to sunrise), rather than later in the day.

As the volume of data and information available for doing statistical analysis continues to increase, analytical processes will sometimes turn up interesting facts or correlations that defy any genuine understanding on our part because we don't have the prior knowledge required to figure out what the story is. As we mentioned in Chapter 8, OkCupid founder Christian Rudder points out that the two questions "Do you like scary movies?" and "Have you ever traveled alone to another country?" are the *most* predictive indicators of relationship longevity! Out of the millions of couples who have answered thousands of different questions in OkCupid's various match-making questionnaires, about 75% of all the long-term couples the company has ever put together have answered both of these questions the same way.[16] That's why these questions make excellent ***Golden Questions.***

But why would this be? What story could possibly *explain* these very strong correlations? No one knows. And this was Rudder's point; the data from statistical correlations will only tell you *what*, but it won't tell you *why*.

Even though the story behind OkCupid's interesting data correlation doesn't reveal itself to us, however, the company can still improve its matchmaking effectiveness by acting on this insight in some fashion, perhaps by more strongly suggesting dates to people who answer these two questions similarly to each other. This would encourage relationships that are likely to be longer-lasting, which would generate higher customer satisfaction with OkCupid in the process.

When it comes to understanding customers, data and information are necessary but not sufficient ingredients. In addition to patterns and correlations in the data, genuine *understanding* requires us to grasp the story behind the data—the *why* behind the *what*.

In other situations, however, not knowing what the story is can create problems for a company trying to act on the data. In their book *Human + Machine*, Accenture executives Paul R. Daugherty and H. James Wilson relate the case of Zest AI (formerly ZestFinance), a fast-growing fintech startup that analyzes data to help lenders "better predict credit risk and expand financing to borrowers who might not ordinarily qualify." The company's algorithms score borrowers on such qualities as their likely stability, prudence, veracity, and so forth, and then they continually validate these scores against borrowers' actual payment performances going forward.

One of the more interesting (and puzzling) findings from Zest AI's voluminous database of payment records, default rates, and other financial metrics is that "people who use all capital letters to fill out their loan applications tend to be riskier borrowers."[17] Again, we naturally ask, *why*? And again, the data can't tell us why, it can only tell us what. But in this case, not knowing the story could present a real conundrum for lenders who use Zest AI, because when they turn a customer down for a loan, the customer will often want to know *why* they were declined. They want to know what they can do to improve their own creditworthiness, and simply saying "the data made us do it" won't suffice. (And it would sound ridiculous to suggest they not use all capital letters when filling out their next credit application!)

Saying "the data made us do it" won't suffice.

[16]Christian Rudder, *Dataclysm: Who We Are (When We Think No One's Looking)* (New York: Crown, 2014), Kindle location 1112.

[17]Paul R. Daugherty and H. James Wilson, *Human + Machine: Reimagining Work in the Age of AI* (Cambridge, MA: Harvard Business Review Press, 2018), Kindle location 1633.

Qualitative Analytics

Place a decimal point behind a figure and people tend to grant it more credibility. This fact has been calculated, they think. This is mathematical. But as rapidly developing and exciting as the customer analytics function is, the fact remains that complex probabilistic formulae and extra decimal points are no guarantor of accuracy. No matter how detailed or carefully developed a company's analytical findings are, the conclusions reached can still lead us astray. Unfortunately, there is a tendency we all have to trust in the inherent wisdom and objectivity of data-informed information, particularly when it is the result of a rigorously structured or finely detailed model. As Christian Madsbjerg and Mikkel B. Rasmussen say in their book *The Moment of Clarity*, "the quantitative obsession leads to a sorely diminished approach to future planning. It tends to be conservative rather than creative because it implicitly favors what can be measured over what cannot."[a]

The discipline of marketing, however, is best viewed as a blending of operational excellence and human creativity—a mix of both science and art. And while the volumes of customer-specific data now available to marketers has understandably spawned a dramatic expansion and acceleration in the use of quantitative analytical processes, genuine **customer insight** will often come from basic human interactions, common sense, and creative thinking. So it's important to recognize the continuing importance of qualitative analysis in aiding an enterprise's development of customer insight, and to explore how it, too, might have been changed, or improved, by the interactive technology revolution that has done so much for quantitative customer analytics.

In his book *Small Data*, Martin Lindstrom extols the insights and wisdom that can be gained by examining consumers' stories face on, rather than relying on having to detect the clues of causation from tables of data and numbers. After all, the whole purpose of developing customer insight is to be able to feel what the customer is feeling, and to know what it's like to *be* the customer. Masterful when it comes to feeling customers' feelings, Lindstrom was once asked to speak to an internal conference for senior managers at a company that makes condoms. So he had the company's own condom packages placed on audience members' tables before turning the houselights out and plunging the room into darkness. Then he asked everyone to try to open their condom packages in the dark. It turned out to be much more difficult—and instructive—than most of the executives had ever anticipated.[b]

Lindstrom argues that individual people's behaviors are based on emotional, often subconscious motivations and needs, a belief shared by an increasing number of influential brain scientists.[c] What this means is that if we only connect with our customers from a purely rational perspective, we won't really be connecting at all. Instead, we should also look for clues to understanding our customers in terms of how they place their shoes, stock their fridges, hang their paintings, or even use their toilet paper, all of which constitute small data and unquantifiable observations. And yet they can reveal a great deal about the psychology and motivation of customers. For instance, according to Lindstrom:

(*continued*)

> your favourite colour is most likely decided by the colour you were exposed to as a child. The magnets on your fridge reflect your emotional hotspot and your future desire. If you have large shelves packed with books in the room where your coffee table book is displayed you're likely to compensate for lack of education.[d]

So yes, quantitative analytics are definitely important, and it's vital to understand what correlations, algorithms, and hard data can tell us about the similarities and differences among our customers. But to gain genuine insight into an individual customer's emotional self, a self that even the customer might not fully understand—for that, we would best come face to face with the customer, as a fellow human being.

[a] Christian Madsbjerg and Mikkel B. Rasmussen, *The Moment of Clarity* (Cambridge, MA: Harvard Business Review Press, 2014), Kindle loc. 544.
[b] Martin Lindstrom, *Small Data: The Tiny Clues That Uncover Huge Trends* (St. Martin's Press, 2016), p. 212.
[c] See Hugo Mercier, *The Enigma of Reason* (Cambridge, MA: Harvard University Press, 2017); Michael S. Gazzaniga, *The Consciousness Instinct: Unraveling the Mystery of How the Brain Makes the Mind* (New York: Farrar, Straus and Giroux, 2018); Eric R. Kandel, *The Disordered Mind: What Unusual Brains Tell Us About Ourselves* (New York: Farrar, Straus and Giroux, 2018); Robert M. Sapolsky, *Behave: The Biology of Humans at Our Best and Worst* (New York: Penguin, 2017); Julia Shaw, *The Memory Illusion: Remembering, Forgetting, and the Science of False Memory* (New York: Cornerstone, 2016); and Antonio Damasio, *Self Comes to Mind: Constructing the Conscious Brain* (New York: Vintage, 2010) .
[d] Martin Lindstrom, "Our Unconscious World and Why We Press Harder on the Remote Control When the Batteries Are Dead," wsb.com, available at https://www.wsb.com/speakers/martin-lindstrom/, accessed August 27, 2021.

LIKELIHOODS, PROBABILITIES, AND REALITY

It is important to recognize that statistical calculations and analyses are designed to help us model reality, but they can never exactly duplicate reality any more than a paper map could perfectly illustrate a square-mile landscape. Even if customer data is perfectly clean and error-free, once we try to infer something from that data, we are forced to use likelihoods and probabilities, because whatever inferences we make do not come directly from the data, but from our thinking *about* the data.

To briefly review the way probabilities affect how we understand the world, consider that in any toss of a fair coin we have a ½ chance of getting heads, and a ½ chance of tails. For this reason, it's easy to see that the likelihood of our getting four heads in our first four tosses is ½ of ½ of ½ of ½, which would be 1⁄16. So in any four random coin tosses, there is only a 1⁄16 chance we will get four heads. But if we toss the coin four times in a row and we *do* get four heads, should we conclude that the coin is somehow flawed, or that there was cheating going on? Of course not! It was just a random set of tosses, and that set of tosses happened to come up in a way that only one out of every 16 such sets would have. That's the way random events work.

Because there's just a $1/16$ chance of getting four heads in a row, the likelihood that our four coin tosses will give us anything else—anything *but* four heads is $15/16$. In percentage terms that's a 93.75% likelihood that four tosses will *not* give us four heads, and in statistical terms we could say that our *confidence level* that four tosses will give us something other than four heads is 93.75%.

Probabilities work the same way in customer analytics (and most other analytics disciplines). Sophisticated statistical calculations can be performed, based on the quantity of data points in a population, the distribution of those data points, the degree to which they vary from one another, and the size of whatever sample we might be examining. Armed with this information a data analyst will use mathematical principles to calculate inferences and predictions, with certain levels of confidence. Based on the consumption patterns of 150 randomly chosen families, for example, a data analyst might conclude, with 95% confidence, that a family with three or more children will consume more breakfast cereal than the average family. Keep in mind, of course, that this would mean that in 1 out of every 20 cases (i.e., 5% of the time) we could easily find a family with three or more children that does *not* consume more cereal. Why? Because the data we analyzed could not give us any higher level of confidence. If we wanted to predict with higher confidence (say, with 99% confidence), then we might be able to achieve such a level of confidence with a much larger sample (say, 2,000 families), or we could keep the sample size the same but change our proposition into a more extreme condition (say, that families with *five* or more children consume more cereal).

Still, as with coin tosses, rolls of the dice, and other random events, no matter how high we set the odds or change the conditions, there will still be exceptions, simply due to the sheer randomness of whatever data we are examining. In coin tossing there may be only a $1/16$ chance of four heads in a row, but there's still a $1/32$ chance of five straight heads, and one-in-a-thousand chance (more than zero) of getting *ten* heads in our first ten tosses.

While the mean, or average, likelihood of getting heads in a fair coin toss is always 50%, small samples of tosses (4 or 5 tosses) are more likely to vary significantly from this 50% level than are larger samples (100 tosses, or 1,000 tosses). Whenever we have a set of "populations" to compare—customers, quarterly sales results, or opinion surveys—there is always some randomness in how these populations are composed, and the smaller the population or sample is, the more randomness there will be. (In a statistician's terms, samples have bigger variances than the larger populations from which they are drawn.)

Consider, for instance, that the average age of almost any random group of people will almost certainly increase if a 95-year-old person is added to the group. But adding a single 95-year-old to a group of 1,000 people won't affect the average age nearly so much as would be the case if we added the 95-year-old to a group of just 10 people.

Or consider this quick and entertaining example: If we survey the *average* political sentiments of all the different municipalities in the United States, what we will find in the data will show that the most politically conservative municipalities in the country, by an overwhelming margin, consist of small towns, rather than big cities. And in our own minds, we can all provide the story for why this would be. After all, our prior knowledge would suggest that conservatives are more likely to be churchgoers, small businesspeople, farmers, or merchants, and they would naturally value a sense of community and family. It's obvious that political conservatism would have stronger roots in smaller communities.

But now consider this: The overwhelming majority of the most politically *liberal* municipalities in the U.S. are also small towns. What? Yes, this is also true, but why? This seeming paradox is not actually a paradox at all, and it has nothing to do with the attractiveness of small towns to either conservatives or liberals.[18] It is purely the result of the statistical principle that smaller samples have larger variances. There will be more small towns than large cities with relatively strong political leanings on *either* side of the political spectrum, for the same reason that we're more likely to get all heads in four coin tosses than in ten.

As a thought experiment, imagine that there are hundreds of *tiny* municipalities scattered around the country, each one composed of just a single, solitary citizen. If this were the case, then every such one-citizen town would have an average political leaning that is either 100% conservative or 100% liberal, and these would clearly be the most extremely conservative and liberal municipalities in the country.

This is an important principle when it comes to how we interpret not just our customer analytics findings, but *all* probabilistic calculations, and if we don't remain cognizant of it, we can easily misread the data. The problem is that in the absence of a clearly established direction of causation, we are more than capable of providing whatever story we need to explain such findings to ourselves. But the story we provide ourselves would be wrong. Or rather, we cannot be sure that the story is right, at least not without first establishing the direction of causation.

The Direction of Causation

When it comes to customer analytics, even more important than dealing with equations, numbers, and calculations is simply being able to make reasonable and useful sense of the data available. And the way human beings make sense of the data is by telling themselves the right story about the *cause* behind whatever effect they observe in the data.

Let's return to the European book club we first talked about in Chapter 8. You'll remember that the book club claimed to have seen a significant improvement in both customer retention and first-year sales after they launched their **complaint discovery** program. This was the effect they observed in their data, and they attributed it to their

[18]Even though survey data will show that conservatives do tend to find small towns relatively more to their liking, while liberals tend to find cities more attractive.

newly introduced program, which involved calling new members during their first month and asking them "Is there anything we can do better?" Simply calling these new members, they said, generated an increase of nearly 8% in new-member sales and a 6% bump in member retention going into the second year. This was as far as we went in Chapter 8, but as a marketing professional reading this story now, are you asking yourself whether they might have produced these results in some other way? Couldn't these improvements have been caused by a better economy in that particular year? Or maybe a runaway best seller happened to be launched around that time? How could the book club possibly know that their complaint-discovery question was the thing that *caused* these beneficial financial results?

In this case, at least, the book club most certainly *did* know that it was the complaint discovery question that caused the positive sales and customer retention results. They knew these results were not just a coincidence for one very simple reason: They conducted a test. They only called a random sample of new members, not all new members. And the result was that the new members they did call had greater first-year sales and second-year retention rates.

This is an example of an A/B test, and it's one of the most important weapons in the customer analytics arsenal, because it can reliably reveal the actual direction of causation. In an A/B test, different groups are chosen randomly from a population and exposed to different messages, or different offers, or different colors on the website homepage—and then their behaviors are compared.

In Judea Pearl and Dana Mackenzie's book on causal reasoning, *The Book of Why: The New Science of Cause and Effect,* the authors suggest that in medicine and scientific research, one of the most reliable ways to investigate the direction of causation is to conduct an A/B test, which in medicine is called a randomized control trial, or an RCT. To do such a trial correctly—to eliminate as many potentially non-random factors as possible—an RCT must be done in a double-blind fashion, meaning neither the test patients nor the administrators and medical professionals involved know whether a particular patient is in the A group, which gets the drug or treatment being tested, or in the B group, which gets a placebo treatment that looks and feels the same.[19]

In the pre-interactive age this sort of **A/B testing** was not practical for a big mass media advertiser, because it simply wasn't possible to expose some randomly chosen customers to commercial A, while others were exposed to commercial B. All the customers in any given market saw the same commercials, which went out the same way to everyone. A marketer could test two different commercials in two different cities, perhaps, but

> Importantly, companies can only do A/B testing by focusing on customer-specific data. But A/B testing is one of the most reliable ways to investigate the *direction* of causation.

[19]Judea Pearl and Dana Mackenzie, *The Book of Why: The New Science of Cause and Effect* (New York: Basic Books, 2018).

it would have been impossible to rule out differences in viewing habits, cultural issues, the weather, or even the local news cycle, each of which might have had an effect on whatever differences in product sales or other data were observed.

As is the case for a randomized control trial, when marketers conduct an A/B test, they should strive to conduct it in such a way as to involve an unbiased group of customers that is representative of the broader population being tested. And this can often be harder than it looks, because the manner in which we select and communicate with our test subjects can easily bias the results of our test. For instance, what if the European book club had told participants in its complaint discovery test that it was in fact a *test,* so their answers would be very important? Or what if calls had only been made only during weekday business hours, or only to customers who lived in cities, or only to nonfiction readers? It's not at all difficult to imagine how each of these choices might have influenced either the answers participants gave or the business results the club later observed.

When we do an A/B test of any kind, we also need to remain cognizant of the nature of the sampling idea, and how it might affect our expectations or planning, going forward. Remember that an A/B test inherently involves drawing a smaller sample population, which will have a larger variance, so a rollout is more likely to under-perform an A/B test than to overperform it. This is because the sample test might have shown better results than the population would show because of randomness. Of course, it could have shown randomly lower results because of randomness as well, but a randomly lower test result would be less likely to lead to a rollout.

Testing customer-specific hypotheses on individual customers can also be useful beyond simply exploring for new business or tuning up a company's marketing efforts. It can help a company monitor and improve the day-to-day management of its current operations, as well. Germany's TeamBank AG, for instance, which lends to consumers under the brand name "EasyCredit," has granted thousands of loans to consumers who do not fit the bank's lending criteria. Millions of euros are lent out this way every year to these customers as the bank constantly tests and re-tests the validity of its lending criteria. Every time someone who doesn't fit the criteria turns out to be a steady and reliable borrower, the bank learns something it didn't know before, expanding the market for its services and improving the management of its ongoing operations.[20] In scientific jargon, TeamBank is *testing the null hypothesis* with this program, a vital part of evidence-based management.[21]

Within the marketing domain, direct mail businesses pioneered the idea of A/B testing, because direct mail is not a mass medium but a customer-specific one. And prior to the web it was practically the only cost-efficient customer-specific medium, although of course it took a minimum of four to eight weeks to print the mail pieces

[20]Christoph H. Loch, Fabian J. Sting, Arnd Huchzermeier, and Christiane Decker, "Finding the Profit in Fairness," *Harvard Business Review*, September 2012.

[21]Don Peppers and Martha Rogers, Ph.D., *Extreme Trust: Turning Proactive Honesty and Flawless Execution Into Long-Term Profits* (Penguin, 2016), Chapter 46: "Science, Trust, and Evidence-Based Management."

up, mail them out, wait for responses, and then do the calculations. Still, many of the *analytical* principles that informed sophisticated direct mail campaigns as long ago as the 1970s have been even more highly developed by online and interactive marketers—which is pretty much everyone. Large online tech companies, such as Google, Amazon, Facebook, Microsoft, or Netflix, conduct hundreds, or even thousands, of A/B tests and similar statistical experiments on a daily basis, across millions of individual customer interactions. They are constantly tweaking, adjusting, validating, and upgrading their customer-specific initiatives, using the rich data now available. And they are doing it in real time.

A/B Testing: Some Guidelines for Non-Statisticians

While it sounds simple, conducting an A/B test that generates valid results is not something that can be taken lightly. And while any skilled data analyst should be able to design and conduct a proper test, it's important for marketers and other customer decision makers to understand the basics, as well.

One Variable at a Time

As a general rule, when we want to use an A/B test to learn about what works and what doesn't, or when we want to figure out how *much* some particular customer treatment will change results, it's wise to limit ourselves to just one variable to be tested at a time. For example, if we want to know whether a more distinct call-to-action message would be better than the invitation-to-**collaborate** message we are currently using, then our test should involve just those two ideas—the test and the control. Everything else should be held constant—background and color, print size and font, product and service offered, etc. The *only* difference between A and B in an A/B test should be whatever variable we are testing for. When the European book club wanted to find out what business results might be observed if new customers were called and asked "Is there anything we can do better?" population A was asked the question, and Population B was not. It was that simple, and it had to be, if the results were to be relied on.

There may be situations, particularly in designing web pages or putting online ads together, when a marketer will want to test more than one variable, just to save time. In some cases, it might be appropriate to test multiple variables. Provided there is substantial web traffic, for instance, a company could structure a multivariate test designed to reveal which combination of headline and image might draw more views, clicks, registrations, or purchases. A multivariate test is somewhat like a compound set of distinct A/B tests. Suppose, for instance, that we have two possible headlines and three different images that we want to test. Each web page or ad to be tested must carry one of the two headlines being tested and one of the three images being tested, which would mean six different web pages to be tested, in total. In a sense, rather than an A/B test, in this case the multivariate test will be an A/B/C/D/E/F test (see Exhibit 12.3).

(*continued*)

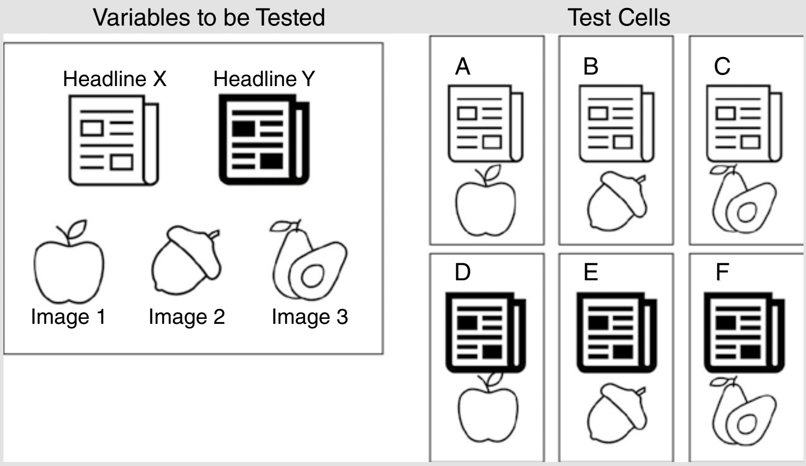

EXHIBIT 12.3 Example of Multivariate Analysis

Obviously, multivariate testing will impose increased complexity and cost—although costs decline all the time, and if a marketer has a high enough volume of web traffic, such tests can still be practical, and their results can be instructive. A multivariate test, for example, will quickly reveal if any single variable has an unduly large influence on the overall outcome.

Sample Size

Another important principle behind testing involves choosing an appropriate size for the sample of customers that we want to test, and it needs to be large enough to deliver valid results that cannot be unduly swayed by sheer randomness. Obviously, we can't just do a test on one or two or a half-dozen customers and expect to rely on them adequately representing a much larger population.

How many do we need to have in our test sample in order to be reasonably confident in our results? Data scientists generally prefer to structure tests so that they can have 95% confidence in the result, that is, be 95% confident that the result from the test is not significantly different from the result they would get if they exposed the entire population to whatever offer or message they exposed the sample to. The number required in a sample to yield that level of confidence (or any other level of confidence) can be figured out mathematically by looking at the characteristics of the population of customers being tested—the number of customers in the population from which the sample is drawn, and some indication of their variance. A marketing data analyst can come up with the answers, in terms of sample size and confidence levels, by inputting a few numbers into a statistical calculation program.

Back when computers were scarce and airline interline charges were based on sampling, such calculation programs were only available on large, "mainframe" computers. Direct mail marketers in those days, however, had a rule of thumb that

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worked fairly well. When doing a test to see what the likely response rate was for a direct mail offer, the accepted wisdom was to start with a large enough sample population that it would likely generate at least a hundred or more *responses*. So, for instance, if a direct mailer had an offer that it expected would generate, say, a 5% take rate, then the marketer would need to test it on a random population of at least 2,000, because 5% of 2,000 would provide 100 respondents. If it did generate around 100 responses, then the mailer could be reasonably confident that the likely take rate for the population as a whole was about 5%, and not 1%, or 10%. If, on the other hand, the test generated, say, just 50 responses, then the marketer could be reasonably confident that the actual response rate from the population would be less than the 5% the marketer was expecting.

Randomness

We can only rely on the results we get from an A/B test when those results are based on a truly *random* sample. If the sample chosen is not composed of randomly selected members of the population being tested, then our test won't be valid no matter how many members the sample is composed of, if that number is anything short of the entire population. In other words, randomness in the sample is even more important than sample size.

Think about Airline Y choosing every 10th ticket it needed to bill to Airline X, and then multiplying by 10 to get the total due each month. Obviously, the airlines participating in this arrangement were not allowed to select whichever tickets they wanted to sample. The airlines all recognized that for this method of billing to be fair to all, each airline had to be bound to some mechanism for ensuring that the tickets chosen were truly chosen in a random manner. And in this case, ticket numbers were unique, sequential, and completely unrelated to the itineraries or fares that would be written on them. Pre-printed batches of numbered, blank tickets were regularly distributed to each airline's issuing office or ticket-writing position, while other, similarly numbered batches were put into the hands of licensed travel agents and tour operators. To prevent fraud, and to discourage greedy airlines from gaming the system, the digit to be used as a sampling mechanism each month was changed regularly, so there was no chance that a ticket writer could know in advance whether the ticket number on the ticket being written for a particular customer would end up as part of the sample or not.

One way to introduce randomness, when we are conducting an A/B test online, would simply be to choose every other interaction as an A or a B, in a manner somewhat similar to the ticket number sampling basis once used by airlines. If we're trying to sample a larger population (as the European book club did), then selecting every tenth interaction, or every hundredth interaction, for the proposition being tested, as and when these interactions occur, could also work. The other 9 out of 10 interactions (or 99 out of 100) would constitute the control for the test, while the proposition itself would be tested on the randomly selected customer. If the European book club received, for instance, an average of 1,000 to 2,000 new-member

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signups every day, then it could have simply tested its complaint-discovery call on 100 randomly chosen signups per day and within the first month it would have accumulated 3,000 customers in its test.

Participation Rate

Importantly, when the customer *chooses* whether to participate in a test, or whether to answer a survey question, then the customer's act of choosing to participate could also bias the sample. Self-selection can introduce a form of selection bias, and this represents one reason why universal surveys of customer sentiment usually will not give marketers a reliable picture of overall customer sentiment. When we ask *every* customer how satisfied they were after *every* transaction, chances are that only a very few customers will go to the trouble of answering—perhaps 5%, or maybe even 1% or less. If we have millions of interactions, this can still generate a large sample over time, but if only one out of every 40 or 50 customers takes the survey, which customers would they likely be? They will be the customers who most *want* to respond to a customer-satisfaction survey (i.e., those who feel strongly about their level of satisfaction, either because they thought the customer experience was brilliant or because they thought it was awful). And taking an average of these intensely held sentiments will not provide a reliable picture of the overall level of customer satisfaction among the population of *all* customers, including those who aren't as motivated to answer the survey question.

When survey participation rates are low, the results won't constitute a representative sample of the whole customer population, no matter how large the sample size is. This doesn't mean that a universal VOC survey is useless, because it's certainly a valuable way to discover complaints and identify friction in the customer experience. Using a survey either to follow up with unsatisfied customers or to identify possible **customer advocates** for later interaction are both useful activities for a marketer. But to get a more accurate picture of the overall sentiment among customers we need higher participation rate, generating a more *representative* set of respondents. One way to do this might be to provide a financial or other incentive for participation—perhaps a $10 coupon, or an extra 10,000 frequent flyer miles, or a chance to win a trip to Disneyworld. Of course, in addition to increasing the cost of running the test or conducting the survey, incentives can *also* bias the results, but the higher the participation rate is, the more likely the test will accurately represent the population being tested.

CONDITIONAL REASONING AND BAYESIAN ANALYSIS

When an enterprise is dealing with real-time customer analytics issues, there isn't time to plan and conduct A/B tests. If, for instance, a customer clicks through an ad to arrive at the product page, what is the likelihood they will now buy the product?

This question involves **conditional reasoning**, which asks the question: How likely is A to happen, *given* that B has now happened? To deal with problems involving conditional reasoning, data analysts use an assortment of tools, many of which employ **Bayesian analysis**. This refers to Bayes' theorem, first postulated in the 1700s by Thomas Bayes, a Presbyterian minister and part-time statistician in Britain. Bayes' theorem is very simple, mathematically,[22] but all we really need to know about it is that it is specifically designed to help an analyst answer the question: What is the probability of A, *given that* B has now happened?

Suppose, for instance, that we are running a subscription business, and one of our subscribers makes a complaint. How likely is it, we might ask, that this subscriber will defect in the next month, *given that* they have now complained?

To answer this question using Bayes' theorem, we need to know (or estimate) three prior probabilities:

1. The prior probability that *any* subscriber would defect this month;
2. The prior probability that a subscriber would complain first if they did plan to defect; and
3. The prior probability that a subscriber would complain even if they didn't plan on defecting.

To calculate or estimate these prior probabilities, we turn to our data records, which reveal that we lose about a quarter of our subscribers every year, on average, so we can estimate the probability that any subscriber will leave in any given month at about 2%. Our records also show that 10% of subscribers who have quit in the past did in fact voice a complaint in the month prior to defecting. And finally, during the last few years, we received complaints from an average of 6% of our customers each year, so we estimate that the probability any customer would complain in any given month, whether or not they were planning on defecting, is about 0.5%.

If we plug these figures into the Bayes equation, the answer to our question, how likely is it that this subscriber will quit, now that they've made a complaint, is 40%. In other words, once a subscriber makes a complaint, they become four times more likely to terminate their subscription in the next month than they were before making the complaint (see the "Bayes' Theorem" sidebar for the equation itself, along with an explanation of how it works).

Bayesian analysis is what underpins many real-time customer analytics functions, as a marketer strives to evaluate various landing pages, offers, and other customer treatments. The marketer is constantly trying to predict what a customer is likely to do next, now that they've just been observed doing X, or Y, or Z. And the rapid-fire, constant interactions involved in the online world, coupled with the increased power of customer analytic methods, means that Bayesian-like equations and conditional reasoning are required to answer real-time questions in an extensive, almost limitless variety of situations:

[22]See the sidebar on Bayes' theorem.

- The probability a customer will abandon their shopping cart, given that they have spent five minutes reading reviews
- The probability a customer on the mobile app will download the Chrome extension now that they have registered
- The probability a customer will click through on a price-off ad, given that they have never clicked through on a premium service ad
- The probability a visitor will register on the website, given that they have viewed the video
- The probability that an app user will order the product through the smartphone app, after being steered to the app by a partner
- The probability that a viewer will become a donor after spending more than four minutes on the website

Importantly, for many of these and other real-time customer analytics issues, there won't be enough data available to calculate the prior probabilities, the way we were able to do with our complaining subscriber who might leave. Instead, marketers make their real-time customer analytics calculations by starting with their best guesses with respect to prior probabilities and then, as they compile more and more examples, they refine and improve those guesses. If the prior probability of event A happening, for instance, was initially estimated to be 10%, and a marketer observes that A does in fact happen, then the prior probability assigned to the same (or similar) situation the next time will be higher than 10%. And with such calculations going on constantly, in real time, for every web visitor, app user, or SMS interaction, this sort of real-time customer analytics will make rapid progress.

Bayesian Analysis Simplified

Bayes' theorem is a way to calculate the probability of event A, given that event B has happened:

$$P(A|B) = \frac{P(B|A)P(A)}{P(B)}$$

In plain English, Bayes' theorem states that the probability of A, given that B has happened (i.e. "the probability of A conditioned on B"), is equal to the probability of B conditioned on A, multiplied times the probability of A and divided by the probability of B.

If we have a subscriber who complains and we want to know what the probability is that they will now defect, we would use A to represent defection, while B would represent a complaint. We're trying to calculate the probability of defection conditioned on a complaint having been made, P(A|B). To solve the equation and figure out the probability of defection conditioned on the act of complaining, we need to ask ourselves three questions that concern the prior probabilities involved

(*continued*)

in this equation—that is, the probabilities that existed prior to the subscriber even making a complaint. Specifically, we need to know:

1. The prior probability that *any* subscriber would defect this month, with no other information, which is P(B), which we estimate at 2%
2. The prior probability that a subscriber would complain first, if they did plan to defect, which is P(B|A), which we estimate at 10%
3. The prior probability that a subscriber would complain even if they didn't plan on leaving, which is P(A), which we estimate at 5%

Using these three data points, and inserting them into the Bayes equation, we can now calculate the probability that this particular subscriber will leave this month, *given that* they have now voiced a complaint as 40%.

We can demonstrate the logic of Bayes' theorem by constructing a table for the data we are trying to get, and then showing what other data we need, in order to solve the table. In this case, we are examining complaints and defections. More specifically, does a customer complain? (Yes or no.) And does a customer defect? (Yes or no.) So in our table, we will put complaints on one axis and defections on the other, and fill in the spaces with letters, like this:

EXHIBIT 12.4 Data for Bayesian Decision

	Complaint	No Complaint	Total
Defects	r	s	t
Doesn't Defect	u	v	w
Total	x	y	z

We know that 2% of customers defect each month, so this will go into the square *t*, which is the total percentage of defections per month (i.e., P(A) in the equation). Also, we know that 10% of customers who defect also complain in the same month, so 10% of that 2% (i.e., 0.2%) must go into square *r*, and the other 90% of that 2% (i.e., 1.8%) must go into square *s*. And while we're filling in these squares, our square w must be 98%, because 100% of our customers either do or don't defect. So now we have our table partly filled in:

EXHIBIT 12.5 Partially Complete Bayesian Data Set

	Complaint	No Complaint	Total
Defects	0.2%	1.8%	2%
Doesn't Defect	u	v	98%
Total	x	y	100%

The third data point we have is P(B), the probability that a customer will complain in any given month, whether or not they defect that month. Remember that we estimated P(B) to be roughly 0.5%, based on the fact that about 6%of our customers complained in each of the last several years, so just estimating a 6% complaint likelihood over a full year would give us a monthly figure of 0.5%, which is the figure that goes into square x. And since the column has to add to that total, square u will be 0.3%, while summing across to 98% and 100%, respectively, gives us squares v and y at 97.7%and 99.5%, respectively:

EXHIBIT 12.6 Complete Bayesian Data Set

	Complaint	No Complaint	Total
Defects	0.2%	1.8%	2 %
Doesn't Defect	0.3%	97.7%	98%
Total	0.5%	99.5%	100%

So now, if you look at the complaint column, you'll see that 0.2% of our customers both complain *and* defect in any given month, which is 40% of those who defected in that month.

Obviously, we have taken a couple of shortcuts in our analysis here. For instance, we aren't tabulating how many customers complained more than once, nor have we asked ourselves if this particular subscriber has complained more than once. To keep it simple, we just assumed that every complaint from every customer was a single, solitary event. Nor have we considered the *type* of complaint, or the type of subscriber, or the tone of voice used during the recorded complaint call, as documented by our voice analyzer. But most of these and other potentially interesting and useful factors can be accommodated by quantitative Bayesian analysis.

Making Objective Decisions and Overcoming Bias

It is a well-established fact that human beings' brains have evolved with certain biases that come naturally to us, and those biases can often undermine our ability to make wise decisions. There are so many natural human biases that interfere with making rational decisions that it is impossible to categorize them completely. But biases need to be recognized before we can minimize or avoid them. Some of the most important biases to avoid are:

- The confirmation bias (i.e., looking the hardest for evidence that confirms our prior beliefs)
- Overconfidence in our own judgments
- Failing to reframe problems
- Focusing on short-term rather than long-term effects
- Loss aversion

(*continued*)

Confirmation bias. Decision-making analysts consider this bias one of the single most difficult human thinking flaws to overcome. We are wired as social animals, and much of our ability to reason likely evolved as a means for helping us persuade others to do what we want them to do, or to rationalize our own actions to others (as well as to ourselves). Whatever the cause, even when we think we are analyzing a problem objectively, what our brains are really doing is searching for data that supports whatever conclusion we've already reached.

One way to deal with the confirmation bias is to try to avoid coming to any conscious conclusion prematurely. With the increasingly prevalent practice of evidence-based medicine, for instance, doctors are encouraged to try not to come to any conclusion at all about a patient's diagnosis before objectively reviewing the evidence itself, including any literature or relevant research. In a group or a corporate setting, one effective way to overcome the confirmation bias is to task different group members with trying to prove conflicting points of view. (Warren Buffett's practice, when considering a merger or some other deal, has sometimes involved hiring two different sets of bankers. One set of bankers earns a high fee if the deal is consummated successfully, while the other set of bankers earns a high fee if the deal is not consummated.)

Overconfidence can be compensated for simply by imagining realistic future scenarios in which your decision turns out to have been wrong. Imagine, for instance, that a year or more after your decision you realize that your plans have been completely undone, with customer loyalty plummeting and marketing costs spinning out of control. Or imagine that the reverse happens—that you are unexpectedly elated with the decision, and perhaps wish you had gone even further with it. Now try to write the stories behind either of these futures—how might either scenario have developed?

Narrow framing occurs whenever we box ourselves in to a particular perspective to the exclusion of other, perhaps equally valid perspectives. Consider the story of a monk who asks the abbot whether they can smoke while praying. Outraged, the abbot replies, "Absolutely not! That would be a terrible sacrilege!" But later a different monk frames the question differently, asking if it would be okay if they prayed while they smoked. To which the abbot replied, "Certainly, my son, God wants to hear from us at any time." The most immediate cures for narrow framing are to widen the set of options being considered or to change the parameters of the problem so it can be stated in a larger context. Rather than asking whether the data you've developed is good enough to make a decision, for instance, ask yourself what the cost would be, in time and effort, to develop a clearly useful data set.

Short-term thinking occurs when a decision goes in a wrong direction because of the immediacy of the reward or cost, and the only real cure is to force ourselves to step back from the emotion of the moment and consider our decision from a distance. One hack for stepping back from the issue is what Suzy Welch has called the 10-10-10 exercise.[a] How will this decision we're about to make feel in 10 minutes? In 10 months? And in 10 years, what will we remember about this decision, and what will be its most important effect after a decade has elapsed?

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Loss aversion is an insidious predisposition to give more weight to some value that is lost than to an equivalent value gained. It is one of the principles that underlies Kahneman and Tversky's famous prospect theory of explaining the irrational behaviors we often see in investors. Let's say that a year ago you spent $10,000 to buy stock in a company you thought had great promise, but now this stock is only worth $5,000. Many people (most, probably) would choose to hold on to the stock rather than selling it, because selling it acknowledges a loss and locks it in. So one way to deal with the bias is to change your perspective. Assume that you woke up one day and someone had, by mistake, sold your stock and replaced it with $5,000 cash. Would you buy the stock back? Probably not. And if you wouldn't, you should sell it now, logically.

If you want to make better, more rational decisions, you could do worse than by focusing on these five biases—the confirmation bias, overconfidence, narrow framing, short-term emotion, and the loss aversion.

[a]Suzy Welch, *10-10-10: 10 Minutes, 10 Months, 10 Years: A Life-Transforming Idea* (New York: Scribner, 2009).

Analytics Run Amok

Perhaps you've heard the oft-repeated management expression "You can't manage what you can't measure." This phrase is sometimes attributed to Peter Drucker, perhaps the world's most famous management consultant ever, and sometimes attributed to W. Edwards Deming, the statistician and quality-control expert credited with having launched the Total Quality Management (TQM) movement. Both men, however, were far too smart ever to have said anything so simplistic and misleading. Drucker often wrote and talked about the importance of inherently *unmeasurable* management issues, such as personal relationships, trust, **mutual** confidence, and the power that comes from having a sense of community.[23] And Deming specifically rebuked the idea in his book *The New Economics*: "It is wrong to suppose that if you can't measure it, you can't manage it—a costly myth."[24]

[23]Paul Zak, "Measurement Myopia," Drucker Institute, July 4, 2013, available at https://www.drucker.institute/thedx/measurement-myopia/ accessed February 5, 2021.

[24]*The New Economics* (2000), as quoted by the Deming Institute, "Myth: If You Can't Measure It, You Can't Manage It," W. Edwards Deming, The Deming Institute, August 13, 2015, available at https://deming.org/myth-if-you-cant-measure-it-you-cant-manage-it/#:~:text=It%20is%20wrong%20to%20suppose,Edwards%20Deming%2C%20The%20New%20Economics, accessed on Feb 5, 2021.

(*continued*)

Nothing becomes more important because you can measure it. It just becomes more measurable.

In our increasingly data-driven world we often put too much confidence in numbers and algorithms, to the point that numbers often can and do corrupt our thinking. So while it is important to figure out the best way to measure what we need to know, it's even more important to know what we need to know.

This was driven home by a story a young professional told one of the authors about one of her marketing consulting assignments at a highly successful dial-up internet service provider.[25] The company was quite proud of its robust testing and analytics capabilities. Apparently, she said, they did A/B testing on literally everything: all their policies, promotions, marketing, and service initiatives. All of the company's strategies and tactics were constantly being modified, tweaked, and tested to ensure that they worked as efficiently and productively as possible, for a large array of differently defined segments of customers. And because the business was primarily driven by subscription, customer loyalty was by far this company's most important KPI. They wanted to maintain absolutely the highest customer loyalty possible, so they were constantly testing a variety of offers and policies for how to improve this metric, and constantly measuring their data.

Through careful A/B testing, for instance, the young woman reported, managers at the company told her that they had found the single most cost-efficient way to improve customer "loyalty" was simply to hide the "Cancel my subscription" button on their website. After all, the harder it was for customers to figure out how to unsubscribe, the more "loyal" they were. Their next most effective strategy for improving "loyalty" was to require customers to call in before canceling, which would allow a call center agent to have a conversation with the customer during which they would try to persuade them not to cancel (and earn a bonus if they did so).

As entertaining as this story is, it perfectly illustrates one of the most central problems afflicting business managers, in an era of big data and sophisticated, algorithmic decision-making: Quantifying things has now become an easy way to escape responsibility for taking a considered, intelligent point of view, or for using what a non-quantitative commentator might call human judgment or wisdom. We must never allow ourselves to take solace in numbers and decimal points as a substitute for ethical considerations, not to mention plain old common sense.

From Exploitation to Exploration. As customer-specific data proliferates exponentially, fueled by the snowballing plethora of interactions and transactions with individual customers, the task of real-time customer analytics soon involves more than simply exploiting the data patterns known to represent the biggest

[25]This unnamed professional is still consulting, and continues to consult occasionally for this client, so she has insisted on anonymity for herself and the client.

(*continued*)

opportunities. In addition to exploiting these opportunities, the analytics function must also explore for new data patterns that might represent even bigger opportunities. And to do such exploration effectively will involve ever more sophisticated analytical techniques.

One increasingly useful approach for rapidly zeroing in on the right tactic or strategy, even when confronted with a multiplicity of choices, is known as a computational technique based on what statisticians call the multi-armed bandit problem.[26] Think of a gambler at a casino who can choose to play many different slot machines (also known as one-armed bandits). Now suppose that each slot machine has its own odds of paying off, unknown to the gambler. How should the gambler decide which machines to play? The more they play, the more they learn about each machine's odds of paying off, but rather than simply betting over and over with the machines that have won in the past (a pure exploitation strategy), their long-term success will depend on investing some funds to play new machines, exploring to find the ones that might pay even higher returns.

Statistically, the multi-armed bandit problem is exactly what an online business faces when trying to evaluate different offers for different types of prospects and customers across a wide range of possibilities. Solving such problems requires experimentation at scale, and a highly sophisticated analytics capability.

But balancing exploration and exploitation is essential to the long-term survival of any complex adaptive system, including businesses operating in a competitive environment. So in addition to its rising importance as a tactical analytics problem, striking the right balance between exploration and exploitation may be the single most important *strategic* task that can be undertaken by any enterprise trying to succeed over the long term in the rapidly evolving domain of real-time customer analytics.

[26]See Bruno B. Averbeck, "Theory of Choice in Bandit, Information Sampling, and Foraging Tasks," *PLOS Computational Biology* 11, no. 3 (2015): e1004164, doi:10.1371/journal.pcbi.1004164; Vincent D. Costa, Andrew R. Mitz, and Bruno B. Averbeck, "Subcortical Substrates of Explore-Exploit Decisions in Primates," *Neuron*. 103, no. 3 (2019): 533–535, doi:10.1016/j.neuron.2019.05.017; Djallel Bouneffouf, Srinivasan Parthasarathy, Horst Samulowitz, and Martin Wistuba, "Optimal Exploitation of Clustering and History Information in Multi-Armed Bandit," IJCAI 2019: Proceedings of the Twenty-Eighth International Joint Conference on Artificial Intelligence, pp. 2016-2022; Michel Gimelfarb, Scott Sanner, and Chi-Guhn Lee, "ε-BMC: A Bayesian Ensemble Approach to Epsilon-Greedy Exploration in Model-Free Reinforcement Learning," Proceedings of the Thirty-Fifth Conference on Uncertainty in Artificial Intelligence (AUAI Press, 2019), p. 162.

A SMALL SECTION ON A BIG TOPIC: USING MARTECH TO BUILD CUSTOMER VALUE AND FOR MARKETING TASKS

Consider the example of customer (and other) analytics for the airline we talked about earlier in the chapter. Let's take the problem one step further. Most airlines (and hotels, and other firms with perishable products) track measures of ***spill*** and ***spoil.*** Spill measures hotels and flights that sold out too far in advance and are assumed to be priced too low. Spoil measures empty rooms or seats that were probably priced too high. Many airlines, hotels, and restaurants still use historic measures such as occupancy rate or average customer spend. But consider the advantage of identifying and understanding the sources of waste and missed opportunity, quantifying those with the help of data, once the data scientists are working with the marketers to work in concert to make sure the right questions are being asked and answered, using the right data, combined the right way.

In many cases, this shift will require thinking about hypothetical scenarios, and then having marketing and data science answer together the question of: *How can we eliminate missed opportunities as well as waste*—spill and spoil? (We have addressed the advantages of using **customer experience journey mapping** in Chapter 2, and can think about using personas and behavioral reactions as part of the customer experience journey mapping process.).

In a *Harvard Business Review* article, Ascarza, Ross, and Hardie use an example of a telecom firm that asked the customer data algorithm the wrong question: They asked, "How do we identify potential defectors and 'bombard' them with promotions design to convince them to stay?" They discovered many of the potential defectors left anyway. The telecom company should have been asking how best to use the marketing budget to reduce churn. In other words, instead of pinpointing the customers who might leave, they should have asked who "could best be persuaded to stay," and spent money on promotions for those customers, in much the same way politicians direct their dollars at swing voters.[27] In many cases, use of longitudinal data would contribute to a successful outcome.

> Of all a company's functions, marketing has perhaps the most to gain from artificial intelligence.

Of all a company's functions, marketing has perhaps the most to gain from artificial intelligence and perhaps that is why study after study shows exponential growth in the use of artificial intelligence (AI) and other martech. We've been saying, over and over, that the primary

[27]See Eva Ascarza, Michael Ross, and Bruce G.S. Hardie, "Why Aren't You Getting More from AI?" in *Harvard Business Review*, July-August 2021, pp. 49-54. They continue: "It's important to recognize that AI's predictions can be wrong in different ways. In addition to over- or under-estimating results, they can give false positives (for instance, identifying customers who actually stay as probable defectors) or false negatives (identifying customers who subsequently leave as unlikely defectors). The marketer's job is to analyze the relative cost of these types of errors, which can be very different [what the authors refer to as the difference between the value of being right and the costs of being wrong]. But this issue is often ignored by, or not even communicated to, the data science teams that build prediction models, who then assume all errors are equally important, leading to expensive mistakes" (p. 50).

function of managing customer relationships and experiences is to **treat different customers differently** in order to increase the value of the firm. It's not surprising to learn:

- Martech had become a $122 billion industry as of 2021, which is more than all print and television advertising combined. At that time it was projected to grow at 22% year over year,[28] and nearly 70% of CMOs are increasing their investments in marketing technology.[29]
- New AI companies appear constantly, and choosing the right technology is essential. Nine out of ten respondents in a Sloan Management Review/Boston Consulting Group survey had invested in AI and martech but fewer than 40% of them had measurable benefits over the previous three-year period.[30]
- A recent McKinsey analysis of over 400 advanced-use cases demonstrated that marketing would benefit the most from the use of AI.[31]
- A 2020 Deloitte global survey of early AI adopters indicated that three of the top five objectives for AI were marketing oriented, including enhancing relationships with customers.[32]
- An American Marketing Association study revealed that use of AI had grown 27% in one 18-month period in 2018–2019.[33]

[28] "New Research Supported by University of Bristol Reveals Impact of Marketing Technology within Organisations," University of Bristol School of Management, October 14, 2019, available at https://www.bristol.ac.uk/management/news/2019/new-research-supported-by-university-of-bristol-reveals-impact-of-marketing-tech.html, accessed on October 27, 2021. Also see Thomas Davenport, Abhijit Guha, and Dhruv Grewal, "How to Design an AI Marketing Strategy," *Harvard Business Review*, July-August 2021, p. 56.

[29] CMO Council, "Nearly 70 Percent of Marketers Expect to Boost Spend in 2021; Only a Quarter to Downsize; Big Focus on Automation," January 28, 2021, available at https://www.cmocouncil.org/about/media-center/press-releases/nearly-70-percent-of-marketers-expect-to-boost-spend-in-2021-only-a-quarter-to-downsize-big-focus-on-automation, accessed October 27, 2021. Also see Thomas Davenport, Abhijit Guha, and Dhruv Grewal, "How to Design an AI Marketing Strategy," *Harvard Business Review*, July-August 2021, p. 56.

[30] Sam Ransbotham, Shervin Khodabandeh, Ronny Fehling, Burt Lafountain, and David Kiron, "Winning with AI: Pioneers Combine Strategy, Organizational Behavior, and Technology," MITSloan Management Review, October 15, 2019, available at https://sloanreview.mit.edu/projects/winning-with-ai/, accessed October 27, 2021. Also see Thomas Davenport, Abhijit Guha, and Dhruv Grewal, "How to Design an AI Marketing Strategy," *Harvard Business Review*, July-August 2021, p. 42.

[31] See Thomas Davenport, Abhijit Guha, and Dhruv Grewal, "How to Design an AI Marketing Strategy," *Harvard Business Review*, July-August, 2021, p. 42.

[32] Thomas Davenport, Abhijit Guha, and Dhruv Grewal, "How to Design an AI Marketing Strategy," *Harvard Business Review*, July-August, 2021, p. 42.

[33] Sarah Steimer, "August 2019 CMO Survey: Hiring, AI on the Rise," American Marketing Association, August 28, 2019, available at https://www.ama.org/marketing-news/august-2019-cmo-survey-hiring-ai-on-the-rise/, accessed October 27, 2021. As cited in Thomas Davenport, Abhijit Guha, and Dhruv Grewal, "How to Design an AI Marketing Strategy," *Harvard Business Review*, July-August, 2021, p. 42.

AN ANALYTICAL FABLE

One day long ago a Sufi master with three disciples was near death and wanted to ensure that the disciples would come under the guidance of another Sufi master after he passed away. The master, who had accumulated 17 camels, laid down the following instructions for the disciples:

> On my death, the three of you shall divide my 17 camels in the following proportions: the eldest disciple shall have half of them, the middle in age disciple shall have one-third, and the youngest shall have one-ninth.

The master died soon after writing this bequest, leaving the disciples in a dilemma, so they sought out advice from learned scholars on how to interpret these instructions. One told them just to make the nearest possible division, while another told them to own the camels communally until they reproduced. A clever trader said they should just sell the camels and divide the proceeds among themselves, and a wizened old judge advised them that the bequest was null and void because it couldn't be executed.

The three disciples weren't happy with any of these suggestions, sensing that their master must have had some deeper and more helpful lesson in mind for them. But what exactly was that lesson?

Lesson 1: Remain Open-Minded

One obvious lesson the disciples learned from their master's instructions was that seeking advice and wisdom from others will always broaden their perspectives. No one ever has a monopoly on the truth, no matter how quick or smart they are. Genuine wisdom requires humility in the face of life's many complexities, so a wise person not only knows how to tolerate and learn from diverse points of view but actually seeks them out.

This is as true in business as it is in life. Rather than seeking information to confirm their own current beliefs, a good manager actively looks for conflicting information and disconfirming facts. Very few business decisions ever involve absolute truth. A business decision almost always boils down to a matter of opinion. Not only that, but the actual outcome of any decision will have just as much to do with the random and unforeseen events that surround it as with the intellectual prowess of the decision-maker, so a good manager always prepares for the unexpected.

Lesson 2: Have Patience

Something else the disciples learned was patience. Their dilemma was significant, and they certainly wanted to resolve it, but there was no urgency to the issue. And for today's managers, learning how to be patient is perhaps more important than ever before, given the fast pace of business and the proliferation of data and information. Every time your inbox is refreshed it produces a new batch of issues commanding your immediate attention. Figuring out not just how to prioritize, but how to let go of the unimportant issues while showing patience for the truly important ones is a skill that would come in handy for even the most bottom-line obsessed, goal-oriented, time-stressed up-and-comers.

The Dilemma Resolved

In the end, the three disciples did find the answer to their Master's challenge. After much searching, a wise old man solved the riddle for them thusly:

> Although I only have one camel myself, I will lend it to you so you now have 18. The eldest disciple should then be given one-half of these, which is 9. The middle disciple should get one-third, or 6, and the youngest disciple should get one-ninth, or 2. That will leave just one camel, which is mine, and you can return it to me then.

And this was how the three disciples found their new Sufi master. It also taught them one final lesson.

Lesson 3: Share

Sharing with others is a natural human urge and comes largely from the human instinct for empathy and social connection. Moreover, as the world fills with data and ever more rapid, constant interaction, trust and sharing are becoming increasingly important. Sharing comes from empathy, and for a business empathy is the ultimate form of customer insight.

Ancient lessons can often be very useful, even in modern situations. Technology may gallop along, but wisdom is timeless.

Increasingly affordable data storage, computational technology, powerful data science, big data, artificial intelligence, **blockchain technology**, machine learning, the Internet of Things, and ubiquitous interactivity have clearly made possible much more powerful analytical capabilities for companies whose goal is to build stronger customer relationships and deliver better customer experiences. But one thing is clear: No matter how powerful the algorithms and tools, they can only be as useful as the data we have about customers, as well as our intelligence with respect to knowing the right ways to think about the questions.

And once we do have good data about customers and use the tools intelligently to answer the right questions, we can have measures that can stand up to any of the old traditional KPIs—which, themselves, have always only been universally acknowledged as useful, and were never perfect, anyway.

CHAPTER 13

Organizing and Managing the Profitable Customer-Strategy Enterprise

Work is of two kinds: first, altering the position of matter at or near the earth's surface relative to other matter; second, telling other people to do so.

—Bertrand Russell

Throughout this book, we have described the **customer-strategy enterprise** by defining the principles of creating a customer-strategy business. In this and the next chapter, we will focus on how a firm establishes itself as an enterprise focused on building the **value of the customer base** and how it can make the transition from product management to managing for **customer equity**. What does a customer-value-building enterprise look like? How does a company develop the organization, skills, and capabilities needed to execute customer-oriented programs? How does the enterprise create the **culture** that supports these principles? How will it integrate the pieces of the organization that have traditionally been managed as separate silos (or "chimneys" or "smokestacks")? To begin our discussion, this chapter examines how the customer-strategy enterprise is different from the traditional organization, and what that means about how we make budget decisions and how we manage people.

WHO OWNS THE CUSTOMER RELATIONSHIP?

In a typical company, Product Manager A wants the website to send an offer for their product to every new site visitor. But Product Manager B wants to send an offer for *their* product. No one can document the correct processes, because no one agrees on them. Thus, the increasing use of **business rules** to drive the automation of customer **interactions** has accelerated the pressure on enterprises to shift from product management to customer management organizational structures.

If one division owns a certain group of customers, then it is clear who is responsible for managing the rules that apply to those individuals. The process of creating and managing rules highlights the limitations of product management structures. These organizations were logical when the toughest challenge an enterprise faced was creating and selling high-quality products. But, today, the toughest challenge is managing individual customer relationships, often in real time. If divisions are competing internally, they make decisions that aren't in the customer's interest.

The phrase "owns the relationship" disturbs some people; after all, a relationship can't be owned. Within the context of this book, *owning* a relationship means being accountable for it, in the sense of owning up to it.

Part of the problem is that large enterprises are, well, large. So business rules need to be created using a common vocabulary. Ron Ross, cofounder of the consulting firm Business Rule Solutions, LLC, explains: "You must be able to trace who is using what terms in what context; you need to be able to trace the impact across the business environment."[1] While business rules can theoretically be created using everyday language, each term must be used with more precision and consistency than we use in normal conversation.

Another issue in large businesses is traceability: being able to follow the impact of certain rules across the entire business environment. "You need to know what task each rule relates to," says Ross, "and you also want to be able to trace rules to the parties that have a stake in a particular rule. When it comes time to change the rule, you must know whom to call." This is a good application for the **customer experience journey mapping** described in Chapter 2.[2]

Now that we have become better at the metrics of customer valuation and equity, can we hold someone responsible for increasing the value of customers and keeping them longer? Most companies have brand managers, product managers, store managers, plant managers, finance managers, **customer contact center** managers, webmasters, regional sales managers, branch managers, and/or merchandise managers. These days, even beyond the obvious high-end personal and business services, more and more companies have *customer* ***relationship managers***. Now that technology drives a dimension of competition based on keeping and growing customers, the questions to ask are:

- Who will be responsible for the enterprise's relationship with each customer? For keeping and growing each customer? For building the short-term revenues and long-term equity and value of each customer?

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[1]Bruce Kasanoff, "A Quick Primer on Business Rules," in Don Peppers and Martha Rogers, *Managing Customer Experiences and Relationships: A Strategic Framework, Third Edition* (Wiley, 2017), 345.

[2]Authors' note about the difference between personalization and customization: Many companies and writers in this field use these terms interchangeably, and that's probably okay. Perhaps it's helpful to think of personalization as Pine and Gilmore's "adaptive" and "cosmetic" customization, whereas what we refer to as customization is more along the lines of "collaborative" and "transparent" customization. Think of it this way: Personalization is what happens when a company puts the customer's name at the top of a letter that is otherwise the same for everyone in the customer segment, whereas customization in the same application would mean that a company has put the customer's name at the top of the letter, and has adapted the content throughout the rest of the letter to the individual customer who received it.

- What authority will that ***customer manager*** need to have in order to change how the enterprise treats their customers, individually?
- How will they use tools and technology to create better experiences for her customers?
- What will they have to do?
- By what criteria and metrics will success be measured, reported, and used for compensation?

In this chapter, we ask the questions: How will executives at the enterprise develop management skills to increase the value of the customer base? How will our information about customers—and our goal to build the value of the customer base—inform every business decision we make all day, every day?

We have shown that in the customer-strategy enterprise, the goal is to maximize the value of the customer base by retaining profitable customers and growing them into bigger customers. This is accomplished by eliminating unprofitable customers or converting them into profitable relationships, and by acquiring new customers selectively, based on their likelihood of developing into high-value customers. The overriding strategy for achieving this set of objectives is to develop **Learning Relationships**, built on trust, with individual customers, in the process **customizing** the mix of products, prices, services, and/or communications for each individual customer, wherever practical, which may require **business process reengineering (BPR)** to adopt **mass customization**.

It should be apparent that the new enterprise must be organized around its customers rather than just its products. Success requires that the entire organization reengineer its processes to focus on the customer.[3] So in this chapter, we also examine the basics of management at a customer-strategy enterprise. Our goal is to understand the capabilities necessary to create and manage a successful customer-strategy company. We draw a picture of what the organizational chart looks like and explain how to make the transition, overcome obstacles, and build momentum. We also have a look at the role of employees in the customer-strategy enterprise.

Before any of that, though, let's look at what it means to manage **customer experiences**—what they are and how to make them better. Alan Pennington notes

[3]Katy Tynan, "Be the Change Leader Your Organization Needs: Master Change Leadership to Drive Your Expression of Customer Obsession," Forrester Research Inc., April 21, 2021, available at https://www.forrester.com/report/be-the-change-leader-your-organization-needs/RES164557, accessed August 31, 2021. James McQuivey, PhD, and Keith Johnston, with Katy Tynan, Emily Stutzman, and Rachel Birrell, "The Customer-Obsessed Leader, 2021," Forrester Research Inc., May 6, 2021, available at https://www.forrester.com/report/the-customer-obsessed-leader-2021/RES165597 and accessed August 31, 2021, points out that customer-obsessed leaders start by committing to CX initiatives and modeling customer obsession in certain ways in their own actions. This report shows that while it feels like more work, committing to customer obsession engages workers to deliver greater customer value creatively and responsively. And see Brendan Witcher, "One Customer, One Organization, One P&L," Forrester Research, Inc., May 19, 2020, available at https://www.forrester.com/report/one-customer-one-organization-one-pl/RES115495, accessed August 31, 2021.

that we should ask: "What is it like to be our customer, and what *should* it be like?" Closing that gap might be called **customer experience management.**

We have been reinforcing the idea that a customer-based initiative is not an off-the-shelf solution but rather a business strategy that will imbue an enterprise with an ever-improving capability to know and respond to its customers' individual **needs**. Executed through a cyclical process, customer-strategy principles can provide an enterprise with a powerful source of competitive advantage. But doing so requires organizational commitment, careful planning, and, ultimately, a well-orchestrated array of people, culture, processes, metrics, and technology. Successful implementation comes only with an understanding of the nature of this comprehensive **business model**.

Customer-centric companies depend on listening to the **voice of the customer**, managing customer data, and using that data to build better customer relationships through better customer experiences. This happens throughout the organization—not just in marketing, sales, **customer care**, and customer experience, but also in finance, technology, research and development, and human resources. By definition, all revenue comes from customers, and therefore, ultimately, every employee has a role to play in increasing that customer revenue for this quarter and in the future.

WHAT IS THE FINANCIAL CASE FOR INVESTING IN CUSTOMER EXPERIENCE?

It has taken many years to build sufficient evidence to make the case for the return on investment on customer experience to be able to convince boardroom skeptics. But the evidence to support the link between commercial bottom line and stock market success and the delivery of a superior customer experience continues to grow every year. The latest round of studies has reinforced this view, showing that where the customer experience is rated highly, the stock performance is similarly high, and vice versa.

Studies in both the United Kingdom and the United States reinforce this **correlation**.

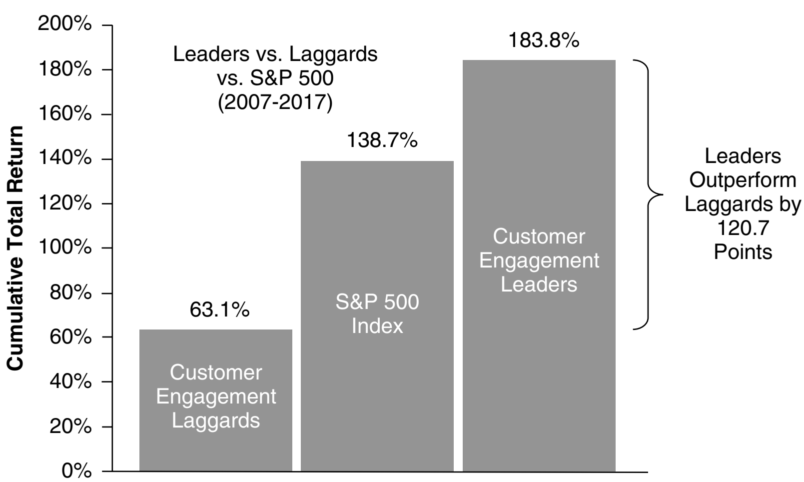

EXHIBIT 13.1 U.S. Customer Experience Leaders vs. Laggards vs. S&P 500, 2007–2017
Source: Watermark Consulting

Since one of the most important questions executives can ask is whether better customer experiences and relationships will pay off for a company, we will summarize a seminal study led by Jeff Gilleland, now Vice President of Marketing, Sales, and Service Solutions, GENPACT. Essentially, the study compared how far along on the **customer-orientation** journey companies were, and compared the performance levels of companies at high and low levels of customer orientation.

The research was done as part of the Customer Experience Maturity Monitor (CEMM),[4] a research project jointly conducted by SAS Institute and Peppers & Rogers Group.[5] The research findings revealed a direct link between the maturity of a company's customer experience management capabilities and its relative competitiveness. For companies that have progressed to the highest levels of maturity (Levels 4 to 5), the advantage is twofold to threefold (see Exhibit 13.2).

Understanding the Customer Perspective

In their book *The Best Service Is No Service* Bill Price (President, Driva Solutions) and David Jaffe (Consulting Director, LimeBridge) point out that customers just want what they want, with no effort or hassle. (We first mentioned their book in Chapter 8.) They point out how a large portion of the work customers are expected to do is unnecessary, including many service interactions, which result from the dumb things companies do to their customers: processes that customers don't understand, bewildering statements, incorrect letters, badly applied fees and charges, or services not working as the

[4]*Customer Experience Maturity Monitor* (CEMM): A global research study initiated by SAS Institute and Peppers & Rogers Group. The initial research included responses from 434 companies. The first phase of the research involved in-depth interviews with over 50 companies focusing on the activities and programs they engage in to ensure a positive experience for their customers. This information was combined with surveys among 384 companies worldwide, which audited their customer experience practices and customer orientation philosophies. The results of this project serve as the benchmark data for the CEMM and provide the foundation for the analysis of ongoing research among companies in different countries and industries as well as in individual companies wishing to understand their customer experience maturity levels. "SAS" and all other SAS Institute, Inc. products or service names are registered trademarks of SAS Institute, Inc.

[5]Studies continue in the area of "customer experience maturity." One model created by consultant Denise Lee Yohn includes the stages of Emerging, Learning, Committing, Accelerating, and Excelling for three key development tracks: Vision and Strategy, Leadership and Alignment, and Organizational Readiness. See Denise Lee Yohn, "The One Customer Experience Management Tool That Every CX Leader Must Use," *Forbes*, October 1, 2019, available at https://www.forbes.com/sites/deniseleeyohn/2019/10/01/the-one-customer-experience-management-tool-that-every-cx-leader-must-use/?sh=61b1807a3e8b, accessed August 25, 2021. Also see "How Mature Is Your CX Program? A Review of 3 CX Maturity Models," eTouchPoint, October 17, 2016, which summarizes three key models: Forrester's four-stage model of Repair, Elevate, Optimize, and Differentiate; Gartner's five-state model of Initial (Fragmented Focus), Developing (VOC Validated), Defined (Execs Engaged), Managed (Profit Parity), and Optimizing (Culture Change); and Temkin's six-level model of Ignore, Explore, Mobilize, Operationalize, Align, and Embed.

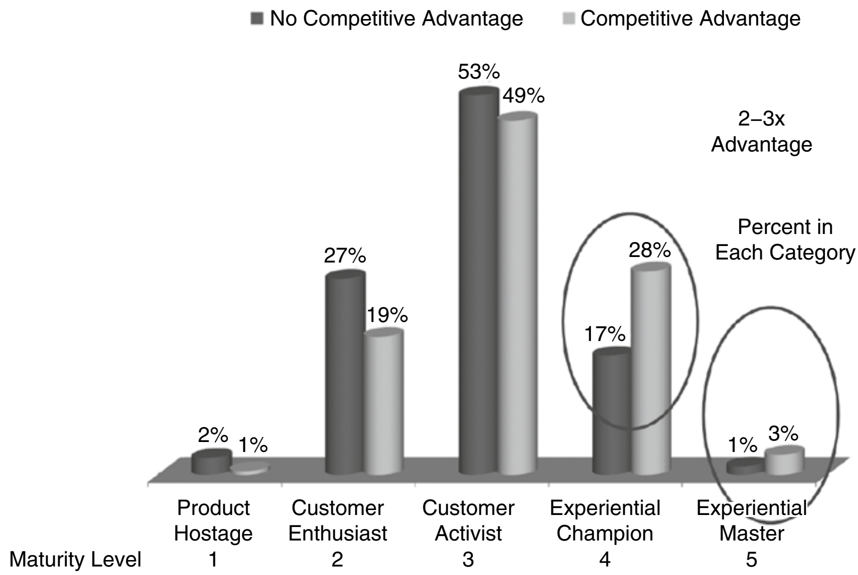

EXHIBIT 13.2 Competitive Advantage Accrues with CEM Maturity

customer expects. In other words, a lot of *friction*. They suggest keeping these best service principles in mind:

Principle 1: Eliminate Dumb Contacts

Price and Jaffe argue that fundamental to their thinking is reducing the "demand for contact," arguing that while most companies carefully measure the efficiency with which they handle inbound customer contacts, including things such as the number of minutes spent per contact, or the number of emails sent, what they really ought to be doing is trying to reduce the volume of contacts required overall. Instead, they are managing their own "service supply," and not trying to eliminate the demand that customers put on them, because they don't understand how to deal with an issue, or do not agree with a policy, or cannot find out important information very easily. Amazon comes closest to taking a demand-reduction approach, by measuring (and trying to reduce) the average number of contacts per order, on a yearly basis. Instead of obsessing about how quickly calls and emails are answered, companies need to spend more effort eliminating the need for many of those contacts to begin with.

Principle 2: Create Engaging Self-Service

It's easy for customers to give up on a website or to get lost in one. Often they have to listen to a set of toll-free menus and are sometimes overwhelmed by the choices, sometimes trying desperately just to find the option that lets them talk to a human agent. However, when self-service works well, customers love it. After all, ATMs took off because they were so much more convenient than queuing in a bank branch during banking hours. And truly engaging self-service is why companies like Amazon and First Direct have grown so rapidly.

Principle 3: Be Proactive

In many cases the company knows that there is a problem, yet still waits for the customer to contact the company to fix it. Consider product recalls: Often a company has no idea which of its customers has the affected product and waits for customers to try to figure it out and then call the company, sometimes in panic mode. This is entirely preventable with modern technology and data storage capabilities.

Principle 4: Make It Really Easy to Contact Your Company

Some companies give customers the impression they would rather not hear from customers at all. The best companies, however, put their phone number on every page of the website. Martha once met the CEO of a small cellular company that eventually sold to one of the large companies. While he was in charge, he made sure every customer had his *home phone number* in case the customer had a problem. The goal for his executives was to make sure he didn't receive any calls at home, because things ran so smoothly that customers didn't have problems.

Principle 5: Own the Actions Across the Company

A bizarre myth has grown up in many companies that the head of **customer service** is responsible for customer service. Although we recognize that someone needs to be dedicated to service and held accountable for it, things work better for both the customer and the company when the company's leadership knows that service operations people cannot "fix" service without the help of all the other company departments and, increasingly, outside partners in the **supply chain** or in other functions. Many areas of a business "cause" increases in the "demand for contacts"—for example, billing, IT, marketing, credit, finance, and other departments. In Price and Jaffe's view, "responsibility for service must be spread across the whole organization."

Principle 6: Listen and Act

Some companies have millions of contacts per year with their customers, yet they still spend considerable money and time researching their customers.

Companies already collect huge amounts of data on each customer, yet they continue to ask for information through surveys and other costly (and less accurate) tools. The interactions that companies have with customers offer an amazing amount of insight about the customers, the company's products and services, and even competitors—if companies can simply tap into what their customers are already telling them and *act* on it.

Principle 7: Deliver Great Service Experiences

Companies have created large centralized contact centers or service functions, separated service from sales or production, added lots of new technology, deluged themselves with meaningless or misleading metrics, and built walls around the customer service functions. They have then become stuck delivering service experiences that have forgotten the customer, obsessing about speed, not quality, and thinking that faster is more efficient. It is hardly a surprise that many customer experiences disappoint customers. For example, customers are justifiably miffed when companies (still!!) ask them to repeat their credit card number, frequent flyer account number, or order identification number after just having done so in an **interactive voice response (IVR)** or with another agent or, as is increasingly the case, after doing so online.[6]

Improving Customer Service at an Online Financial Services Firm

In one instance, an online financial services firm was reengineering the **customer interaction center** to implement many of the principles we've been discussing. The firm separated its customer base into four groups based on key customer characteristics (assets and use of the services). Once it identified its customer groups, it was easy for the firm to identify the knowledge, skills, and abilities that were required to support them. The firm implemented routing technology to redirect customer calls based on the customer grouping and the skill set of the available representatives. The firm created automated business rules that could utilize the best available personnel to handle the needs of each individual customer in the call queue. Prior to this change, any customer could be routed to any **customer service representative** (CSR). It was not unusual, for example, to have a **most valuable customer (MVC)** routed to a newly hired and ill-informed rep or a rep who lacked the required skills to execute particular transactions. This required a customer hanging up and (if the firm was lucky) calling again; or perhaps the customer would be transferred to another CSR. The changes resolved these problems. A key benefit for the rep was the ability to work through a learning curve—she was directed to the types of calls that she could handle, and this significantly decreased stress levels, which reduced all the company costs related to **turnover**.

When you *do* need customer service, high-quality customer service is one of the beneficial outcomes of adopting customer strategies. Enterprises must keep in mind the cost of *not* providing sufficient service, thereby risking the loss of customers, the cost of lost long-term customer equity, and the expensive task of acquiring new customers. General wisdom places the estimate for customer defections due to a poor sales or service interaction between the customer and the enterprise at about 70%. It isn't necessary for a company to make formal **Return on Customer (ROC)** calculations to understand that the short-term losses in revenue and long-term customer equity cost to shareholders of poor service far outweigh the current perceived cost savings of reducing service quality.

Moreover, an enterprise must balance the cost of providing customer service with the needs and desires of the customer. This must be done in such a way that the customer will find sufficient value in the enterprise to remain a customer. At a minimum,

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[6]Adapted from Bill Price and David Jaffe, *The Best Service Is No Service: How to Liberate Your Customers from Customer Service, Keep Them Happy, and Control Costs* (San Francisco: Jossey-Bass, 2008), pp. 8–19.

certain standards of accuracy, timeliness, and convenience must be in place to placate most customers. The right technology and processes must first be deployed, followed by the training and adoption of service practices by customer-facing representatives. But to do this properly requires the enterprise to confront a number of very frank questions about the amount and type of customer-oriented service it is trying to provide:

- What is the right amount of customer service? What do customers actually need and want?
- Are we doing the same expensive things for everybody when our most valuable customers would be even happier with less expensive service (think mobile or online banking versus the service counter at the bank branch)?
- Taking different customer needs into consideration, what is the least expensive amount for the enterprise to spend on service that works for the customer?
- Which channel do customers want to use? Can they be easily moved to one that costs less—especially customers with low **actual value** and **potential value**?
- Should different levels of service be offered to different kinds of customers?
- Might customer service mean different things to different customers?
- When is self-service appropriate?

These and other questions should be addressed if an enterprise is to find the balance of service that serves both the customer and the budget. Some companies still look at customer service as a cost center, but others see customer service interactions as a chance to build customer equity, and therefore an opportunity. The difference is palpable in the resulting customer experience. The key is not wasting the customer's time. Gartner reports that 70% of customers use self-service channels, but only 9% can fully resolve their issue through those channels. The reason? Many enterprises simply add more self-service channels without realizing they're creating a complex, disconnected experience, unintentionally frustrating their customers.[7] The solution is to create an integrated customer journey and to match service and mode to the consumer need at the moment.

> The key is not wasting the customer's time.

According to Art Schoeller, Vice President and Principal Analyst at Forrester, "While consumers hop channels to research products and services, there usually is a **moment of truth** when an informed agent can make the right offer and close the sale. Companies that capture consumer interaction data from web and mobile self-service touch points can more effectively match the right agents with prospects."[8]

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[7]Jordan Bryan, "Rethink Your Customer Service Strategy to Drive Self-Service," Gartner, September 25, 2019, https://www.gartner.com/smarterwithgartner/rethink-customer-service-strategy-drive-self-service/, accessed July 21, 2021; and Kate Leggett, "Your Customers Want to Self-Serve—It's Good for Them and Good for You," Forrester, May 23, 2019, https://go.forrester.com/blogs/your-customers-want-to-self-serve-its-good-for-them-and-good-for-you/, accessed May 25, 2021.

[8]Art Schoeller, "Connect the Dots between Customer Self-Service and Contact Centers," Forrester Research, Inc., February 24, 2014, available at www.forrester.com.

In the summer of 2021, for example, as COVID-19 travel bans were lifted, eager airline customers had an unprecedented number of questions about the ever-changing travel guidelines. When telephone and chat wait times spiked, not only did Delta hire more than 5,000 people to meet the need, but it also updated its self-service channels via website and app to allow customers to change their previously nonrefundable, nonchangeable economy flights themselves with no change fee.[9]

So, is good customer service in the eyes of the beholder? Some criteria an enterprise could consider from the customer's perspective include:

- Saving time or money
- Accuracy of a transaction
- Speed of service
- Ease of doing business
- Providing better (not just more) information
- Recording and remembering relevant data
- Convenience
- Allowing a choice of ways to do business
- Treating customers as individuals
- Acknowledging and remembering the relationship
- Fixing problems quickly
- Thanking the customer

Not all of these elements are equally important to all customers. Any one of these criteria could be a deal breaker to one customer and of no consequence to another. Adding or upgrading customer services uniformly for everyone is an expensive way to raise the bar. Better to know what's important to an individual customer and then to make sure that customer gets the services most important to them.

Adding or upgrading customer services uniformly for everyone is an expensive way to raise the bar. Better to know what's important to an individual customer and then to make sure that customer gets the services most important to them.

Many enterprises have learned that the integration of the contact center with all other communication vehicles may be the first step toward successful completion of the customer's mission. For example, live online customer service, text-based chat, and callbacks are some of the vehicles that can elevate good, basic customer service to

[9]Bailey Schulz, "Delta Allows Free Basic Economy Ticket Changes as Travelers Struggle to Reach Agents," *USA Today*, July 27, 2021, available at https://www.usatoday.com/story/travel/airline-news/2021/07/27/delta-allows-free-flight-changes-travelers-struggle-reach-agents/5395596001/.

excellent and highly satisfactory service, the latter of which translates into customer retention, growth, loyalty, and profitability.

> It's better to *treat different customers differently* than to treat different problems differently.

It is also important to note that just as the service itself must be geared to each customer with an inquiry or problem, the *level* of service must likewise be dependent on the value of each customer, at least as much as the problem itself. Imagine two customers at a casino have the same problem. The casual, one-time patron gets a resolution and an **apology** and a bottle of wine, but the frequent high-roller gets a resolution, an apology, and a complimentary weekend in the honeymoon suite, demonstrating that it's better to ***treat different customers differently*** than to treat different problems differently.

Improving Service at a Local Retailer

Chris Zane, President of Zane's Cycles in Connecticut and named a Customer Champion by 1to1 Media, explains how his whole business focuses on customer experiences and service. At Zane's you can get bicycles, bicycle accessories, bicycle repair and service, and what Chris Zane himself calls "epic" customer service. He wants to create customers for life—and for generations.

There is constant communication with the staff about embracing a customer experience culture. The following are a few quotes that are constantly reinforced and are top-of-mind throughout the Zane's organization:

- Customer service starts when the customer experience fails.
- The only difference between us and our competition is the experience we deliver.
- We want our customers to have more fun here than at Disney World.
- And finally, from Len Berry's book, *Discovering the Soul of Service*, great service not only improves business, it improves the quality of life.

As Zane says:

> *Probably the most important tool in the customer experience toolbox is understanding the customer* **lifetime value (LTV)**. *It's easy to deliver on the promise of a unique and enjoyable experience when the customer you're working with is buying a bike for a few thousand dollars, but when you are trying to juggle five customers and the sixth needs help getting a bike out of her car for a free service adjustment and it's raining—well, that's when knowing the customer LTV provides the discipline to maintain the focus to ensure a unique experience. At Zane's Cycles, starting with the first bike at age three and ending with your last bike, usually the retirement present to yourself, our customer LTV is $12,500. Simply, the customer with the free service today is as valuable as today's few-thousand-dollar bike purchaser over a 60-year relationship.*

How Do We Measure the Success of Customer Service?

At many firms, the customer service function is thought of as a cost of doing business rather than as an integral part of the products or services actually being sold to customers. It is easy to spot an enterprise with this attitude. This is the company that hides its toll-free number on the website and that has an impenetrable IVR system (see Chapter 8).

Increasingly, customer transactions are moving to an e-commerce model, and transactions normally handled with a phone call are now being done electronically, via the website, and this inevitable transition has been greatly accelerated by the COVID-19 pandemic. In many customer service areas, this has changed the mix of calls that are handled by the customer service rep. Easy transaction calls (such as order taking) are now being replaced with more difficult customer situation calls (complaints, inquiries, billing and invoicing questions, etc.). Naturally, this can increase the level of stress experienced by the customer service reps.

Traditional measures for customer interaction centers have focused on "talk time" and "one and done" measures. (See a more complete discussion about the customer interaction center in Chapter 8.) As we dig deeper into customer metrics, we start measuring average talk time for valuable customers versus customers who call into the customer interaction center frequently and yet do not generate enough revenue to warrant high levels of service. We begin to understand which customers are buying a wide range of products and services offered by the enterprise and which customers should be buying but aren't. Many customer interaction center managers are left to fight a battle to increase talk time for the customers who warrant more attention, but they lack the analytics and resulting insights to be able to justify that decision. This is where partnering with the customer manager is key. The justification for these measures should be in the customer strategies.

A customer-strategy company often can keep its costs down by centering on customer needs.

The fact is, however, that a customer-strategy company often can keep its costs down by centering on customer needs. Calls are more often resolved in one session and in less total time. Customer service reps do not chase down information or transfer customers from department to department. Voice response unit options are reordered to present the most likely option desired by *that* customer as soon as the customer is identified. This process can significantly decrease phone costs for an enterprise maintaining a toll-free phone line. And it requires that people within the enterprise start thinking like customers, taking the customer's point of view during key interactions (such as a sales call or customer care call), and combining this point of view with the **customer strategy** and business rules that have been identified for this customer. Change often demands new skill sets. As the enterprise begins to define specific roles and responsibilities (or job descriptions) for various customer care representatives, it also will need to develop training and development plans and recruitment and staffing plans. These descriptions include competencies and behaviors that will be required of all employees—things like customer empathy—and skills associated with different roles. Employees might determine how they touch the customer directly or indirectly by supporting another department.

An often-neglected step in this process is planning around the way customer care representatives are supported, measured, and compensated to reinforce the new behaviors, which should incorporate the customer-centered metrics described earlier. Unfortunately, the reporting capabilities at many enterprises are not up to the task, and some great customer-oriented efforts have gone awry because this last step was not implemented. Employees often want to do the right thing, but they aren't supported or measured adequately or correctly. More important, many companies equate **customer relationship management (CRM)** with customer service, when in fact customer service—important as it is—*is not* the same as relationships, customer experience management, or customer equity building. The heart of a Learning Relationship is a memory of a customer's expressed needs so that this customer can be treated in a way that works for them without their having to be asked again, and so a dialogue can pick up right where it left off. Customer service, in contrast, is often more like *random acts of kindness* masquerading as customer relationship management.

RELATIONSHIP GOVERNANCE

As we said at the beginning of this chapter, one of the biggest single difficulties in making the transition to an enterprise that pays attention to its relationships with individual customers and creating better experiences for them is the issue of **relationship governance.** By that we mean: Who will be in charge at the enterprise when it comes to making different decisions for different customers?

Optimizing around each customer, rather than optimizing around each product or channel, requires decision making related to customer-specific criteria, across all different channels and product lines. When Customer A is on the website or on the phone, the enterprise wants to ensure that the very best, most profitable offer is presented *for that customer*. The firm's call center shouldn't try to compete with its own stores to try to get the customer to buy from them, nor should the product manager for Product 1 compete with the product manager for Product 2 and try to win the customer for one product line or another. What the customer-centric enterprise wants is to deliver whatever offer for this customer is likely to create the most customer value, overall, for the company and the customer without regard to any other organizational or department goals or incentives that might have been established at the firm. This, in a nutshell, is the challenge of *relationship governance*.

The challenge most companies face when they make a serious commitment to managing customer relationships becomes obvious once the firm pulls out its current organizational charts, which usually are set up to manage and reward brands, products, channels, and programs. Most companies have organized themselves in such a way as to ensure that they can achieve their objectives in terms of product sales or brand awareness across the entire population of customers they serve.

But as we hurdle headlong into ever-more-powerful analytical and communication technology, managing customer relationships individually will require an enterprise to *treat different customers differently* within that customer population. Inherent in this idea is the notion that different customers will be subject to different objectives and strategies and that the enterprise will undertake different actions with respect to different customers. So we ask again: With respect to any particular customer, who will be put in charge, and held accountable, within the enterprise, to make sure this actually happens? And when that person is put in charge of an individual customer relationship, what levers will they control in order to execute the strategy being applied to their customer? How will their performance be measured and evaluated by the enterprise, for the current period as well as the long term? (Recall the Canadian bank example we cited in Chapter 11, a company where ***customer portfolio managers*** are measured in the current quarter for the current revenue by the bank of the customers in their portfolios and for the three-year projected value, as of today, of that same group of customers.)

This is the problem of relationship governance. It's one thing for us to maintain, safe between the covers of this book, that in the interactive age a company should manage its dialogues and relationships with different customers differently, analyzing their individual values and needs and adapting its behavior to each one. It's another thing to carry this out within a corporate organization when, at least for many companies at present, no one is actually in charge of making it happen. In the first chapter of this book, we showed the orthogonal relationship of customer orientation when compared to ***product orientation***: that is, whether an enterprise is finding customers for its products or products for its customers. We can extend this customer orientation thinking in the way it's shown in Exhibit 13.3.

The customer-oriented company will focus on one customer at a time and try to find the next right offer, service, and/or product for that customer. And another one and another one, winning a greater and greater share of each customer's business by generating top-notch customer experiences and building Learning Relationships. But how is a company structured to accomplish this mission?

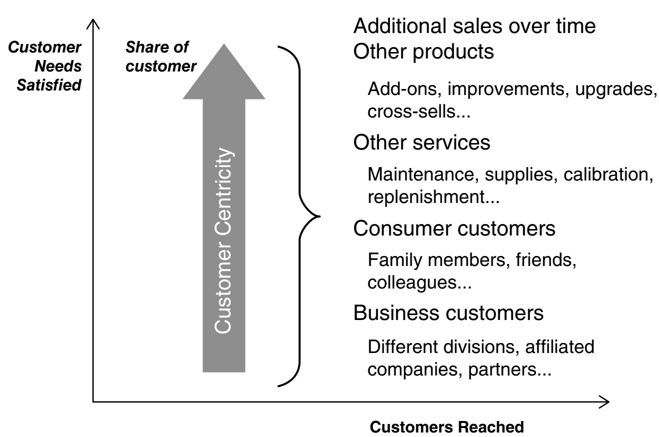


EXHIBIT 13.3 Share of Customer = Share of Need

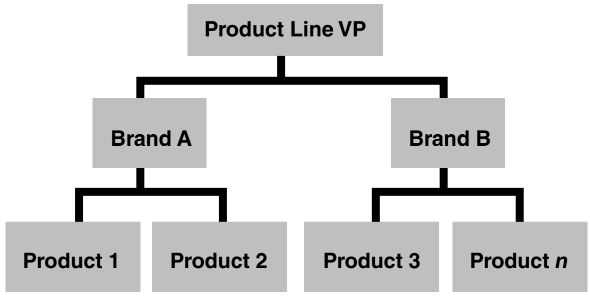


EXHIBIT 13.4 Product Management Organization

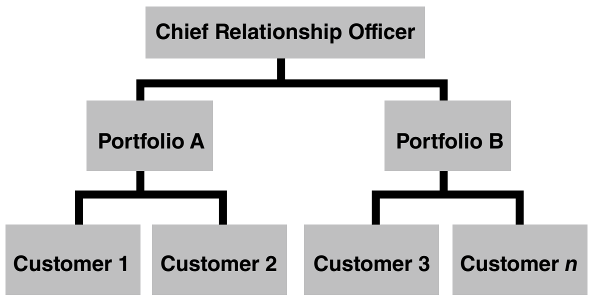


EXHIBIT 13.5 Customer Management Organization

Exhibit 13.4 is an oversimplified example of a typical Industrial Age organization chart. In such an organization, each product or brand is the direct-line responsibility of one individual within the organization. In this way, the enterprise can hold particular managers and organizations responsible for achieving various objectives related to product and brand sales. The brand or product manager is the protector of the brand or product, watching out to make sure that it does well and that sales goals or awareness goals are achieved. The manager controls advertising and promotion levers to ensure that the best and most persuasive message will be conveyed to the right segments and niches of customers or potential customers. This is all in keeping with the most basic goal of an old-fashioned Industrial Age company: *to sell more products to whoever will buy them*.

The most basic goal of the customer-strategy enterprise, however, is to increase the long-term value of its customer base, by applying different objectives and strategies to different customers. Yes, in the process it's practically certain that more products will be sold in the short term. But in order for the primary task to be accomplished, someone within the organization has to be put in charge of making decisions and carrying out actions with respect to each individual customer, even if that task is completely automated.

In Exhibit 13.5, a different organization chart is drawn for the customer-value-building company, one that emphasizes *customer management* rather than product management. In an enterprise organized for customer management, ideally every customer will be the direct-line responsibility of a single customer manager (even though the customer may not be aware that the manager is in charge, as they work in the background to determine the enterprise's most appropriate strategy for that customer and then to make sure it is carried out). Because there are likely many more customers than there are management employees, it is only logical that a customer manager should be made responsible for a whole group of customers. We refer to such a group as a ***customer portfolio*** avoiding for the present the phrase ***customer segment***, in order to clarify the concept.

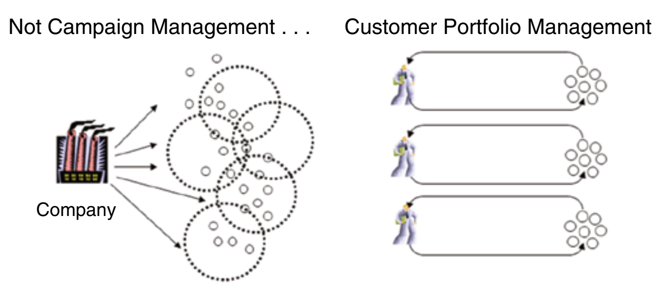
A customer portfolio is made up of unduplicated, unique, and identified customers. No customer will ever be placed into more than one portfolio at a time, because it is the portfolio manager who will be in charge of the enterprise's relationships with the customers in her portfolio and the resulting values of those relationships.

A customer portfolio is made up of unduplicated, unique, and identified customers.

If we allow a customer to inhabit two different portfolios, then we are just creating another relationship governance problem—which portfolio manager will actually call the shots when it comes to the enterprise's strategies for *that* customer? How will we calculate that customer's value accurately? And who gets credit or blame if the customer's value rises or falls?

A customer manager's primary objective is to maximize the long-term value of their own customer portfolio (i.e., to keep and grow the customers in their portfolio), and the enterprise should reward them based on a set of metrics that indicate the degree to which they have accomplished their mission. In the ideal state, the enterprise's entire customer base might be parsed into several different portfolios, each of which is overseen by the customer manager, like a subdivided business that creates value in the long term and the short term as of today. (See Exhibit 13.6.)

Clearly, if we plan to hold a customer manager accountable for growing the value of a portfolio of customers, then we'll also have to give her some authority to take



Customers Targeted:	• Anyone, including BZs	• MVCs and MGCs
Objective:	• Launch positive ROI campaigns	• Maximize lifetime values
Customer Reaction:	• Block interactions	• Invite interactions
Acceptance Rate:	• 2–5%	• 30–70%
Nature:	• Transaction: Buy something now	• Relationship: Buy more vs. buy now

EXHIBIT 13.6 Managing Customer Portfolios for the Long Term

actions with respect to the customers in the portfolio. The levers that a customer manager ought to be able to pull, in order to encourage her customers to attain a higher and higher long-term value to the enterprise, should include, literally, every type of action or communication that the enterprise is capable of rendering on an individual-customer basis. In communication, this would mean that the customer manager will control all of the enterprise's **addressable** forms of communication and interaction: direct mail as well as interactions at the call center, on the website, ads displayed on the customer's screen when they're visiting another website, on their mobile device, and even (to the extent possible) in face-to-face encounters at the store or the cash register.

In communication, the customer manager will control all of the enterprise's addressable forms of communication and interaction to each customer.

In effect, the customer manager would be responsible for overseeing the enterprise's continuing dialogue with a customer. In terms of the actual product or service offering, ideally the customer manager would be responsible for setting the pricing for her customers, extending any discounts or collecting premiums, and so forth. The customer manager should own the offer,[10] and the communication of the offer, with respect to the customers in the manager's portfolio.

The enterprise will still be creating and marketing various programs and products, but the customer manager will be the traffic cop, with respect to their own portfolio of customers. They will allow some offers to go through as conceived, they will adapt other offers to meet the needs of their own customers, and they will likely block some offers altogether, choosing not to expose their customers to them.

The customer manager should own the offer, and the communication of the offer, with respect to the customers in the manager's portfolio.

In a high-end business or personal services firm, such as a private bank, the role of *customer manager* is played by the firm's **relationship manager** for each client. The relationship manager owns the relationship and is free to set the policies and communications for her own individual clients, within the boundaries set by the enterprise. The enterprise holds her accountable for keeping the client satisfied, loyal, and profitable. The company probably does not formally estimate an individual client's actual LTV, in strict financial terms; more than likely, however, it does have a fairly formal process for ranking these clients by their long-term value or importance to the firm. And a relationship manager who manages to dramatically improve the value of her client's relationship to the enterprise will be rewarded.

[10]Reminder: The phrase "owns the relationship" disturbs some people; after all, a relationship can't be *owned*. Within the context of this book, owning a relationship means being accountable for it in the sense of "owning up to it."

However, most businesses have many more customers than a private bank, law firm, or advertising agency. For most businesses, it would simply be uneconomic for a relationship manager to pay individual, personal attention to a single customer relationship, to the exclusion of all other responsibilities. Realistically, then, the way most of the addressable communications will be rendered to individual customers, at the vast majority of companies, will be through the application of business rules. Just as business rules are used to mass-customize a product or a service (see Chapter 10), they can be applied to mass-customize the offer extended to different customers as well as the communication of that offer. Thus, one of the customer manager's primary jobs will be to oversee the business rules that govern the enterprise's mass-customized relationship with the individual customers in their own portfolio.

> Realistically, the way most of the addressable communications will be rendered to individual customers, at the vast majority of companies, will be through the application of business rules.

In addition to customer relationship managers, the one-to-one enterprise will need **capabilities managers** as well (see Exhibit 13.7).[11] These may be product managers or service managers, or anyone who makes it possible for customer managers to increase the value of their customers. Their role is to deliver the capabilities of the enterprise to the customer managers, in essence figuring out whether the firm should build, buy, or partner to render any new products or services that customers might require. We could think of capabilities managers as being something like product managers at large. The products and capabilities they bring to bear, on behalf of the enterprise, actually will not necessarily be marketed to customers but very likely instead to the customer managers in charge of the enterprise's relationships with customers.

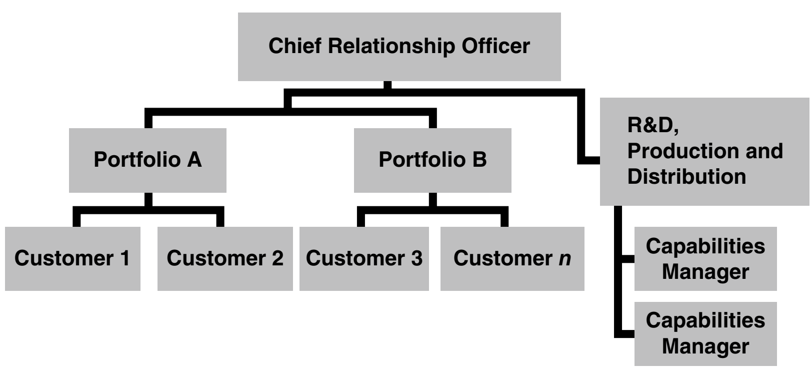


EXHIBIT 13.7 Product Managers Become Capabilities Managers

[11]B. Joseph Pine II coined the term "capabilities manager" in his book *Mass Customization* (Cambridge, MA: Harvard Business School Press, 1993).

None of this is to say that companies can afford to forget about product quality, innovation, efficient production, or cost reduction. These tasks will be just as important as they always have been for the simple reason that few customers would choose to continue relationships involving subpar products or service. However, as we've already discussed, product and service quality by themselves do not necessarily lead to competitive success, because no matter how stellar a company's service is, nothing can stop a competitor from also offering great service—or a great, breakthrough product, or a low price. In the final analysis, the most important single benefit of engaging a customer in an ongoing relationship is that the rich **context** of a Learning Relationship creates an impregnable competitive barrier, with respect to that customer, making it nearly impossible for a competitor to duplicate the customer experience the customer is now receiving.

MAKING IT HAPPEN

Now that we've described the larger-scale processes needed to transition from a product-centric to a customer-centric enterprise, we need to get specific: What needs to be done throughout the organization to increase the value of customers?

Many companies born in the 21st century will have customer centricity in their DNA. But some new ones, and plenty of enterprises which originated before technology drove customer centricity, have frequently underestimated the degree to which all facets of the business—beyond marketing and other customer-facing parts of the company—will be affected by the ongoing efforts that will be required to achieve full business benefits. The organizational and cultural transition to customer management have sometimes represented a genuine *revolution* for the enterprise, but it is more likely to be successful when it can be treated as an *evolution* within the organization.

Here, we discuss three ways to speed this evolution process, any or all of which can be adopted by an enterprise.

1. Pilot Projects and Incremental Change

Most companies launch their customer initiatives in a series of pilot projects. The objective, over the longer term, is to accumulate a large number of small improvements. The identify-differentiate-interact-customize (IDIC) process (Chapters 4 to 10) is an ideal vehicle for conceiving and executing incremental changes. A small change might involve, for instance, obtaining, linking, and cataloging more customer identities, using a sweep of existing databases containing customer information. Or it could involve setting up a prioritized service level for customers now identified as having higher long-term value to the enterprise, or higher growth potential. Many incremental change initiatives are also likely to involve streamlining the customer interaction processes, so as to cut duplicative efforts or to resolve conflicting communications.

Incremental change projects are rarely undertaken to resolve the problem of relationship governance for the enterprise. One of the key benefits, in fact, of concentrating on the IDIC process implementation methodology is the fact that significant progress can still be made without having to come to grips with this very thorny problem. At some point, however, any enterprise that wants to begin engaging customers in actual relationships, individually, will have to deal with the issue of relationship governance, and there are at least two methods for dealing with it on an incremental or transitional basis.

> The organizational and cultural transition to customer management represents a genuine revolution for the enterprise, but it is more likely to be successful when it can be treated as an evolution within the organization.

2. Picket Fence Strategy

The right way to transform a company gradually into a customer management organization is not to do it product by product or division by division but customer by customer. And one way to begin such a transition is by placing just a few customers under management, then adding a few more, and a few more (see Exhibit 13.8). In order to make this type of transition successful, it must be recognized that the enterprise will be operating under different rules with respect to the customers under management than it will be with respect to all other customers. In essence, the customers under management will be fenced off and treated differently from the remainder of the customer base. As the transition progresses, the number of customers behind this **picket fence** will increase.

If an enterprise has ranked its customers by value, it can prioritize its transition in such a way as to place the more valuable customers behind the picket fence first. When customers go under management, the implication is that a customer manager in the enterprise will be setting objectives and strategies for each of them individually. Technology, data management, and analytics will make this highly efficient. The objective and strategy set for any particular customer should reflect the entire enterprise's relationship with that customer. For this reason, at least with respect to the customers behind the picket fence, the customer managers must have not only an integrated view of the enterprise's offering to and interactions with those customers, but they also

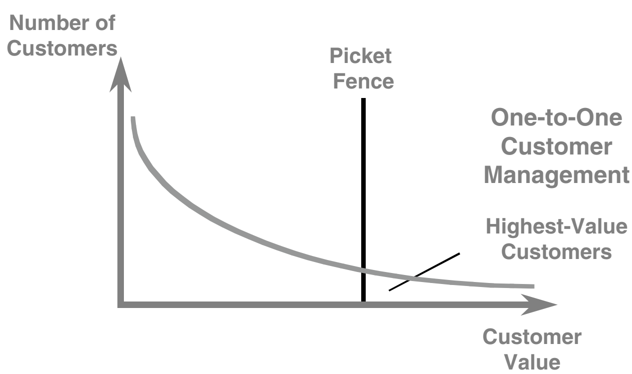


EXHIBIT 13.8 Set Up a Picket Fence

must have authority to make policy and implement programs, on behalf of the enterprise, for everything from levels of service to inclusion in online pop-up advertising.

The picket fence transition strategy is especially compelling for companies that already **identify** their customers individually, during the natural course of their business, and **differentiate** them by value. This would include banks and financial services firms, telecommunications companies, personal services businesses, online retailers, and most business-to-business (B2B) companies with internal sales organizations.

Remember that the customer manager should own the business rules for determining all of the targeted communications that her customers receive. This means that the enterprise's general online offers, mobile messaging, or direct-mail pieces would not go to customers behind the picket fence without the initiation or approval of the customer manager responsible for them. For each customer behind the picket fence, there should be a particular objective and a strategy for achieving that objective, set by the customer manager. In fact, the customer manager will herself be rewarded and compensated based on her ability to meet the objectives set for each of her customers, one customer at a time. Over time, as technology makes it better and more cost-efficient to process customer information, and the enterprise gains more knowledge and confidence in the process, it can expand the picket fence and put more customers behind it.

Although the transition involves expanding the area behind the picket fence (i.e., placing more and more customers under management), the enterprise most likely will never actually place all of its customers behind the fence. Some customers, for instance, may not be willing to participate in a relationship of any kind, or to exchange information. Moreover, no matter how cost efficiently the enterprise has automated the process, there will always be customers who are not financially worth engaging in relationships.

3. Segment Management versus Customer Portfolio Management

Segment Management

Another way to begin the transition to a customer management organization is with segment managers. The picket-fence transition is a customer-specific process that places an increasing number of individual customers under management; the segment management transition is a *function*-specific process that gives segment managers an increasing number of roles and capabilities with respect to their segments.

Remember that we chose the term *portfolio* rather than segment with deliberation, when we introduced the concept of customer management. The primary reason for this choice was to convey the thought that, in a customer portfolio, the customers themselves are uniquely identified and unduplicated: No customer would be in more than one portfolio at a time. And just as you manage each stock in your stock portfolio individually, you would manage each customer in your customer portfolio individually.

Segment management is particularly appropriate for the types of businesses that have greater difficulty identifying and tracking customers individually. The picket fence transition works best for companies that either identify customers in the natural course of their business or can easily do so, whereas the segment manager transition works for all other companies. A consumer packaged goods company, for instance, might have a highly developed customer management organization already in place to ensure that its relationships with its retailer customers are managed profitably, but the company is unlikely to have the identities of more than a microscopic fraction of its consumer-customers—even those who interact with the company's brands through Facebook, You Tube, or other online media. Such a firm might establish an organization of consumer segment managers who are responsible for shaping the firm's advertising and promotion efforts with respect to particular segments of consumers, across a variety of different products and brands.

A *segment management* organization, therefore, can be thought of as a transition state somewhere between product management and customer management. The most critical missing ingredient in a segment management operation is likely to be the capability to identify individual customers and track their interactions with—and individual values to—the enterprise over time. Until the enterprise is able to add this capability, it will not be able to move from segment management to true **customer portfolio management.** But even in the absence of customer-specific capabilities, a segment management organization still can be a useful tool for an enterprise to begin **treating different customers differently** and for creating the value proposition for the relationships that eventually could come.

Customer Portfolio Management

At the heart of the customer management idea is the concept of placing customer managers in charge of *portfolios* of separate and individually identifiable customers who have been differentiated by their value to the enterprise and grouped by their needs. It is these customer managers who are charged with managing customer profitability. This is the core structure of the customer management organization, one in which each individual customer's value and retention is the direct responsibility of one individual in the enterprise. Managers may each be in charge of a large number of customers or portfolios, but the responsibility for any single customer is assigned to one customer manager (or, in a B2B setting, often to a customer management team). That manager is responsible for building the enterprise's **share of customer (SOC)** for each of the customers in their portfolio and for increasing each customer's *lifetime value (LTV)* and *potential value* to the enterprise (see Chapter 6).

Managers may each be in charge of a large number of customers or portfolios, but the responsibility for any single customer is assigned to one customer manager.

The responsibility for customer management may spring from the marketing department, or sales management, or product development, or even, occasionally, from the database and analytics department, where the customer data are housed. Wherever in the organization customer management resides, however, it must have a clear voice in the enterprise and have enough power to make decisions and influence other areas of the enterprise. One difficulty for this group is that the enterprise might try to hold it accountable for increasing the value of customers but fail to give it the authority to take the appropriate actions with respect to those customers. In the customer-value-building enterprise, the customer strategies should become the unifying theme for the organization; other areas of the enterprise should be made to understand how their own departmental goals relate to the customer strategies developed by the customer management group, and these other departments should be held accountable for executing the strategies ultimately designed to increase customer equity.

At one company we know, the customer management team was measured partly on **Net Promoter Score (NPS)**, but one quarter, when the enterprise was having a cash flow bind, the financial department unilaterally cut off all refunds to all customers, no matter how much the customer deserved the refund or how valuable the customer was. The result, in terms of customer value, was disastrous. Since then, all decision makers in all parts of the company, including finance, are dependent on NPS for a good part of their evaluation and compensation.

The biggest hurdle to becoming a successful customer-strategy enterprise is not choosing and installing the right software, or hiring the most brilliant young analysts and programmers to manage and analyze a dizzying flood of customer data. Many organizations have had to learn the hard way that customer relationships cannot be installed; they must be *adopted*. The biggest hurdles to successful customer management have little to do with technology. The greatest obstacles are a firm's traditional organization, culture, processes, metrics, and methods of compensation.

> Many organizations have had to learn the hard way that customer portfolio management cannot be installed; it must be *adopted*.

How Has the Sales Department Changed?

The sales team can help confirm that those selected as most valuable customers (MVCs)[12] are indeed the best customers. The sales team can also find the **most growable customers (MGCs)** who have been missed. It will be important for the organization to provide the sales team with information across other touch points in the organization, such as the web and the customer service center. Real-time information is required to coordinate all interactions with a customer, and feeding in this

[12]See Chapter 6 for more about MVCs and other customer value categories. Differentiating customers according to their value (and their needs) represents a core component of the IDIC process. Ultimately, there are five primary customer-value categories: most valuable customers (MVCs), most growable customers (MGCs), low-maintenance customers, super-growth customers, and below-zero customers.

information is a crucial role for many salespeople. The trade-off is that the enterprise can handle a lot of the most tedious recordkeeping and servicing very efficiently, freeing up the salesperson for real relationship building and customer growth.

Compensating the Sales Force

Sales force compensation is often one of the most important drivers of change, partly because the salesperson's salary and bonus usually depend on product sales results. One challenge facing the enterprise is deciding how to compensate salespeople and others for encouraging and ensuring customer loyalty and growing the long-term value of a customer, even when there may be no short-term product sale involved. The fact is that many salespeople are compensated in ways that make them indifferent to customer loyalty. In some cases, new-customer incentive programs actually *benefit* the salespeople when **customer churn** increases, enabling them to resell a product or service to a relatively educated customer. If customer loyalty and profitability are the objectives, then the enterprise needs to explore compensation systems that reward sales reps on the basis of each individual customer's long-term profitability (or LTV). (See the sidebar "Using Up Customers" in Chapter 11.) There are at least two ways an enterprise can accomplish this:

1. *Value-based commissions derived from customer, rather than product, profitability*. The enterprise identifies certain types of customers who tend to be worth more than others and pays a higher up-front commission for acquiring or selling to this preferred type of customer. It considers lower commissions for price buyers or returning former customers as well as other variable commission plans that emphasize acquisition and retention of customers whose value is greatest to the enterprise overall, not just to the salesperson.
2. *Retention commissions*. The enterprise pays a lower commission on the acquisition of a customer. Instead, it links compensation to the profitability of a customer over time. For example, instead of paying a $1,000 commission just for landing a customer, the company pays $600 for a new account and $300 per year for every year the customer continues to do business with the enterprise.

   Meanwhile, the marketing group is responsible for traditional marketing activities, including creating brand image and awareness, communicating with the customer, utilizing the internet and other old and new channels, and, often, creating communications within the enterprise (e.g., an intranet, company newsletters, and project communications). The skills and activities change constantly now, but the principle remains the same: Increase the value of the company by increasing the value of the customer base, and do this by treating different customers differently. And to provide insight into short-term profitability and long-term customer equity and **total shareholder return (TSR)**.

The Customer Success Management Discipline

(See Chapter 10 to understand how SaaS and Customer Success Management help to seal business relationships through deep collaboration and mass customization.)

As wireless, ubiquitous interactivity has taken hold, newer and more robust tools for managing customer relationships have become available.

First-generation enterprise CRM systems were costly and time consuming to implement, often difficult to integrate with other systems, and costly to update and maintain. The cost for an **enterprise customer** to buy its own CRM system and install it on its own servers and computers (called an on-premises installation), could easily run to millions of dollars, while taking months to install and integrate with the rest of the company's systems.

Popularized during the 1990s, on-premises CRM applications were based on client/server computing and represented a quantum leap in functionality over simple spreadsheet and contact-management applications. Unfortunately, not only did their complexity make them costly to install and maintain, but in many cases adoption rates lagged because end users were forced to adapt to processes dictated more by software design than by business needs. Often-rigid data entry and workflow requirements resulted in slow buy-in among users, particularly the marketing and sales people who stood to benefit the most from the use of the tools. (In one widely publicized survey, some 80% of salespeople reported that their own firm's CRM solution didn't work.)

Second-generation CRM solutions have relied on interactivity to convert the relatively large and risky capital expenditure required for an on-premises installation into a monthly subscription fee. Rather than paying a million dollars or more to buy, install, and integrate an on-premises solution, a company can now subscribe to a cloud-based CRM system from a host of vendors. **Software as a service (SaaS)** CRM vendors offer all the capabilities a company could get from having its own on-premises solution, such as contact management, lead management, integrated email capabilities, sales forecasting, workflow management, and so forth, but at a fraction of the cost, because these capabilities no longer have to be installed on the customer's servers. Instead, they reside on the vendor's servers, and are accessed interactively, from the cloud, by the sales reps, executives, and others who need them.

SaaS solutions took the implementation burden off the shoulders of the corporate IT group, and also brought the benefits of robust CRM systems to many of the small and medium-size businesses who could not otherwise have afforded to install their own on-premises solutions at all. Moreover, these SaaS offerings were more scalable than their predecessors, allowing companies to add seats or functionality as needed, considerably reducing IT expenses.

Nor is CRM the only enterprise capability now offered via the cloud. In fact, cloud-based SaaS businesses in a wide variety of disciplines and capabilities, including enterprise resource management (ERP), data storage, accounting, invoicing,

(*continued*)

HR, project management, **collaboration**, and other areas are taking over much of the computing and data-management tasks that a company used to have to manage using its own servers and databases.

SaaS businesses measure their success differently because they are recurring revenue businesses. A traditional B2B competitor will carefully measure and try to reduce their **customer acquisition cost** (CAC), for instance, but for a recurring revenue business, CAC is measured not in terms of cost per customer, but cost per incremental dollar of annual recurring revenue, or ARR (sometimes referred to as annual contract value, or ACV). So there would be one CAC for new customers (what it costs to acquire $1 of ARR from a brand new customer), and there would be another CAC for existing customers (the cost to *increase* a current customer's ARR by $1). According to a recent Pacific Crest Securities report on the state of SaaS, the median cost of an incremental dollar of ARR from a new customer was $1.18, and the median cost for an incremental dollar of ARR from an existing customer was $0.28, while the cost per dollar of ARR from renewing an existing customer's contract was $0.11.[b]

However, as more and more software vendors have climbed onto the SaaS bandwagon, selling their solutions to companies via such cloud-based monthly subscriptions, the importance of customer retention has dramatically increased. After all, if a customer hasn't actually paid to acquire and install the capability on its own enterprise servers, then the only requirement for switching from one vendor to another is simply to stop its monthly subscription with one and start a new subscription with the other.

To keep such customers happy, SaaS companies need to ensure that these customers are *successful* with whatever cloud-based services or capabilities they are subscribing to. That is, a vendor wants to make sure that their customers' employees can access and use their solution as and when they need it. They want to know about any bottlenecks, obstacles, or barriers to using their solution, and to take corrective action as soon as possible. In fact, the vendor will only feel confident that a customer will remain loyal if that customer is actually being successful with their application—that is, if the customer's business is better off because of it.

SaaS vendors also have a secret weapon in their struggle to maintain their customers' loyalty. Because each customer's use of the vendor's solution takes place in the cloud, the vendor can actually see when and how a customer uses the application. As a result, they can see the problem immediately if, for instance, a customer is paying for 500 seats, but only 200 sales reps and account managers are using it regularly, or if some users only access the system every few days rather than daily (or hourly), or if a customer's executives have difficulty accessing certain kinds of data, or if the email integration is making it cumbersome to send some types of reports, or if managers are using patches or work-arounds to deal with some

(*continued*)

recurring problem. Moreover, because the SaaS vendor can compare how one customer's use of the system differs from that of more effective customers, the vendor can actually *coach* a customer to make the application more valuable for their own business.

For this reason, SaaS businesses have given rise to a whole new discipline within traditional B2B relationship management: ***customer success management***. According to the Customer Success Association, customer success involves "a long-term, scientifically engineered, and professionally directed business strategy for maximizing customer and company sustainable profitability."[c] And a variety of customer success software vendors have sprouted up in the last few years to assist SaaS companies in these efforts. As Guy Nirpaz (CEO of Totango, a customer success software firm) writes in his book *Farm Don't Hunt,* customer success managers can run "customer success programs" or "customer success plays." A customer success program, he says is an ongoing, repeatable activity, such as a quarterly business review with the customer, or a regularly offered service such as a "New Feature Introduction" for customers. A customer success play, by contrast, is some kind of activity that has been triggered by an observable event, such as a sudden fall in usage.[d]

By combining SaaS with the commercial open source development model, an "open cloud" CRM solution can be created that proponents say reduces investment risk significantly. Portable across platforms and partners, interoperable with other open source data and applications, and more customizable by end users, an open cloud CRM solution also allows customers themselves to participate in the environment rather than simply serving as targets or leads. In effect, this turns the focus of CRM away from management and toward the relationship. Twitter, blogs, wikis, YouTube, and RSS feeds all become tools in the CRM toolbox. But here's a key point: IT no longer owns the toolbox.

This is where the open cloud can have a significant impact, because it enables companies to track more than just transactions. There's a seemingly endless cache of unstructured data wafting around the web, and the companies that can capture it, analyze it, and act on it are the ones that will carve out competitive advantage.

One could argue that CRM in the cloud is not even CRM anymore. It's a self-service model in which the customers themselves are taking over.

[a] Nick Mehta, Dan Steinman, and Lincoln Murphy, *Customer Success: How Innovative Companies Are Reducing Churn and Growing Recurring Revenue* (Hoboken, NJ: Wiley, 2016), Kindle loc. 723.
[b] Guy Nirpaz with Fernando Pizarro, *Farm Don't Hunt: The Definitive Guide to Customer Success* (2016), Kindle loc. 1047.
[c] "The Definition of Customer Success," The Customer Success Association, available at https://www.customersuccessassociation.com/library/the-definition-of-customer-success/, accessed January 30, 2021.
[d] Nirpaz with Pizarro, *Farm Don't Hunt,* Kindle loc. 349–451.

HOW DOES RELATIONSHIP GOVERNANCE AFFECT CUSTOMER SERVICE MANAGEMENT?

A service organization might be the appliance repair personnel, the hotel staff, operators answering the 800-telephone number, representatives monitoring website chat and **social media** for customer questions or complaints, or the delivery crew. Every product that's manufactured and sold has a service organization associated with it in some way, whether customers obtain the product directly from the enterprise or through a channel organization. In the customer-strategy enterprise, the service organization has access to more customer information than in other traditional enterprises, and uses this information to deliver a valuable experience or to collect information (or both). For example, in a customer-strategy enterprise, the delivery driver might be asked to survey a customer's warehouse informally and take note of the number of competitors' cartons that are stacked within view of the delivery door. This information can help an enterprise begin to understand its share of customer.

Ironically, as pressures mount for enterprises to cut costs and improve efficiency, the customer service area may be squeezed in the process. In the customer-strategy enterprise, the customer service area plays a key role in executing customer strategies, including collecting, analyzing, and utilizing data while servicing the customer. Customer calls are routed based on value and need, and the most appropriate customer service representative is assigned the call based on the skills of the rep. During the call, customer-defined business rules are applied to maximize the impact of the interaction with the customer, and the reps have been trained in how to interact most effectively with various customers. Also, the individual needs, talent, and experience of the reps are considered in the routing decisions. Reps are encouraged to enhance the skills needed to serve each customer efficiently and effectively. As customer needs change, the skills of the reps also must evolve.

The closer to customers a company gets, the more the employees matter in all parts of the organization. And in the next chapter, we will look beyond customer-facing parts of the firm, and take a look at how all parts of the organization contribute to the creation or destruction of customer value.

CHAPTER 14

Leading to Build Customer Value

The human mind treats a new idea the way the body treats a strange protein; it rejects it.

—P. B. Medawar

For companies to reap the benefits of **Learning Relationships**, departments outside the "customer-facing" part of the business will also need to play a role in increasing customer value. Finance, product (capabilities) development, research and development (R&D), information technology/information services (IT/IS), partnerships, and human resources (HR) are also directly responsible for *capabilities building*—or how well the organization is able to build strong Learning Relationships with customers, **treat different customers differently**, and increase customer value. The two we must examine now are finance and HR. Then we will consider the kind of leadership needed to grow **customer equity**.

Jonathan Hornby, lead product manager at Peak, cites an example of a bank in which Department A believed Department B was a drain on resources (and this attitude was likely a drain on company **culture**). Their manager used a tool created by Joel Barker called the Implications Wheel, where employees were prompted to specify the first-order, second-order, and third-order implications of a certain action—in this case, eliminating Department B. By the time both departments completed this exercise, Department A realized that their potential customers came directly from Department B, and they changed their position of their own accord. Strategic managers will come up with similar creative ways to encourage trust and transparency among employees, departments made up of employees and managers, and customers.[1]

[1] Jonathan Hornby, *Radical Action for Radical Times: Expert Advice for Creating Business Opportunity in Good or Bad Economic Times* (Cary, NC: SAS Institute, Inc., 2009), 10–13.

HOW MARKETERS WORK WITH THE FINANCE DEPARTMENT

We have more than once met with and made presentations to major financial accounting firms and their clients. Obviously, we start with the fundamentals: an introduction to **customer-centric** business competition, and what it takes to manage a business based on improving the **customer experience**.

> How much profit will the business get in the future for the money it must spend now?

But because these are financial and accounting professionals, we spend a lot of time discussing one of the most difficult internal obstacles that marketers face in trying to improve the customer experience: the difficulty of using financial metrics to try to evaluate the actual economics of a marketing initiative. It costs real money to improve the customer experience—money that has to be spent in the current period. So the question is: How much profit will the business get in the future for the money it must spend now?

We talked in Chapters 2 and 11 about **Return on Customer**. Because the financial value of a customer is customer **lifetime value (LTV)**, if a business wants to evaluate the true economic effect of its marketing initiative then it should not just tabulate current-period profit, but also whatever change in lifetime value results from the initiative, positive or negative. In a data-rich environment such changes in lifetime value will be signaled in advance by **leading indicators** of LTV change.

Emphasizing the importance of collecting customer-specific data, we recognize actions marketers can take, and finance types welcome, to help bridge the metrics divide that often separates marketers from the financial types who approve marketing budgets:

- Do an A/B test whenever appropriate. Technology allows us to treat different customers differently.
- Agree on some reasonable lifetime value figures for different types and categories of customers. Obviously, the more data, the better, but even with little data you can form a hypothesis. And if it's a reasonable enough hypothesis that the CFO can agree on its likelihood, then it will provide a basis for a financial discussion.
- Identify in advance at least a few of the major leading indicators of lifetime value change (account penetration, **churn rate**, etc.).
- Track Net Promoter Score, or even customer satisfaction carefully and professionally, as an important leading indicator of LTV change.
- Agree in advance on a "financial exchange rate" between marketing outcome and economic value delivered. For instance, an improvement in NPS of X% (relative to competitors) is worth a Y% improvement in customer lifetime value.

HUMAN RESOURCES: MANAGING EMPLOYEES IN THE CUSTOMER-STRATEGY ENTERPRISE

The road to becoming a customer-value-building enterprise is fraught with speed bumps. We have shown so far how the customer-centric organization requires an organizational infrastructure that is populated by **customer managers** and **capabilities managers** who fully understand the financial payoff from Day One. The enterprise with a customer-strategy **business model** will almost certainly require capabilities for relating to customers individually, even if only through carefully directed algorithms. The enterprise will need to assess where the gaps lie in its established capabilities so it can build profitable, long-term customer relationships based on accurate **customer insight** and a **frictionless** customer experience. The **customer-strategy enterprise** requires knowledge workers—people who will **recognize** and act on relevant customer information, as well as people who will make or break rules as needed. As we mentioned in Chapter 4, customer experience depends on trust. It used to be pretty easy to set up a rulebook for customer experience, but no longer. Creating great customer experiences means not only being able to break a rule, but also to respond to something that has no rule. Customers already know this—if they call a company and the first person can't solve their problem, they'll simply hang up and call back until they find someone who can.

So human resources now means recruiting, training, retaining, and rewarding people who can think on their feet and thus create a great customer experience. You need smart people working in a strong culture who do exactly what you would have done *when no one is looking,* as they respond to customers in real time.

HR can directly influence the shift toward becoming a customer-strategy company in several ways:

- *Redefining the organization.* By taking an active part in defining the new roles and responsibilities, the HR function can map out the transition plans for many key areas of the enterprise. Part of doing this requires that HR help the business define the changes and understand how employees will be affected by those changes.
- *Addressing all of the key recruiting, training, and ongoing support issues.* Is there adequate funding to help employees migrate to advanced analytic and strategic responsibilities? How should these line items in a project plan be incorporated into annual training and development budgets or plans?
- *Creating career path opportunities that did not exist before.* At most companies the old, top-down bureaucratic method of organizing the firm does not allow for nor accommodate individual initiative, except within the confines of the structured organization. But in the same way that technologies have empowered the enterprise to treat different customers differently, **interacting** with individual customers, one customer at a time, these same technologies have empowered individual workers to interact with others throughout the enterprise, instantly. New skills will be needed to focus on building company value by

improving customer experiences. And **customer-focused** thinking will affect recruiting, too.

- *Demanding and rewarding customer-value-building successes.* The HR leaders of a customer-centric company will hold employees accountable not just for activity but for results measured in current net revenue from customers as well as current measures of long-term equity built by customers. To be successful, employees will be simultaneously responsible for increasing customer value this quarter and also for increasing the projected value of customers XX quarters from now.
- *Actively trying to manage and develop the corporate culture.* Technology now enables the lowliest employee to leap tall corporate hierarchies with a single click, subverting the power of organization charts and structured personnel policies. This means that corporate culture is even more important when it comes to determining a company's ultimate success. A corporate culture that will give a customer-centric enterprise the best chance to succeed will be one that is centered on earning and keeping customer trust.

Technology now enables the lowliest employee to leap tall corporate hierarchies with a single click.

This last point, regarding corporate culture, is worth spending some time on, because it is so critical to success. Importantly, as businesses continue to streamline, automate, and outsource, corporate culture is becoming more important than ever before. A number of factors are at work here, including the increased complexity of modern organizations, greater sophistication of the workforce, globalization, and communications technologies that are accelerating the pace of routine business processes.

We should always remember the fact that, as far as an enterprise's customers are concerned, the ordinary, low-level customer-contact employee they meet at the store, talk to on the phone, or interact with during a service transaction of any kind—*that employee is the company*. And corporate culture is the most potent tool available for ensuring that everyone at the enterprise is pulling in the same direction.

Leaders Manage People in a World Ever More Automated

Organizations used to be simpler to manage, because most tasks were routine, most problems could be anticipated, and desired outcomes could be spelled out in official policy. An employee's job was to follow the policy. But with the advent of new information and communications technologies, more and more of these routine tasks have been automated or outsourced, and the resulting organizations are slimmer and more efficiently competitive. What remains at most firms, and will continue to characterize them, are the functions and roles that cannot be automated or outsourced. These are the kinds of jobs that require employees to make decisions that cannot be foreseen or mapped out and therefore aren't spelled out in the standard operating processes. These jobs require nonroutine decision making. Many of them involve high-concept roles and other functions that can't be covered by a rule book any more than they can be handled by an algorithm.

As the world becomes ever more automated, one of the consequences will be that the rules we apply to our lives—rules that govern how we buy, sell, and consume things, how we allocate our resources, and even how we carry out governmental policies—will become smarter and more efficient. Automated services will become ever more frictionless, with fewer and fewer mistakes. However, in such an otherwise highly efficient future, whatever mistakes do occur will be that much harder to correct for. And it's highly doubtful that we'll ever have an automation solution for human problems that never makes mistakes—not in our lifetimes, certainly, and probably not in our grandchildren's lifetimes.

Still, it can't be denied that over the last several decades the world's economic efficiency has improved quite dramatically, as computer technology has allowed more products and services to be tailored to individual customer specifications. Overall, automation has meant that the customer experience rendered by most businesses has become increasingly frictionless. But while the goal of creating a fully automated, totally friction-free economy has tantalized CEOs and Silicon Valley entrepreneurs since the birth of the web, when a company pays too much attention to the goals of efficiency and cost reduction it risks overlooking the enormous value residing in the human qualities of creativity, initiative, and empathy—qualities that are abundant within any capable and productive body of employees, not to mention the exponential benefit to be achieved by combining the individually diverse ideas of employees, customers, contractors, distributors, and others.

A few companies are starting to implement commonsense policies designed to harness the natural empathy and problem-solving abilities of their frontline people. Rather than constantly trying to control and prescribe, they are deploying the human option, which involves empowering and encouraging individuals to use their judgment and creativity. They are using computers, automation, and **mass customization** to reduce friction and improve the quality of their customer experience to the extent they can, but then they use these same tools to augment the ability their human employees have to solve problems and to suggest empathetic, human solutions to customers.

For most companies, however, the biggest obstacle to this way of thinking lies in the hardwired belief that in the absence of top-down direction and careful supervision, their lower-ranking, frontline employees either won't know what to do or can't be trusted to do it, an implicit but unspoken assumption behind many old, twentieth-century management principles.

Just as the customer-strategy enterprise strives to keep and grow its customers, however, so too must it seek to keep and grow its best employees. Just as the customer-strategy enterprise strives to create the most value with every customer, it must also seek to create the most value with every employee. And recognizing the often underutilized power of employee empathy, creativity, and initiative is a step in this direction.

One large contact center, for instance, has harnessed the individual initiative and creativity of frontline workers by empowering them to come up with their own solutions to customer issues or problems that have not already been anticipated in advance and scripted into the computer system. Although most of the issues, problems, and queries raised by customers at a contact center can be handled by training and established protocols, callers and online customers often present new issues. Such unanticipated problems or difficulties had not been coded into the computer system for a rep to find. In most contact centers such an unforeseen problem is called an exception or an escalation, because it requires the agent to find a supervisor, who might then have to escalate the issue even farther, to a more senior manager, for a decision.

But at this contact center the frontline workers are encouraged to figure things out, and then empowered to take action on their own initiative. If a rep thinks they have a good solution for how to handle what would otherwise require an escalation—if it's good for the customer and fair to the company—then the only requirement for them to offer it immediately to the customer is to get the agreement of one other frontline rep that the idea makes sense. When the two of them sign off on the action, the customer can be offered the solution immediately. Such solutions are then logged and reviewed regularly by more senior managers at the firm, and frequently they are incorporated into future protocols, scripting, and training. Moreover, the director of the contact center said, this policy has charged the agents up, engaging and energizing them to use their own creativity and initiative, and to take personal responsibility for customer satisfaction.[2]

Human employees, with their imperfect yet demanding emotions, their unexplainable hunches and instincts, and their tenacity for solving problems, represent an enormous and unique intellectual asset for any organization. Unfortunately, however, most companies have come to think of employees and automation as nearly interchangeable instruments of production—one form of production that requires a regular salary, while the other form can be purchased outright and requires no salary (or paid vacation, or raises, or recognition). Automation operates as directed through coding and algorithms, while at most companies employees operate as directed through policies, processes, and transactional incentives. But both these ideas—algorithm-following automation and policy-following employees—represent top-down, command-and-control systems designed primarily to minimize costs and ensure quality and consistency.

Rather than using machines solely to direct operations more efficiently, however, a smart competitor can gain an advantage by using technology to augment the authentically human capabilities and contributions it has access to among its workers, empowering them to generate more human and emotional connections with customers, as well as devising more commonsense solutions to many operational problems. Tomorrow's customer-centric enterprise will not rely on technology merely to deliver a streamlined and frictionless customer experience; it will use it to unleash and

[2] Story told to the authors.

augment the creativity, resilience, empathy and initiative of its workers. In the process, it will not only adapt more robustly to increasingly frequent disruptive challenges, but it will also deliver a more desirable and human customer experience. As new technologies permit it, all business disciplines will inevitably come to rely more and more on the open, multipath principle of self-organization and agile management, rather than the closed, single-path principle of top-down command and control.

At another company, whenever a problematic issue arises in which the customer may have a legitimate problem but also bears at least partial responsibility (perhaps having overlooked one of the directions for using the product, or violated some policy), the contact center associate dealing with the issue is authorized simply to ask the customer "What do you think would be fair?" This question is designed to get the customer's agreement to accept some responsibility, and to split the difference with the company in a way that leaves the customer satisfied but doesn't require something as expensive as, say, a full refund or make-good. Importantly, while "What do you think is fair?" is the kind of question a friend might ask of a friend, and will almost certainly have a calming effect on an otherwise upset customer, it's certainly not the kind of question that a chatbot could ask.

In a similar vein, National Australia Bank pioneered an original and innovative policy for managing the bank's collection calls.[3] According to Karen Ganschow, formerly NAB's General Manager of Consumer Marketing and Strategy, when a customer fell behind on their loan payments and the bank called them to try to ensure that the debt would be repaid, it used to be they would simply put the customer on a schedule of payments based on the size of the debt and the bank's standard repayment terms. But while a contacted customer would almost always agree to whatever schedule of weekly payments the bank suggested, data showed that the majority didn't keep up with the payments, and some didn't even make the first one. A deeper look at the problem revealed to NAB that the amount required of a customer was often just beyond their ability to pay, so even though they acknowledged and agreed to the payment schedule during the phone call itself (anything to end the call!), the fact was that when the payment deadline arrived, they couldn't handle the bill, so rather than making even a partial payment they simply paid nothing at all. Again and again.

Today, rather than suggesting a repayment schedule based on the size of the debt and the bank's own (rather arbitrary) deadline for full repayment, once an agent at NAB makes voice contact with an overdue customer they simply ask:

"How much do you think you can afford to pay toward this each week?"

As is the "what do you think is fair?" question, "what do you think you can afford to pay?" is uniquely human. It's the kind of question any reasonable person might ask another reasonable person, but that a chatbot or automated system could never ask.

[3] These details are based on a personal conversation with Karen Ganschow, former General Manager Consumer Marketing and Strategy for NAB, and verified by email.

The question gets the customer to accept responsibility for the obligation, but it does so in a reasonable way that allows the customer some control over their own customer experience. And sure enough, the fact that the customer designs their own repayment schedule generates higher repayment rates than the prior policy. Once a customer is allowed to choose their own, individual repayment schedule, they really do make the payments.

In *A Whole New Mind*, author Dan Pink persuasively described this new, postautomation, postoutsourcing Conceptual Age. It may once have been true that information workers would inherit the world, but—especially since the COVID-19 pandemic—they can work from home in Ireland or China. Even doctors and lawyers are finding their jobs increasingly threatened by computers and online substitutes. Indian engineering programs turn out some 1.5 million graduates a year, and most of them are willing to work for $15,000 annual salaries.[4] So what type of work can't be outsourced or automated? Pink says the type of work that will characterize successful executives in the future (at least in the United States and other advanced Western economies) is work that involves creativity and sensitivity and requires skills in design, entertainment, storytelling, and empathy. This idea makes sense. Consider lawyers, for instance: Legal research and paperwork can be outsourced to Ireland or India, but cases have to be argued to juries in the courtroom, in person, or at least on Zoom. Consider doctors: X-rays can be evaluated remotely and diagnoses rendered, but bedside manner has to happen at the bedside.[5]

This trend is already showing up in employment figures. According to one prediction, about half of total employment in the United States is in the high-risk category of being at least partly automatable in the next decade or so. Even in the seemingly human fields of diagnosing illness and fraud detection, for example, estimates suggest "that sophisticated algorithms could eventually substitute for approximately 140 million full-time knowledge workers worldwide."[6] In another view, **supply chain**, production and transactional jobs, which recently made up about 60% of the workforce, are being automated rapidly, while the other 40% of jobs, involving nonroutine decision making, have grown two and a half times faster in recent years and pay 55% to 70% more than routine jobs.[7]

[4] Stefan Trines, "Education in India," *World Education News and Reviews*, September 13, 2018, available at https://wenr.wes.org/2018/09/education-in-india, accessed August 25, 2021.

[5] See Daniel H. Pink, *A Whole New Mind: Why Right-Brainers Will Rule the Future* (New York: Riverhead, 2005), pp. 36–37.

[6] Carl Benedikt Frey and Michael A. Osborne, "The Future of Employment: How Susceptible Are Jobs to Computerization," Oxford Martin, September 17, 2013, p. 19, https://www.oxfordmartin.ox.ac.uk/downloads/academic/The_Future_of_Employment.pdf, accessed August 30, 2021.

[7] Frey and Osborne, "The Future of Employment: How Susceptible Are Jobs to Computerization"; and Bradford C. Johnson, James M. Manyika, and Lareina A. Yee, "The Next Revolution in Interactions," McKinsey Quarterly, no. 4 (2005): 21.

The consensus among many experts is that a number of professions will be totally automated in the next five to 10 years, accelerated by COVID-19. A group of senior-level tech executives who comprise the Forbes Technology Council named 13, including insurance underwriting, warehouse and manufacturing jobs, **customer service**, research and data entry, long-haul trucking, and a somewhat disconcertingly broad category titled "Any Tasks That Can Be Learned." In fact, Amazon—whose warehouses are buzzing with robots and will be increasingly automated in years to come—recently announced "it would retrain a third of its 300,000-strong U.S. workforce to the tune of $700 million. Participation is voluntary in a program the company calls 'Upskilling 2025,' which is designed to teach employees skills they can apply to work in technical roles inside or outside of Amazon."[8]

There are limits; certain manual labor require human dexterity that is not likely to be replaced with robots very soon—such as dentists, cooks, and gardeners. The non-routine jobs require workers to deal with ambiguous situations and difficult issues—problems that often have no direct precedent or at least no correct solution—in creative areas, and in arenas requiring interpersonal contact; machines are not good at "motivating, nurturing, caring, and comforting people." So entrepreneurs, kindergarten teachers, salespeople, CEOs, and nurses have job security for the foreseeable future. Maybe.[9]

As we've said, a company can automate the contact report a sales rep has to file, but it can't get a computer to look into a client's eye and judge whether to push for the sale right away or ask another question first. Jobs like this require judgment, creativity, and initiative on the part of the employee. As a result, according to one study, many companies are turning their attention to "making their most talented, highly paid workers more productive," because this is the surest way to gain competitive advantage.[10]

Companies have spent the last several decades economizing, streamlining, and automating their more routine, core processes, but the cost and efficiency advantages they secured from these activities were short-lived, as the benefits of automation quickly permeated whole industries and their competitors became equally efficient. Efficiency, cost cutting, running lean and mean—these are just the greens fees required to remain in the game. By contrast, when a company gains an advantage by making its nonroutine decision-making employees more productive and effective, that company

[8] Mike Thomas, "Will a Robot Take Your Job? Artificial Intelligence's Impact on the Future of Jobs," BuiltIn, August 9, 2021, available at https://builtin.com/artificial-intelligence/ai-replacing-jobs-creating-jobs, accessed October 29, 2021.

[9] Erik Brynjolfsson as quoted in Nick Heath, "AI Is Destroying More Jobs Than It Creates and How We Can Stop It," TechRepublic, August 18, 2014, https://www.techrepublic.com/article/ai-is-destroying-more-jobs-than-it-creates-what-it-means-and-how-we-can-stop-it/, accessed August 30, 2021.

[10] Johnson, Manyika, and Yee, "The Next Revolution in Interactions," 21; and Michael Chui, James Manyika, and Mehdi Miremadi, "Four Fundamentals of Workplace Automation," *McKinsey Quarterly* (November 2015), available at https://www.mckinsey.com/business-functions/mckinsey-digital/our-insights/four-fundamentals-of-workplace-automation, accessed August 30, 2021.

is building a competitive advantage, described by three authors writing in the *McKinsey Quarterly* as likely being:

> more enduring, for their rivals will find these improvements much harder to copy. This kind of work is undertaken, for example, by managers, salespeople, and customer service reps, whose tasks are anything but routine. Such employees interact with other employees, customers, and suppliers and make complex decisions based on knowledge, judgment, experience, and instinct.[11]

If an enterprise can figure out how to manage these "conceptual age" employees better, in other words, it will have an advantage that is hard for a competitor to see or imitate. Good managers will "grapple with the tricky business of redefining processes and roles."[12] The secret, however, is not technology and process, because it just can't be spelled out like that. If it could be documented in advance and defined as a process, then it could be automated, right?

Reprise: Culture Rules

We have discussed in Chapter 10 how mass customization makes a lot of intuitive sense and is certainly productive when based on **business rules**. But now we are acknowledging that there are still some situations that won't be covered by an enterprise's business rules. What happens when a customer presents some problem or need for which there is no valid, preconfigured set of solutions that can be rendered in a cost-efficient way?

No enterprise can write a business rule that requires employees to delight customers. The employees themselves have to want to do that. An enterprise's secret sauce is its *culture*—the unwritten rules and unspoken traditions that define how employees actually approach their jobs. This is what guides employees when there is no policy—no applicable business rules.

Abraham Lincoln was once asked the secret of General Ulysses S. Grant's success during a particularly difficult Civil War campaign. Always ready with an anecdote, Lincoln told the reporter it reminded him of a story about the great "automaton" chess player that had astonished Europeans nearly a century before. Popularly known as the Mechanical Turk, it had been constructed to resemble a mechanical man, dressed in a costume like a Turk, seated behind a wooden cabinet, and apparently capable of playing chess. It had defeated many human players, but after one celebrated competitor suffered two embarrassing defeats at the hands of the machine, the player angrily wrenched off the cabinetry to peer inside and then rose up to exclaim, "Hey! There's a person in there!" That, said Lincoln, was the secret of Grant's success.

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[11] Johnson, Manyika, and Yee, "The Next Revolution in Interactions," 21.

[12] Chui, Manyika, and Miremadi, "Four Fundamentals of Workplace Automation."

It is also the final, underlying secret of any business enterprise's success when it comes to satisfying customers and ensuring they continue to create value. There has to be a person in there somewhere. No matter how well the business rules are architected, and no matter how many "modules" of product or service delivery are available to drive the mass-customization effort, human judgment always will have to be accommodated in the enterprise's customer-facing processes. It's impossible to serve customers well without it, and generally the more important decisions are the ones that require the most judgment and innovation. For a customer, the most vital problem or difficult issue often involves some type of crisis situation—a situation that is likely to be unusual or at least one that hasn't already been anticipated by the enterprise. This means that almost by definition, any issue of utmost importance to a customer is likely to be something that falls through the cracks if an enterprise is operating entirely by predocumented processes and procedures. The enterprise won't be able to specify it in advance. There has to be a person in there, capable of making the right judgment call.

> Nowhere does an enterprise's corporate culture play a more important role than in dealing with customers.

Doing this often requires Conceptual Age, nonroutine skills such as empathy, creativity, and sensitivity,[13] so many companies try to cut costs by outsourcing and automating their more routine customer service tasks. Most find out the hard way that it's a big mistake to outsource judgment calls. Nor is it the best idea to hardwire all a company's policies and processes entirely into the system, leaving no room for flexible responses to unanticipated situations.[14]

Not long ago a friend of ours went online to book family trips on two different airlines for successive weekends. The first trip was on a well-established carrier with a great service reputation, but it is heavily unionized and often hemmed in by its own bureaucracy. It was a complicated itinerary involving coordinating with some other people, so our friend first booked her family's outbound trip, then did some more calling to make sure the return flight was coordinated with others before booking it too. But guess what? When she booked the return flight, she realized that a round trip would cost less than either of the one-way trips just purchased. So she called the

[13] Daniel H. Pink, *A Whole New Mind* (New York: Riverhead, 2005). As an example of this principle in action, Publix Super Markets has accumulated a number of accolades, and CEO Todd Jones credits the company's culture, which treats both customers *and* associates as their most important assets. See The Shelby Report, "In Recognition of Excellence, Company Racking Up Rankings," December 3, 2020, https://www.theshelbyreport.com/2020/12/03/rankings-racking-up-publix-2020/, accessed May 15, 2021.

[14] Chris DeRose and Noel Tichy, "Here's How to Actually Empower Customer Service Employees," *Harvard Business Review*, July 1, 2013, available at https://hbr.org/2013/07/heres-how-to-actually-empower-customer, accessed August 30, 2021; and Rob Markey, "Earn Customer Loyalty without Losing Your Shirt," *Harvard Business Review*, July 17, 2012, https://hbr.org/2012/07/earn-customer-loyalty-without, accessed August 30, 2021.

reservations office directly now, having been defeated by the online experience, and—you guessed it—"No, sorry, no can do." Basically, she was told, she had bought the tickets online and a deal was a deal, that's that. Then the agent even said something to the effect that "Yes, I know it's unfair, but I am powerless to make the change; the system just won't let me."

Fast-forward to the following weekend, and our friend was on the way to a different weekend destination with her family, this time on a new entrant carrier, one of the price competitors. You book your seat, and it's a great low price but absolutely nonrefundable. The family ran into a traffic snarl and arrived at the airport way too late for the flight. Our friend found herself thinking that this was going to be a very expensive weekend for not going anywhere at all. But when the family got to the counter, an agent said something like "Sorry you missed your flight, but why don't you just take a room at the airport hotel tonight, and I'll put you all on the 7 a.m. flight tomorrow morning? Tell you what, I'm also going to waive the $50 rebooking fee, and I'll call your destination hotel, see if they can resell your rooms for tonight, maybe save you some money."

Here are two different companies with two different ways to handle exceptional customer service situations. Although it's important to do a competent job using efficient processes, good service cannot spring solely from processes or rules or systems. The important process for winning customer loyalty is ***customization***, as we talked about in Chapter 10. We need to remember that mass customization is simply a process for customizing more cost efficiently. However, it is in the exception to the rules, the unusual and problematic situation, the **moment of truth**, that a company has to rely on individual people to make wise decisions. If an enterprise has the wrong employee culture, for whatever reason, good systems and processes actually might magnify this problem. Instead, particularly in the service sector, the enterprise wants frontline employees who are not only *empowered* to make decisions and take action (as the first airline's employee was not) but also *motivated* to make those decisions in a way that is in the long-term interest of the firm (i.e., in a way that customers feel they have been treated fairly).[15]

> Culture is what guides employees when there is no policy. Culture is what employees do when no one's looking.

The difference between the customer's experience—and future value—at these two companies can be laid at the feet of company *culture*.

Culture is an elusive yet critical part of any company's nature. Everyone talks about it, but no one can really put a finger on it. You could think of a company's culture as something like the DNA of its business operation. It consists of the shared beliefs and values of managers and employees, usually passed on informally from one to another. A company's culture consists of the mostly unwritten rules and unspoken

[15] Excerpted and adapted from Don Peppers and Martha Rogers, Ph.D., *Rules to Break and Laws to Follow: How Your Business Can Beat the Crisis of Short-Termism* (Hoboken, NJ: John Wiley & Sons, 2008), pp. 113–115.

understandings about "the way we do things around here." Culture is what guides employees when there is no policy. Remember: *Culture is what employees do when no one's looking*.

Regardless of whether a company overtly tries to manage it or not, every organization has a culture.

As a company matures, shared values and beliefs harden into business practices and processes, until workers and managers find it increasingly difficult to describe their own cultures or to separate cultural issues from organizational structure and process issues. At some organizations, managers take a proactive role in guiding or shaping their own corporate cultures, trying to ensure that the informal beliefs and values of employees and managers support the organization's broader mission. Google's flexibility, The Toyota Way, Apple's "Think Different" mentality, Walmart's Four Basic Beliefs, IKEA's aversion to bureaucracy, and the egalitarian HP Way have all contributed importantly to the long-term success of those firms, and managers at each of these companies actively encourage an employee culture based on these value statements.

A culture with bad karma will impede virtually every effort a firm could make toward better and more integrated customer-facing processes.

But regardless of whether a company overtly tries to manage it or not, every organization has a culture. Difficult or conflicting cultures tend to be the biggest factors accounting for why mergers and strategic alliances fail, why change management efforts don't gain traction at a firm, and why major corporate strategy initiatives fizzle. And culture is also one of the biggest single impediments to most customer-centric transitions. In fact, a culture with bad karma will impede virtually every effort a firm could make toward better and more integrated customer-facing processes.

The old command-and-control philosophies of management—philosophies that might have worked reasonably well throughout most of the twentieth century—are no longer very effective. It's been over a decade since Doug Monahan, founder and chairman of tech marketing firm Sunset Direct, sent this charming message to employees:

> *I expect my computers to be used for work only. Should you receive a personal call, keep it short. Should you receive a personal email, I expect the email either not answered, or a brief note telling whoever is sending you emails at work to stop immediately. Should I go through the machines, which I assure you, I will be doing, and I find anything to the contrary, you will be terminated immediately. For those who think I am kidding, and do not get with this program, I promise you that by Christmas Eve 8:00 you will be gone.*[16]

[16] Adam Horowitz, "101 Dumbest Moments in Business," *Business 2.0* (January/February 2004): 81.

Not surprisingly, it's difficult for a company such as Sunset Direct to trust employees. And for good reason. In such a setting, it's nearly impossible for anyone to feel good about anybody. Whatever culture develops certainly won't be based on trust. Soon after this ominous threat was issued, however, and in direct violation of the edict, a Sunset Direct employee used one of the company's computers to post Monahan's message on InternalMemos.com, where it has now become a legend. Doug Monahan has achieved immortality on the web, as Scrooge.

It's good to remember that employees are not only networked with each other, they're networked with the rest of the known universe. The same interactive technologies that empower customers to share their experiences electronically with other customers also empower the employees at any firm to share their own experiences with the employees at other firms.

Culture is propagated the old-fashioned way—by imitation, that marvelously important survival tool. A new employee comes onboard and learns the ropes by finding out just how things are done around here. When they encounter a new situation, they'll ask someone who's been around for a while. Culture is inculcated. Successful behaviors are those that are rewarded by the organization, so how an enterprise provides recognition and incentives is important, but just as important is how the employees already working within the firm tend to socialize the values, processes, and rules when it comes to teaching newbies how to fit in.

The culture at an enterprise will reflect how it measures success, how it rewards people, what tasks it considers to be important, what processes it follows to accomplish those tasks, how quickly and effectively it makes decisions, and who approves decisions. The culture will reflect how friendly or competitive employees are with each other, how trusting they are, how much disagreement is tolerated, how much consensus is required, what privileges go with rank, what information is available to whom, what customers or suppliers are the most valued, and what actions are considered out of bounds. Although any enterprise can write down the values it aspires to and post those values on the wall, if the values are to become part of the real culture, then all the company's systems, metrics, processes, rewards, and HR policies must be aligned with them, too.[17]

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[17] Martha was asked to advise different groups and departments within an overseas banking institution to help gel the idea of universal support for customer value and customer experience. There were even signs posted throughout the organization that said "Put Yourself in the Customer's Shoes" and that phrase was carved in stone (literally) over all the entrances of the headquarters building. But it became apparent early on that employees and middle managers in the organization simply did not buy in because they all believed top management only cared about one thing: this quarter's numbers. The reason became apparent in the boardroom meeting she attended: In a 90-minute meeting, not one executive mentioned the word *customer*, even with a customer expert in the room. See Lindsay McGregor and Neel Doshi, "How Company Culture Shapes Employee Motivation," *Harvard Business Review*, November 25, 2015, available at https://hbr.org/2015/11/how-company-culture-shapes-employee-motivation, accessed August 30, 2021; also see Don Peppers and Martha Rogers, Ph.D., *Rules to Break and Laws to Follow: How Your Business Can Beat the Crisis of Short-Termism* (Hoboken, NJ: John Wiley & Sons, 2008), pp. 98–101.

In terms of ensuring success for a customer-centric transition, the HR department needs to take a proactive approach to the enterprise's corporate culture, dealing directly with the many values and issues that lie beneath the surface of the firm's organization chart. Employees view many HR functions unfavorably: HR polices the rules and procedures, or it is viewed as a purely administrative function. The transition to customer management can serve as an opportunity for HR to address proactively the many issues that arise in the transition, because the changes are wide and deep. Directly or indirectly, though, they all echo back to the basic relationship issue of trust: Do things right, and do the right thing, proactively.

KEEPING AND GROWING CUSTOMERS IS ALIGNED WITH KEEPING AND GROWING EMPLOYEES

Remember, just as the customer-strategy enterprise strives to keep and grow its customers, so too must it seek to keep and grow its best employees. The truly customer-centric organization will be better able to do this, however, because of its very corporate mission. If the firm's mission is encapsulated by earning the trust of customers, always acting in the interest of customers, this philosophy itself can provide the underpinnings for a culture of trust to permeate the entire organization. If employees are taught that every problem at the firm needs to be tackled from the standpoint of respecting the interests of the customer involved, then it is only a very short step to suggest that employee problems should be addressed from the standpoint of respecting the interests of the employee.

Trustworthiness is not an elastic concept. It doesn't stretch. No one ever has just *some* integrity.[18] People either have integrity or they don't. They are either trustworthy or they are not trustworthy. And if earning and keeping the trust of customers is the central mission at a company—if acting in the customer's interest is the direction of success that drives every problem-solving activity—then it is highly likely that this business will also enjoy the trust of its employees, since research confirms that employees' trust in and helpfulness to each other is the primary indicator of the success of work teams and achieving objectives.[19] And earning and keeping the trust of employees may be the single most critical step to having a productive and value-creating organization.

[18] We are indebted to Lt. Gen. (Ret.) J. W. Kelly, who made comments about the inelasticity of integrity in his commitment dinner speech to USAFA Class of 2007, August 9, 2005, USAFA, Colorado Springs, as reported in the Association of Graduates Magazine. Also see Sarah Brown, Daniel Gray, Jolian McHardy, and Karl Taylor, "Employee Trust and Workplace Performance," *Journal of Economic Behavior & Organization* 116 (August 2015): 362–378.

[19] Adam Grant, "Givers Take All: The Hidden Dimension of Corporate Cultures," *McKinsey Quarterly* (April 2013), available at https://www.mckinsey.com/business-functions/organization/our-insights/givers-take-all-the-hidden-dimension-of-corporate-culture, accessed August 31, 2021.

The Importance of Corporate Culture

The same corporate culture that will help a company earn the trust of its customers and support innovation will also help it remain adaptive, resilient, and innovative.

Harvard Business School professor Clayton Christensen (of "**disruptive innovation**" fame) suggests that any company's ability to innovate and adapt depends on how it defines its capabilities, and that a company defines these capabilities differently as it goes through its life cycle. For a young firm, the *resources* it has available (e.g., people, technologies, expertise, or cash) represent its capabilities. During a company's growth phase, these capabilities begin to morph into well-defined and understood *processes*—including processes for product development, manufacturing, budgeting, and so forth. Then, when a company matures into a larger firm, its capabilities will be defined by its *values*—including things like the limitations it places on its own business, the margins it needs before considering an investment, and its corporate culture. According to Christensen, the reason younger companies are more flexible, adaptable, and inherently innovative is that resources are simply more adaptable to change than are processes or values, which, by their very nature, are designed to turn repetitive activities into more efficient and predictable routines, and to minimize variation.[20]

In Christensen's hierarchy, it is clear that he regards a company's values and culture as the most hardened of capabilities, and we certainly agree with that. Nothing is quite so difficult to change as a company's culture, and once "the way we do things around here" becomes "the way we've always done things around here," a company already has one foot in the grave.

While long-term success is certainly facilitated by a strong culture, it must also be the *right kind* of culture. After all, there are many failed companies that also had strong corporate cultures: Enron, Kodak, Blockbuster Video.

Sometimes the sense of purpose or mission that unites a group can be destructive, rather than beneficial. History is chock full of examples of human organizations that were united by strong cultures focused on the wrong values—sometimes evil values, and usually with disastrous results. The Nazi Party and the Ku Klux Klan each have a very strong set of values. And members of the Taliban and al Qaeda are highly motivated by a unifying sense of purpose.

In the Enron trial, one of the most telling clues that the company wasn't just rotten at the top but rotten at the core was the poisonously cynical attitude that Enron's middle-level employees had toward the firm's own customers. The firm's unifying value—its sense of purpose—hinged on making extra profits for the company by trading *against* customers and taking advantage of their lack of information or access. Transcripts of the recorded conversations of Enron's gas traders documented their open mocking of the stupidity and gullibility of the customers on whose behalf they

[20] For a complete overview of Clayton Christensen's disruptive innovation theory, see "Disruptive Innovation," Christensen Institute, available at https://www.christenseninstitute.org/disruptive-innovations/, accessed August 25, 2021.

were ostensibly trading for, and it's a very short step from deceiving customers to deceiving shareholders.

Even when a company's strong culture is based on good, customer-centric values, however, there's another obstacle that must be avoided. While a strong enough corporate culture will ensure that a person who doesn't fit in will be "rejected like a virus," as Collins and Porras suggested,[21] a strong culture may also result in *ideas* that don't fit in being ejected like viruses, as well. Drucker might have said "culture eats strategy for breakfast," but Atul Gawande, the celebrated physician and author of *Being Mortal*, added that "culture strangles innovation in the crib."[22] A strong culture can create strong social resistance to the introduction of new ideas or different perspectives within the organization. While it's critical to have a strong corporate culture if you want everyone in the organization to be focused on delivering a consistently good customer experience, it's also important that it be the *right* culture—one that not only unites the company around a customer-centric set of values, but one that can benefit from new and *different* ideas without threatening those values.

What has to happen to create a strong culture that also facilitates rather than hinders innovation? If an enterprise is to remain truly innovative, it must have a sense of purpose that doesn't depend for its success on its own current business model. The enterprise's unifying purpose must involve some objective that lies *outside* of the business itself, so that it will motivate decisions and behaviors to accomplish this purpose *even if* it might be detrimental to whatever business model the enterprise currently employs. In that way, the enterprise's purpose will motivate changes to the business model itself, if and when such changes would make the enterprise better at accomplishing its purpose.

Consider Blockbuster Video, a once–highly successful chain of retail outlets that rented video DVDs to consumers back in the days before streaming had become a thing. At its peak, Blockbuster operated more than 9,000 stores and employed 84,000 workers.[23] But the sense of purpose that drove Blockbuster Video's culture revolved around becoming the single most successful and profitable chain of video stores in the world. And they were. This sense of purpose served them very well, until their physical retailing model itself was undermined, as videos by mail, and then online streaming, stole increasing amounts of Blockbuster's retail business. But suppose the company's unifying purpose, instead, had simply been "to provide consumers around the world with inexpensive and convenient home video entertainment." A culture based on this sort of purpose would have embraced the convenience of mail-order videos and then streaming, and this might just have allowed the company to survive and prosper even after the video DVD business had been outdated.

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[21] Jim Collins and Jerry Porras, *Built to Last* (New York: HarperCollins Publishers, 1994).

[22] Atul Gawande, *Being Mortal: Medicine and What Matters in the End* (2014), Kindle loc. 1676. Gawande was quoting Dr. Bill Thomas, an executive at a retirement center who was lamenting the strong culture at the center, which resisted any change or innovation.

[23] Andy Ash, "The Rise and Fall of Blockbuster and How It's Surviving with Just One Store Left," *Business Insider*, August 12, 2020, accessed December 13, 2021.

However, what if the culture that hardens into a company as it becomes mature is a culture that celebrates change, creativity, and innovation applied to the business? What if the repetitive activities and routines that a firm's culture enshrines have to do with a constant exploration for innovations and improvements? Some established, mature companies really do seem to have cultures that allow them to innovate and adapt more effectively, even while adhering to efficient business practices. Apple is not the only large firm with a track record of constant invention; Disney, Amazon, and Google come to mind.

A business enterprise is an organization made up of individual employees and managers who interact with each other and, while pursuing their own individual objectives, produce a collective outcome. Academics call this a complex adaptive system. Beehives are complex adaptive systems, as are economies, social networks, governments, and even weather patterns and galaxies. The behavior that emerges from a complex adaptive system is often different from what you'd expect if you observe the actions of any single member of the system. You could watch a honeybee's actions all day, for instance, and still not be able to predict the shape, texture, or social structure of the hive.

Every year a business makes a profit or incurs a loss, and it builds or destroys customer equity. It becomes more trustable or less trustable. These events are the collective results of the individual actions of all the employees who make up the company. Like honeybees, the employees are each pursuing their own objectives, but the overall outcome of all the employees working together is the short- and long-term value that the firm creates for its shareholders. And this outcome itself becomes additional feedback driving future employee behavior.

Sometimes the behavior that emerges from a system can appear irrational or counterproductive. For example, if managers and employees can get ahead by achieving immediate, short-term results in their own particular areas, then the firm's overall behavior may be characterized by a lack of coordination among various silos of the organization, coupled with poor customer service or even abuses of customers, or "***using up customers***"—perhaps in direct violation of the company's written mission statement to "act in the customer's interest at all times." Even though no single manager thinks they are undermining the trust customers have in the firm, the overall behavior of the company might still have that effect.

The success of a complex adaptive system—beehives and businesses included—depends on its being able to strike the right balance between exploiting known food sources and exploring for additional sources. Honeybees are great exploiters, doing complex dances for the other bees that direct them to any new food source. But in addition to exploiting known food sources, bees are constantly exploring for new food, even when they already have more than they need. And they are excellent at it. Scientists have shown that bees will find virtually any viable new food source within about two kilometers of their hive with great efficiency, regardless of the nectar resources already available.

The analogy with business is clear. When a business is exploiting its known sources of income, it is living in the short term. It will become ever more efficient at its current operation, but long-term success requires exploration and innovation, as well as efficiency. One of the biggest problems with most businesses is that they just don't do as good a job as honeybees do when it comes to constantly exploring for additional income sources. The way businesses are organized, financially measured, and rewarded simply makes most of them better at exploiting than exploring.

Suppose, in an experiment, we could alter the DNA of a hive of bees, genetically programming them to focus exclusively on exploitation rather than exploration. Then we put that hive of bees down in the middle of a large field of flowers. What would happen? Over the short term the hive would grow much more rapidly than the surrounding hives, because every available bee would be put to the task of exploiting the field. But what happens next? Once the field is fully exploited, the growth in nectar supplies would tail off, and soon the hive would have to fire its CEO, get in a new management team, and try to move the whole operation into a different field somewhere.

To balance exploitation and exploration, an enterprise must be willing to devote resources to both activities. Google maintains its innovative edge by encouraging employees to dedicate one day per week to exploring innovative or creative initiatives of their own choosing. Think about it: That's an investment equivalent to 20% of the company's overall personnel budget. Traditionally, 3M's researchers have been encouraged to spend 15% of their time on unstructured projects of their own choosing.

No matter how we define it—exploitation versus exploration, production versus innovation, or selling more today versus selling more tomorrow—it ought to be clear that a business will always experience some tension between short-term profit and long-term value creation. And we've already talked extensively about how important it is for a customer-centric company to balance short-term results and long-term value, optimizing the blend of current sales and changes in customer equity.

Probably the single best overall description of the organizational traits more likely to succeed both in operating the current business and in innovating for the future can be found in Jim Collins and Jerry Porras's still-classic bestseller, *Built to Last*.[24] Collins and Porras identified a number of companies that have been consistently more successful than others in their competitive set, and not just for a few years, but for decades. Then they directly compared the philosophies, policies, and characteristics of these long-lasting companies with other, not-so-successful firms, in an effort to uncover the secrets of long-term corporate success. What they found was that the companies that prosper over the long term almost inevitably have an extremely strong *corporate culture*. At most of the durably successful companies Collins and Porras studied, including Hewlett-Packard, Walmart, Disney, Johnson & Johnson, 3M, and Marriott, among others, the culture is something "almost cult-like."

This conflict has been sharpened immensely by the radical improvements in information technology (IT) we've seen over the last few decades. These technologies

[24] Jim Collins and Jerry Porras, *Built to Last* (New York: HarperCollins Publishers, 1994).

have fueled a global rush of efficiency-improvement and cost-reduction initiatives, as processes are more easily automated, routines are codified, and the everyday frictions of ordinary commerce melt away. The result is that while companies were always better at exploiting than exploring, technology has now made them even *better* at exploiting.

Exacerbating the problem is the fact that while efficiency-improvement programs, such as Total Quality Management, ISO 9000, or Six Sigma, can significantly improve a company's operational execution and streamline its cost structure, they also may tend to limit a company's ability to think outside the box, reducing or eliminating altogether the chance a firm will be able to bring to market a truly breakthrough idea. According to Vijay Govindarajan of Dartmouth, "The more you hardwire a company on total quality management, [the more] it is going to hurt breakthrough innovation. The mind-set that is needed, the capabilities that are needed, the metrics that are needed, the whole culture that is needed for discontinuous innovation, are fundamentally different."[25]

We already mentioned that Peter Drucker is credited with saying: "Culture eats strategy for breakfast."[26] Our point earlier was that rigid cultures may discourage innovation, but we also know that a strong, beneficial corporate culture builds a safe place for employees to excel. And to create a strong corporate culture, nothing will be more powerful than some sort of unifying sense of purpose within the organization. What is the *why* behind the enterprise's existence? Having a strong sense of purpose can unite employees from the top to the bottom of the organization, as well as making it easier to empower them to make their own decisions in unanticipated situations, without top-down direction. We could think of an enterprise's purpose as providing the direction of success to strive for in solving a problem, overcoming an obstacle, or deciding what to do whenever there's no stated rule or policy.

A Culture Based on Customer Trust Will Welcome Innovation

Innovation is essential for any company, especially in today's very fast-paced, technologically changing world. So the question for us is: What kind of internal, cultural values will be more likely to *welcome* innovation, when employees hold those values strongly?

We've already shown that if the sense of purpose at a company is based on the company's success in its current business, it won't be sufficient to withstand threats to the business model itself—threats that are ever more frequent with the steady march

[25] Govindarajan was quoted in Brian Hindo, "At 3M, a Struggle between Efficiency and Creativity," Bloomberg Business, June 10, 2007, available at http://www.bloomberg.com/bw/stories/2007-06-10/at-3m-a-struggle-between-efficiency-and-creativity, accessed August 30, 2021.

[26] "Peter Drucker Quotes," AZ Quotes, available at https://www.azquotes.com/author/4147-Peter_Drucker, accessed August 25, 2021. While this quote is often attributed to Drucker, it may not have been written by him. See Adam Bryant, "Does culture *really* eat strategy for breakfast?," *Strategy + Business*, Autumn 2021, Issue 104, available at https://www.strategy-business.com/blog/Does-culture-really-eat-strategy-for-breakfast, accessed August 25, 2021.

of new technologies. But if an enterprise's sense of purpose hangs on accomplishing some broader mission involving the welfare of the customers being served, or even a social good of some kind, then its employees will probably welcome whatever new and innovative ideas might help them to achieve this broader, more engaging purpose. Still, there will likely be disagreements in any organization when it comes to addressing change and navigating the best course for the future.

In his book *The Difference: How the Power of Diversity Creates Better Groups, Firms, Schools, and Societies,* economist Scott Page argues persuasively that in any group of people, when there is general agreement on what should be done and why (i.e., the direction of success), then the more diverse the members' views are on *how* to get it done, the better the group's collective decision will be. A professor in complex systems, economics, and political science at the University of Michigan, Page has the equations to prove this point. In his book he shows mathematically how such a group's ultimate decision will, in almost all cases, end up better than the decision that would have been taken by any one of its members deciding alone—better even than its smartest single member. Page's research shows that having access to a wide range of diverse and different ideas is key for any group of people working together when it comes to making more accurate predictions, solving collective problems faster and more effectively, and innovating. After all, encouraging diverse points of view among workers and managers is what makes room for curiosity, exploration, and innovation. Done right, *diverse thinking* can make a company more resilient and resistant to downturns, and even to disruptive technologies or other forces.

A truly customer-centric organization should be better able to accommodate innovation, provided that the firm's unifying purpose is centered around always acting in the interest of customers and earning their trust. If the direction of success applied to every problem is to treat customers the way you'd like to be treated if you were in their position, then innovation and technological change will be embraced, not shunned. And when employees are taught that every problem at the firm needs to be tackled from the standpoint of respecting the interests of the customer involved, then it is only a very short step to suggest that employee problems should be addressed from the standpoint of respecting the interests of the employee.

LEADERSHIP BEHAVIOR OF CUSTOMER RELATIONSHIP MANAGERS AND OTHERS LEADING THE CUSTOMER-CENTRIC ORGANIZATION

When a firm undertakes a customer-focused effort, a great deal of integration is required in all aspects of the enterprise. The management team has to buy in at the very top; and, if it does, we should expect certain types of activity and behavior at the leadership level. The leaders of any customer-strategy enterprise will accumulate expertise about managing customer relationships and will be cheerleaders for this business model. They will highlight it in company meetings and in business gatherings; they will openly share their expertise in and around the organization; in sum, they will be authorities on the relationship management business model.

In a leadership role, a manager must be capable of sponsoring a customer-focused project and in some cases sheltering the people involved in the pilot project. One of the easiest ways to make progress in the journey toward customer centricity is to engage in a series of increasingly comprehensive pilot projects. But a pilot project does not necessarily make money on its own. Most small pilot projects, in fact, never even have the possibility of making money. They are proofs of concept for larger projects that will be rolled out only if they make sense on the smaller level. The pilot project might be an operational test of a customer-strategy program, or a test of the value-building effectiveness of the program, or a test of the accuracy of a metric or predictive model.

Because the participants in a pilot project are exposed in the business financially—that is, they don't have enough profit underlying their activity to justify their existence—they are supported only by the learning they will gain from the pilot project. It is up to the leader, therefore, to shelter them from any economic down-turn that might affect the enterprise from keeping them onboard. Ideally, a pilot project needs to be funded at the beginning, then given some running room—often one or two years—before any future decisions can be made.

The customer's relationship with an enterprise will be based on the customer's view of the business, not any particular product or division's view of the customer.

A leader will measure their own success and the success of their people differently, establishing new types of metrics for the enterprise's activities and accomplishments. But they will also create a new set of rewards structures. We know from previous chapters that one of the central goals of managing customer relationships is to improve the **value of the customer base**, over time—that is, to conserve and increase the enterprise's customer equity. This value is nothing more than the sum total of LTVs of all customers; but the problem is that LTV is a future number based on future behaviors of a customer. It's a number that has to be predicted or foretold, and it is impossible to measure exactly. Thus, a leader has to figure out what the leading indicators are of this future customer value that can be measured, and determine how a firm can tie organizational performance and compensation to those metrics this quarter. And has to help make the case that customer metrics can be at least as accurate as traditional business metrics, which we've all learned to accept as reasonable ways to agree on how to manage and reward success.

A leader should be willing and able to cross boundaries to generate enterprise-wide results. One thing we know about customer-specific initiatives is that they are neither division specific nor product specific. The customer's relationship with an enterprise will be based on the customer's view of the business, not any particular product or division's view of the customer. It is a relationship that might go across several different divisions and encompass the purchasing of several different products and services. Taking a share-of-customer approach to a business inherently means crossing boundaries. The leader is constantly on the lookout for ways to expand the scope of their customer relationships beyond their own product or division and to reach out and encompass aspects of that relationship that go beyond their particular domain. Crossing boundaries is one of the main reasons to engage the senior leaders at a customer-strategy enterprise, and their involvement is critical because they can cross boundaries more easily and more effectively.

Good leaders will insist on having direct contact with customers. They will attend the focus groups, do phone interviews, listen in at the customer interaction center, and have meetings with business executives at the customer organization. Leaders *want* to be directly connected to customers in as much detail as possible. Leaders *want* to have a realistic picture of what it is like to be a customer of their enterprise. Seeing their enterprise from the customer's point of view is one of the key tasks of making this kind of transition successfully. For all the practical advice about crossing boundaries, supporting pilot projects, and coming face-to-face with customers, however, the fact is that on this never-ending journey toward customer centricity, every future manager should keep two all-important navigational tools in mind for guidance in difficult situations. As executives apply the principles in this book to new problems and unanticipated technologies in their own roles at work, they should think of these two navigational tools as lighthouse beacons, shining through a dense fog of unforeseeable economic disruptions and ever more rapid technological change:

1. Strive always to maintain and increase the trust of customers.
2. Innovate, innovate, innovate.

In an environment of trust and innovation, employees can create an environment for customer experiences that drive company success.

Consider the trials you have had as a customer—both as a consumer, and as a business customer. Your response likely reveals why it's so important to consider what distinguishes leaders at the companies that have made the lists of "The 100 Best Companies to Work For" and "100 Best Companies for Working Mothers." Carlson Companies has been on both lists. Marilyn Carlson Nelson was at the helm of Carlson, Inc., as its chief executive officer from 1998 to 2008. Here are her views about it.

The Everyday Leader

Marilyn Carlson Nelson

A favorite quote of mine is "We are defined by what we tolerate." Leaders who forget this truism do so at the risk of their organization. Like the ever-observant child, the organization always knows when behavior is being allowed that is inconsistent with its purported values. And, ultimately, it will undermine all the good that you might do.

The only sustainable way to develop trust is for leaders to model it. It cannot be imposed. It must be inspired, rewarded, and recognized in as many settings as possible, up and down the organization.

(*continued*)

In my book, *How We Lead Matters*, I set out to write about the leadership moments I have experienced or witnessed in others during my career. Soon into the project, I realized that leadership moments don't just happen on the top floor, they also happen on the shop floor; they happen at the board table and the kitchen table. Leadership choices are being made every day by each one of us. The complexity of the choices made by those in charge that resulted in the Great Recession of 2009 will no doubt engage scholars for a long time to come. One conclusion, however, is immediately evident: Leadership at the top of these failed institutions can be rightly blamed for irresponsible and gluttonous behavior. But there were many others throughout these organizations who tolerated the practices—who had an opportunity to make leadership decisions on a daily basis, but who instead became complicit with their silence.

The truth is for all of us, regardless of title or position. Our legacy of leadership will not be written some distant day in a moment of great triumph; it is being written with each passing day.

The Long View

It's been said that the mark of a true leader is thinking well beyond their years—that is, establishing a leadership culture in an organization that becomes the organization's hallmark.

When we heard the news at Carlson headquarters that the World Trade Center towers had been hit on September 11, 2001, we called immediately for a phone bridge to communicate with our employees in more than 150 countries. Our instructions were simple: Take care of each other. Take care of our customers. Take care of our competitors' customers. Take care of your communities.

Finally, we told them that if we lost communication, we were authorizing them to act according to Carlson's credo: "Whatever you do, do with integrity. Wherever you go, go as a leader. Whomever you serve, serve with caring. And never, ever give up."

When we think about the world's great leaders, did their impact not become better understood decades later? Only time made clear who was truly great.

Rather than expend all their energies on the short term, leaders who aspire to greatness beyond their time might well be advised to approach the world with this curiosity: What will generations say about them "years beyond their ken"?

Source: Adapted from Marilyn Carlson Nelson with Deborah Cundy, *How We Lead Matters: Reflections on a Life of Leadership* (New York: McGraw-Hill, 2008), pp. 49, 61. Updated 2021. Marilyn Carlson Nelson is co-CEO of Carlson Holdings and the retired chair and CEO of Carlson, Inc., a global travel and hospitality company that includes such brands as Radisson and Regent Hotels, Country Inns & Suites, T.G.I. Friday's restaurants, and Carlson Wagonlit Travel.

FUTUREPROOFING THE CUSTOMER-CENTRIC ORGANIZATION

As long as this book is, it could easily have been longer. We are learning more every day about how to grow the value of the customer base, how to interact with customers more effectively, and how to integrate a customer-centric view of the business into an enterprise's daily operations as well as its long-term strategic planning. In this last chapter, as we close our discussion of managing customer relationships and experiences, we need to address one more topic: Where do we go from here?

Building customer value and becoming more customer oriented is not a destination, it's a journey.

What guiding principles can help a company deal with the as-yet-unforeseen technological innovations and business process changes likely to continue disrupting the economic environment throughout your own upcoming business career? If we've learned anything from clients, research, and academia in the past 25 years, it's this: Building customer value and becoming more customer oriented is not a destination, it's a journey, and it's very, very difficult to do well. But the payoff can be huge. More and more, the question is not how much it will cost to be a customer-strategy enterprise but how much will it cost *not* to. We can't fit everything we know today about building customer value, or about how to become a customer-strategy enterprise, or build trusted Learning Relationships, into this book, because—as we said at the outset of this book—we are learning more every day. Moreover, within months or even weeks of this revised edition going to press, we're certain there will be still more technological innovations in interaction, customization, **social media**, analytical capabilities, and peer-to-peer production that we haven't addressed. What we've tried to do so far in this text is to establish a basic foundation for understanding what customer management is, how it helps an organization, and how companies benefit from it. Everybody claims to know what it is. Every consulting company and ad agency offers expensive advice about it. Every boss thinks they understand how to go about this.

In an environment of trust and innovation, employees can create an environment for customer experiences that drive company success.

The corporate culture that is most likely to stimulate and encourage innovative ideas is one that tolerates dissent and celebrates respectful disagreement. This is a culture in which employees *trust* each other, and they trust management. People in such an organization won't always agree, nor should they, but they must disagree respectfully. Handling disagreement in a respectful way holds a lot of implications for the type of workplace that best facilitates a climate of innovation. It means the boss shouldn't just squash conversation by issuing edicts. It means setting up a zing-free workplace, where it's not okay to make snide comments about coworkers, either in their presence or behind their backs. It means assuming that people who work together deserve explanation and clarity about what's going on behind the scenes. It means rewarding people who work with others and serve as catalysts for group action, and not just the lone rangers who succeed because they trounce everyone else. It means no one at the company pulls the rug out from under people.

What it means, in other words, is that a climate of innovation and customer-centricity creates a better customer experience, which builds customer equity. And it starts with a culture of trust.

As standards for trustability continue to rise, the companies, brands, and organizations shown to lack trustability will be punished more and more severely. Eventually, for competitive reasons, all businesses that aren't fly-by-night, temporary grifters, will respond to the increase in demand for trustability by taking actions that are more worthy of trust from the beginning—that is, actions that are more transparently honest, less self-interested, more competently executed, less controlling, and more responsive to others' inputs. More proactively trustworthy. Trustable.

Part III: Food for Thought

1. Chapter 11 stated, "Jeff Bezos has pointed out that a long list of initiatives such as Kindle, Amazon Web Services, and Amazon Prime—all of which have paid off in the long run but ran as a loss in the short term—would never have been started if the financial results at Amazon had always had only a two- or three-year horizon. Now that Bezos has left the active management at Amazon, it will be interesting to see how the company's planning horizon may be affected over the next decades." How do you predict it will change? Why? What would a devil's advocate say?
2. Let's imagine you are the customer portfolio manager of a wireless phone company. How should you be evaluated at the end of the quarter? Straight sales from your customers? Net sales (sales minus cost to serve)? Customer satisfaction? Would it make sense for you to be evaluated on a combination of how much your company made from your customers this quarter and also—as of this quarter—what the two-year projected value of your customer base is? Five-year projected value? Why?
3. If a company rewards employees based on a combination of current and future values of customers, how might that change decision making?
4. Should the value of customers a company doesn't yet have be calculated and taken into account in the present quarter? Why or why not?
5. How is retention different from share of customer (SOC) as a measure and how would it be used differently? Why are both important?
6. See Exhibit 11.2 on page 331. If your rich relative died and left you your choice from their estate of 1,000 shares of Company 2 OR 1,000 shares of Company 5, which would you rather have? Why?
7. From the customer's perspective, which is better—to buy through one channel or through several channels? The obvious answer is to have multiple channels available—order from the web, make returns at the store, check on delivery by phone—and have all of those contact points able to pick up where the last one left off. But is there any advantage—to the customer—of using only one channel? Why does research show that customers who use more than one channel are more likely to be more valuable to a firm than those who use only one?
8. Often, the challenge in using predictive models boils down to a misunderstanding of the nature of cause and effect. Although statistical analysis might reveal that two observable events tend to happen at similar times, it does not necessarily mean that one event causes the other. What is more important: to understand *what* will happen next or *why* it will happen?
9. Customer analytics can be used for improving retention rates. How?
10. Choose an organization and draw its fundamental organizational chart. How would that chart have to change in order to facilitate customer management

and to make sure people are empowered, evaluated, measured, and compensated for building the value of the customer base? Consider these questions:

- If a customer's value is measured across more than one division, is one person placed in charge of that customer relationship?
- Should the enterprise establish a key account-selling system?
- Should the enterprise underwrite a more comprehensive information system, standardizing customer data across each division?
- Should the sales force be better automated? Who should set the strategy for how a sales rep interacts with a particular customer?
- Is it possible for the various Web sites and call centers operated by the company to work together better?
- Should the company package more services with the products it sells, and if so, how should those services be delivered?

11. For the same organization, consider the current culture, and describe it. Would that have to change for the organization to manage the relationship with and value of one customer at a time? If so, how?
12. At the same organization, assume the company rank-orders customers by value and places the most valuable customers behind a picket fence for 1to1 treatment. What happens to customers and to customer portfolio managers behind that picket fence?
13. In an organization, who should "own" the customer relationship? What does that mean?
14. What are the best ways to compensate and reward customer managers?
15. Think about how to start a customer experience push. The approach requires a company to have some basic building blocks in place to engage successfully in a coordinated engagement with the customer agenda that is most likely to succeed. This simple set of 10 questions gives the company a chance to understand its state of readiness to engage. Think of a company you know pretty well. For that company:
    - What is the current customer experience promise/proposition?
    - What do customers need to receive from the company in experiential terms?
    - How well does the company deliver on the customer experience promise today?
    - Is it clear to everyone in the company what experience we want to deliver to our customers?
    - Is there an outside-in end-to-end customer life cycle or customer experience journey map of what it's like to be our customer?
    - What customer measures exist today?
    - What is the hierarchy of the current measurement framework?
    - Which customer interactions are the most important for the company's customers?
    - What does the company do really well in terms of the current customer experience?
    - What does the company do really badly today in terms of our customer experience? What could the company just do better?

16. Should different levels of service be offered to different kinds of customers? Why? How?
17. Imagine you have been assigned the responsibility to change a currently product-oriented company to a customer-oriented firm. Select the company. What is the first thing you do? What is your road map for the next two years? The next five?
18. Name two or three different industries. For each, consider completely different business models that are sustainably successful and that would be based on more collaborative and trust-building ways of creating value. Compare the principles of a merely *trustworthy* company with those of a company that can be designated as having high *trustability*. How will the higher standard of Extreme Trust be applied?
19. What are some ways an auto manufacturing brand could demonstrate that it is trustable?

Glossary

3D printing Through the use of a printer and precise computer programming, the ability to print three-dimensional figures made of plastic or food or other substances.

A/B testing A customer experience research method designed to use randomized samples to measure the difference between the effect that two different independent variants, A and B, will have on a dependent variant, the customer experience. If, for instance, an enterprise wanted to decide how many incremental sales a 25% discount offer would generate, as opposed to a simple headline ad, it could run an A/B test, randomly assigning prospects either to the A group (the 25% discount) or the B group (no discount), and simply measuring the result.

Actual value The net present value of the future financial contributions attributable to a customer, behaving as an enterprise expects them to behave—based on its current knowledge, and with no different actions on its part. (*See also* **potential value**.)

Adaptive customization Offering a standard but customizable product that is designed so that customers can alter it themselves to meet their own needs or preferences.

Addressable Refers to media able to send customized messages individually, to individual addressees.

Analytical CRM (*See also* **Operational CRM**) The part of the customer relationship management (CRM) process that involves understanding individual customer characteristics, including their values to the business and their needs. In the four-step IDIC process, analytical CRM involves generating **customer insight** by accomplishing the first two steps, identifying and differentiating customers.

Apology An expression of sorrow or regret for a mistake made. To be effective, an apology to a customer must sincerely accept responsibility for the mistake and explain what the enterprise is doing to remedy the problem or to prevent similar mistakes in the future.

Artificial intelligence A system of computational technology capable of reacting to its environment or findings and taking actions to maximize its chance of achieving its goals.

Attitudinal data Data supplied by a customer that reflect the customer's attitudes about products and services, including satisfaction levels, perceived competitive positioning, desired features, and unmet needs, as well as lifestyles, brand preferences, social and personal values, and opinions.

Attributes Features, characteristics, or qualities in a product or service that differentiate it from other, similar products or services.

Bayesian analysis A statistical technique in which the probability of an event or hypothesis is updated, based on additional evidence or information about a different event or hypothesis. An example of the kind of question Bayesian analysis is designed to answer is: "What is the likelihood that a customer will stop doing business with the company, now that the customer has registered a complaint?"

Behavioral data Data supplied by a customer based on the customer's purchase and buying habits; their web, mobile app, and other interactions; communication channels chosen; language used; product consumption; and so on.

Behavioral loyalty (*See also* **emotional loyalty**) Behavioral loyalty, also called *functional loyalty*, is evidenced by a customer's repeated patronage, as measured by the customer's actual buying behavior.

Below-zero (BZ) customer A customer that is likely always to cost the company more than that customer contributes, often because the company's business model or established processes cannot profitably serve the customer.

Benefits The advantages customers get from using a particular product, not to be confused with customer **needs**, which are the desires a customer wishes to satisfy with the product. One benefit of a more expensive luxury car, for instance, is that it is more reliable, but while some customers may need reliability, other customers may need status, others may need simplicity, and still others may need comfort.

Big data A term referring to the process of analyzing, extracting information from, or dealing with data sets that are too large or complex to be handled with traditional data-processing application software.

Blockchain technology Digital technology using a chain of cryptographically secure blocks of data to guarantee the veracity, accuracy, or provenance of a digital file.

Business model How a company builds economic value.

Business process reengineering (BPR) Focuses on reducing the time it takes to complete an interaction or a process and on reducing the cost of completing it. BPR usually involves introducing quality controls to ensure time and cost efficiency.

Business rules The instructions that an enterprise follows in configuring different processes for different customers, allowing the company to mass-customize its interactions with its customers.

B2B Business-to-business.

B2C Business-to-consumer.

Capabilities manager With respect to the process of customer management, the person in the organization charged with delivering the capabilities of the enterprise to the customer managers, in essence deciding whether the firm should build, buy, or partner to render any new products or services that customer managers might require for their customers. Customer managers represent their own customers' interests within an enterprise, while capabilities managers have the authority and responsibility for meeting the demands placed on the enterprise by the customer managers, on behalf of the customers they are managing.

Causation Literally, the act of causing. When the value of one event or variable (A) is affected in some way by a change in another event or variable (B), we can say that event B is causing event A, or that the direction of causation is from B to A.

Churn rate *See* **customer churn rate**.

Cloud computing *See* **cloud technology**.

Cloud technology The delivery of computing services over the internet (the cloud), offering faster, less expensive access to computer servers, storage, databases, networking, software, and analytics. A company pays only for cloud services used, which reduces overall costs, and it accesses the cloud on demand, which minimizes the implementation time required. Also called *cloud computing*.

Collaboration Interaction between a customer and an enterprise to specify some aspect of how the customer experience should be provided or how the product or service should be rendered in their specific case. The customer and the enterprise are collaborating in the production process with respect to that customer experience.

Collaborative customization Customizing a product or service based on conducting a dialogue conducted with an individual customer to help them articulate their own specific needs, and then identifying and providing the offering or treatment that fulfills those needs for them.

Collaborative filtering A software algorithm that is used to sort through groups of customers to find commonalities among different customers. (*See* **community knowledge**.)

Commoditization The steady erosion in unique selling propositions and unduplicated product features that inevitably comes about as enterprises all seek to improve their own offerings by imitating the more successful features and benefits of their competitors' offerings, with the result that competitive products become less and less differentiated. (*See* **decommoditize**.)

Community knowledge (*See also* **collaborative filtering**) Insight into an individual customer's needs and/or likely future behaviors, derived from the community of customers with similar traits, and known to exhibit similar behaviors.

Complaint discovery An outbound interaction with a customer, on the part of a marketer, to elicit honest feedback and uncover any problems with a product or service, or any point of friction in the **customer experience**.

Conditional reasoning A form of logical reasoning based on conditional statements. "If a customer complains, then the customer is 30% more likely to quit in the next two months" would be an example of conditional reasoning.

Content marketing Using informative, relevant, or otherwise valuable content to attract and engage customers.

Context The history built up over time in an iterative relationship between the enterprise and an individual customer, as each interaction adds more data to this relationship, making future interactions ever more efficient and producing a **Learning Relationship.**

Contribution Financial benefit provided. For a business, a particular customer's financial contribution consists of that portion of the business's cash flow or income that the business would not have realized except for the patronage of that customer.

Cookie A small text file dropped by a web browser on a computer's hard drive and used to maintain information as the user navigates different pages on the site or returns to the site at a later time. Because a cookie remains on the user's computer after the user leaves a site, it can be used to allow an advertiser to track a user as they surf other websites.

Correlation The state of being correlated.

Cosmetic customization Presenting a standard product differently to different customers.

Crowd service Customers helping other customers solve problems online.

Culture The unwritten beliefs and assumptions shared by employees or members of a business or an organization that guide their individual behaviors.

Customer acquisition cost (CAC) The cost to a business of acquiring a new customer.

Customer advocate A customer who enthusiastically supports a brand's offerings and regularly refers other customers to it.

Customer analytics Enables the enterprise to classify, estimate, predict, cluster, and more accurately describe data about customers, using mathematical models and algorithms that ultimately simplify how it views its customer base and how it behaves toward individual customers.

Customer care *See* **customer service**.

Customer centricity One of many different terms used to describe the kind of marketing processes and activities being described in this textbook, made possible by computer technology and ubiquitous interactivity, and based on **treating different customers differently**. Other terms include customer-centric marketing, customer-oriented marketing, customer orientation, customer-focused marketing, customer focus, customer-driven marketing, customer relationship management, customer strategy, or one-to-one marketing.

Customer churn rate The rate at which customers leave and enter the franchise. High churn indicates a simultaneously high number of defecting customers and high number of new customers, which is usually a symptom of low customer loyalty. Also called customer churn or **turnover**.

Customer collaboration *See* **collaboration**.

Customer competence The second two qualities in a frictionless customer experience—relevance and trustability—are referred to as "customer competence," as contrasted with the first two qualities—reliability and value—which are referred to as product competence.

Customer contact center The functional department or unit charged with receiving, understanding, and dealing with individual customer inquiries and requests, using phone, chat, video, or other communication technologies. Contact centers were formerly known as call centers because the only practical way for customers to contact and interact with a company without visiting a store and doing so in person was by phone.

Customer data platform (CDP) Packaged software that ensures an efficient and accurate mechanism for identifying customers, as and when those customer identities are required by other software within the enterprise. With a CDP, not only can conflicts and mistakes be minimized, but an enterprise's customers won't be required to provide the same information over and over, and security around customer identifying data can be enhanced, as well.

Customer equity (CE) The total financial value of an enterprise's customer base. Specifically, customer equity is defined as the sum of the **actual lifetime values** of all of an enterprise's current and future customers. The term can also be applied to a specific sub-set of customers, in which case the "future customers" value will often be omitted. The financial goal of every customer-strategy enterprise is to maximize its customer equity.

Customer experience (CX) The totality of a customer's individual interactions with a brand, over time. In the context of the IDIC model, customer experience represents the two final steps, interact and customize.

Customer experience journey mapping (CEJM) *See* **customer journey mapping**.

Customer experience management (CEM) The processes, tools, and procedures required to design, understand, manage, evaluate, and improve individual customer experiences at an enterprise. The goal of CEM is to create **Learning Relationships** with customers, thereby building customer equity and shareholder value over the long term.

Customer focus *See* **customer centricity**.

Customer insight A term used to describe the knowledge that a business might develop with respect to both the value a customer has to the enterprise and the needs the customer has from the enterprise. In the context of the IDIC model, customer insight represents the first two steps, identify and differentiate.

Customer interaction center *See* **customer contact center**.

Customer journey mapping (CJM) A process of diagramming all the steps a customer takes when engaging with a company to buy, use, or service its product or offering. As customer experience journey mapping, expanding the diagram from the diagnostic mapping to a prescriptive plan to create and manage a positive customer experience.

Customer life cycle The trajectory a customer follows during their relationship with an enterprise, from the customer's first awareness of a need, to their search for a product or service to meet that need, then procuring it, using it, and perhaps even recommending it to others, all the way to the end of the relationship. The term *customer life cycle* does not refer to the customer's actual lifetime or chronological age but rather to the time during which the product is in some way relevant to the customer.

Customer manager *See* **customer portfolio manager**.

Customer orientation *See* **customer centricity**.

Customer portfolio A mutually exclusive, needs-based category of customers, in contrast to a **customer segment**, which is not mutually exclusive. A customer can belong to more than one customer segment, but to **only one portfolio**. The treatments rendered by an enterprise to a portfolio of customers are advocated for or determined by a **customer manager**.

Customer portfolio management Refers to the process of having **customer managers** in charge of different **customer portfolios**.

Customer portfolio manager The person at an enterprise who is in charge of particular customer relationships. The customer manager's objective is to increase the value of the customers in their charge, and the authority required to do this should include responsibility for understanding and advocating on behalf of the interests of their **portfolio** of customers within the enterprise, and (ultimately) determining every type of individually specific interaction or communication that the enterprise is capable of rendering to these customers.

Customer relationship management (CRM) (*See also* **one-to-one marketing**.) As a term, CRM can refer either to the activities and processes a company must engage in to manage individual relationships with its customers (as explored extensively in this textbook) in order to create better customer experience and increase the value of customers, or to the suite of software, data, and analytics tools required to carry out those activities and processes.

Customer sacrifice *See* **satisfaction gap**.

Customer segment Any group of customers who have similar characteristics. Unlike **customer portfolios**, a customer can belong to more than one customer segment. For instance, a customer may belong to the segment of married customers, as well as to the segment of customers in suburban postal codes, and the segment of recent purchasers. Generally useful to a company's product managers looking for customers, who may simultaneously communicate with customers without the knowledge of other product managers. Also known as **market segment**.

Customer service Customer service involves helping a customer gain the full use and advantage of whatever product or service was bought. When something goes wrong with a product, or when a customer has some kind of problem with it, the process of helping the customer overcome this problem is often referred to as **customer care.**

Customer service representative (CSR) A person who interacts with customers at a **center contact center**. Often called a rep, or an associate.

Customer strategy *See* **customer centricity**.

Customer-strategy enterprise An organization that builds its business model around increasing the value of the customer base. This term applies to companies that may be product oriented, operations focused, or customer intimate.

Customer success management (CSM) A business process to ensure that customers achieve success (i.e., their desired outcomes while using your product or service). Customer success management is relationship-focused client management, primarily for B2B businesses, aligning client and vendor goals for mutually beneficial outcomes, and should result in decreased customer churn and increased up-sell opportunities.

Customer value management (CVM) The process and activities involved in managing a business's functions (including sales, marketing, production, and distribution) in a manner designed to increase the value of its customer base.

Customize (customization) The fourth step in the IDIC model, customization involves altering some aspect of the customer experience to meet the individual needs or demands of a particular customer. It might involve physically altering a product, or more specifically configuring a service, or (more commonly) it can simply involve rendering an individually relevant online message or interaction with the customer. When a customer goes to a website, for instance, and the page reflects the customer's own previous purchases, searches, or clicks, the enterprise is customizing the customer experience for that customer and making it easier for that customer to continue to engage in repeat business with that company than to start over with a competitor.

Data mining The process of exploring and analyzing large quantities of data in order to discover the most meaningful patterns and relationships among variables.

Data model A method for organizing data elements and their various relationships, to describe and understand how they relate to one another and to the properties of real-world entities in a more systematic manner. For instance, a data model may specify that the data element representing a customer's past purchases be composed of a number of other elements which, in turn, represent date, price, and item number of each purchase.

Data warehousing A process that captures, stores, and analyzes a single view of an enterprise's data, collected from multiple sources, to gain business insights and improve decision making.

Decommoditize (decommoditization) To provide a customer experience that is customized to the particular needs of an individual customer, despite the fact that the product being sold is actually a commodity, not distinguishable from other, similar products. This is, for many companies, the ability to efficiently *treat different customers differently*.

Deep learning An advanced form of **machine learning** involving layered networks and capable of extracting higher-level features from raw inputs. In processing an image, for instance, one layer of analysis might identify boundaries, while a higher level might identify internal edges, and a still higher layer might distinguish squared and rounded objects delineated by those edges.

Demand chain As contrasted with the supply chain, demand chain refers to the chain of customer-facing activities and processes extending from customers back through retailers, dealers, resellers, distributors, and all other intermediaries, all the way back to the production line of a manufacturer or to the service-delivery activities of a service provider.

Descriptive data Data about individual consumers that include specific descriptors such as age, income, education level, marital status, household composition, gender, home ownership, and so on. Sometimes referred to as *demographic data*.

Differentiate The second step in the IDIC model, customer differentiation involves discovering and analyzing customers' individual differences, when compared to other customers, in terms of both their different values *to* the enterprise and their different needs *from* the enterprise—that is, their preferences, demands, specifications, or requests. Not to be confused with product differentiation, which involves an enterprise's effort to promote the uniqueness of a product, when compared to competitors' products.

Disintermediation Going directly to customers by skipping one or more of the intermediaries in a demand chain or a supply chain. For example, a manufacturer that sells directly to consumers is disintermediating whatever retailers might have been involved in the demand chain.

Disruptive innovation Innovation intended to undermine an established business model or to alter how a majority of competitors operate. It contrasts with incremental innovation, which works to improve an existing business model. Uber is an example of a disruptive innovation in the taxi and limousine category, but the next version of Apple's iPhone is likely to be an incremental innovation in the smartphone category.

Drip irrigation dialogue An enterprise's sustained, incremental dialogue that uses each successive interaction with a customer, whether initiated by the customer or by the firm, to learn one more incremental thing that will help the enterprise grow its **share of customer** with that customer. (*See* **Golden Questions**.)

Economies of scale *See* **scope of information**.

Economies of scope *See* **scope of information**.

Emotional loyalty (*See also* **behavioral loyalty**) manifest by a customer's good wishes or affection for a product or brand. When a customer has affection for a brand, as measured in surveys of customer opinions or attitudes, the customer can be said to be emotionally loyal.

Enterprise customer A large and complex B2B customer, characterized by relationships within relationships that often involve specifiers, approvers, reviewers, and other individuals within the customer organization who all have varying roles and degrees of influence over the purchasing decision.

Event-driven marketing Marketing campaigns and initiatives characterized by offers or communications that are triggered by preidentified events—for example, the automatic offer of certain socks to an online buyer who purchases rugged hiking boots.

Expanded need set The broader set of needs a customer has that are related to or indicated by an individual customer's basic need. This broader set of needs could be satisfied not just by the product itself, but by ancillary services, information, or supplemental products, enhancing or expanding the customer's original, basic need.

Explicit bargain Providing some explicit value to a customer in exchange for that customer's time and attention, or for information and insight about that customer. When a store provides discounts or bargains to a customer for showing their membership card or giving their email address, it is making an explicit bargain. (*See also* **implicit bargain**.)

First-call resolution (FCR) The rate at which customer complaints or problems are resolved at a customer's first interaction with a company, whether it is through telephone, email, or any other method of interaction. **FCR** is a frequently used metric for evaluating the quality and efficiency of an enterprise's **customer care** function.

First-party data Customer data that a marketer collects directly, usually via cookies that the marketer drops onto its customers' computers from its own website (*See also* **second-party data** and **third-party data**.)

Frictionless A term used to describe a streamlined, highly convenient and efficient customer experience that does not require a customer to accomplish any extra task or to expend any unnecessary effort, when satisfying whatever need they were trying to satisfy with a product or service.

Functional loyalty *See* **behavioral loyalty**.

General Data Protection Regulation (GDPR) The law designed to secure data and protect the privacy of citizens of the EU and EEA (European Economic Area). The GDPR is meant to enhance citizens' control and rights over their own personal data, while simplifying the regulatory environment governing how international businesses must operate within Europe.

Golden Question An interaction with a customer designed to reveal important information about the customer while requiring the least possible effort from the customer. It is often the result of analyzing the answers to many questions in a sample, and determining which question yields the most predictive answer.

Identify The first step in the IDIC model, identifying a customer involves recognizing and remembering a specific, individual person, and being able to tell them apart from any other customer, regardless of the channel, geography, organizational division, or timeframe in which an interaction with the customer is taking place.

IDIC methodology The four-step model for building and maintaining customer relationships, over time, IDIC stands for identify-differentiate-interact-customize.

Implicit bargain Implicitly providing a value to a customer in exchange for that customer's time and attention. An advertiser that pays for the cost of producing and providing media that a consumer wants, such as a television program or a magazine story, is making an "implicit bargain" with the consumer. The bargain implied is that the customer will pay attention to the ad in exchange for getting the media content free. (*See also* **explicit bargain**.)

Information Age The era generally thought to have commenced with the development of transistors, microprocessors, and computers in the middle of the 20th century, which led to a shift away from the traditional mass production processes developed during the Industrial Revolution, in favor of computerized processes based more on data and information.

Integrated marketing communications (IMC) An aspirational model for mass-media marketing messages that do not conflict with one another, from one medium to the next. IMC requires that print ads for a product or brand not conflict with or contradict broadcast TV or radio ads for the same product or brand.

Interact (also **Interacting** and **Interaction)** The third step in the IDIC model, involves exchanging and remembering information with and about a specific customer as part of the enterprise's effort to learn more about the customer and to provide a more appropriate **customer experience,** for that customer.

Interactive voice response (IVR) Now a feature at most contact centers, IVR software provides spoken instructions for callers to push 1 to check their current balance, push 2 to transfer funds, and so forth.

Internet of Things (IoT) A term describing the rapidly increasing network of products and other physical objects that have connectivity and/or computational capabilities built into them and are therefore connected to and accessible via the global internet.

Iterative Building on itself. Conversations are iterative when they pick up where they left off. A customer relationship can be iterative if both the enterprise and the customer remember their previous interactions with each other, so that future interactions do not need to start all over again from the beginning. In effect, an iterative relationship is one that learns ever more about the customer over time, enabling the enterprise to develop and deliver an ever-better customer experience for this specific customer.

Key opinion leaders (KOLs) In knowledge-intensive endeavors, such as medical or technological industries, a KOL is a professional whose views are highly respected by their peers in the industry.

Key performance indicators (KPIs) The key metrics that a business considers essential to success, or performance. An established enterprise might consider quarterly net profit to be a primary KPI, while a rapidly growing startup might consider a more important KPI to be quarter-over-quarter growth rate.

Leading indicators Variables or metrics that indicate changes in a customer's LTV—either suggesting that the customer's LTV has increased, or that it has decreased. Such variables would tend to fall into four general categories: **LTV drivers**, lifestyle changes, behavioral cues, and customer attitudes. So for instance, a decline in a segment's average customer satisfaction level indicate that LTVs for that segment have declined.

Learning Relationship A relationship that gets smarter and smarter over time, based on a collaborative dialogue between the enterprise and the customer. This dialogue continually adds to the context of the relationship, making impossible for a competitor to offer the customer the same level of convenience and familiarity, unless the customer spends time re-teaching the competitor what they have already taught the enterprise.

Legacy metrics Metrics for running a business prior to technology making it possible to treat different customers differently, including monthly or quarterly sales, cost of goods sold, number of new customers acquired, and financial measures such as EBITDA (earnings before interest, taxes, depreciation, and amortization), ROI (return on investment), and TSR (total shareholder return). Also refers to any measurements a company has traditionally used.

Lifetime value (LTV) Synonymous with actual value. The net present value of the future financial contributions attributable to a customer, behaving as we expect them to behave—knowing what we know now, and with no different actions on our part.

Lifetime value drivers (LTV drivers) The individual elements of an enterprise's LTV equation, i.e., the actual component variables that are used for modeling how much value the customer is likely to create for the company over time—including such variables as average customer retention rate, purchase volume, cost to serve, and so forth.

Longitudinal insight Insight into an individual customer's ongoing behaviors, over time.

Low-maintenance customer A customer with a relatively low actual lifetime value as well as low unrealized **potential value**. Individually, such a customer is not very profitable for the enterprise, nor does the customer have much growth potential, but there are probably a lot of them, so value can be realized by streamlining or automating the customer experience, or otherwise reducing the cost to serve such a customer.

Machine learning A computational process involving computer algorithms capable of improving themselves automatically, as more data is processed and more information is accrued.

Market segment A group of customers who share a common trait or attribute. Product benefits are targeted to those market segments thought most likely to desire the benefit. Because the idea of segment is more focused on finding customers for products, customers can easily fall into multiple market segments. Also known as **customer segment**.

Martech Marketing technology.

Mass customization *See* **customization**.

Mass marketing Using mass media advertising and promotion to appeal to an entire market of customers, treating all customers to the same message concerning some aspect of product or brand differentiation.

Metcalfe's Law The tendency of a network to increase in value in rough proportion to the square of the number of members connected in the network. For this reason, many enterprises with multiple customer-facing applications rely on a **customer data platform (CDP)** to ensure that master data about customers is consistently presented and available to each and every application within the enterprise that might need it.

Mindset A term describing the attitudes or sentiments held by employees at an organization.

Modularization Configuring a product's various components in a manner designed to facilitate assembling them in a number of different, but standardized, ways, so as to facilitate the process of mass customization.

Moment of truth (MoT) Interaction with a customer that has a disproportionate impact on the customer's emotional connection with a product or brand, and therefore more likely to drive significant behaviors.

Most growable customers (MGCs) Customers with high unrealized potential values but not very high actual values.

Most valuable customers (MVCs) Customers with high actual values but not very high unrealized potential values. These are the customers who do the most business with an enterprise, yield the highest margins, and tend to be the most loyal and willing to collaborate.

Multichannel marketing *See* **omnichannel marketing**.

Mutuality Refers to the two-way nature of a relationship.

Needs What a customer needs from an enterprise, synonymous with what they want, prefer, or would like. The term *needs* encompasses all of a customer's desires, preferences, wishes, or whims. While each of these terms might imply some nuance of need—perhaps the intensity of the need or the permanence of it—in each case we are still talking, generically, about the customer's needs.

Needs-based differentiation The process of differentiating customers by their different individual needs.

Net Promoter Score (NPS) A widely used customer satisfaction metric consisting of a single question asking respondents to rate on a scale from 1 to 10 how likely they would be to recommend a product, service, or brand to others. NPS is a proprietary instrument developed by Fred Reichheld, who owns the registered NPS trademark in conjunction with Bain & Company and Satmetrix (now a unit of NICE).

Nonaddressable Refers to media that cannot send customized messages individually, to individual addressees, but instead sends the same message to everybody. (*See also* **addressable**.)

NPV Net present value. The current value of a future stream of cash flows (both in and out), discounted at an appropriate rate.

Omnichannel marketing A marketing buzzword that refers to an organization's capability to interact and transact with an individual customer via any or all channels (website, app, text, etc.), while ensuring that every interaction takes place in the channel of the customer's own choice, and that each successive interaction is informed by any previous interactions with that customer in any other channel.

One-to-one marketing Treating different customers differently in such a way as to ensure that each individual customer is treated in a manner appropriate to that customer, by using customer databases, interactivity, and mass-customization technologies. Often used today as a descriptor applying only to the most advanced form of customer-centric marketing, the term one-to-one marketing was originally defined and proposed in the 1993 book *The One to One Future: Building Relationships One Customer at a Time*, by Don Peppers and Martha Rogers, Ph.D. As more technologies and applications have been developed to execute this kind of business strategy, the term **customer relationship management (CRM)** has come to be more frequently used, although this term has often been used to describe the tools, rather than the process.

Open source Refers to computer programming source code that is freely available to anyone, without charge, to be modified and/or redistributed as desired. This results in a completely decentralized software development model encouraging open collaboration.

Operational CRM (*See also* **analytical CRM)** The part of the **customer relationship management** (CRM) process that involves whatever software installations, data requirements, and processes are required at a firm to manage interactions and transactions with individual customers on an ongoing basis. In the four-step IDIC process, operational CRM involves the last two steps, interacting with and customizing for customers, and is often referred to as **customer experience management**.

Opt in/Opt out When customers must proactively elect to receive future communications or some other service from an enterprise, it is said that they must "opt in" to receive the treatment, as opposed to "opt out," which applies to a situation in which a customer must proactively choose *not* to receive the treatment.

Picket fence An imaginary boundary around customers selected for customer management. Customers outside the picket fence likely will be treated as customers have always been treated, using traditional marketing and customer care; but each customer within the picket fence will be the management responsibility of a **customer portfolio manager**, whose primary responsibility will be to keep and grow each of the customers assigned to them.

Potential value The net present value of the future financial contributions that *could* be attributed to a customer, if through conscious action the enterprise succeeds in changing the customer's future behavior. (*See also* **actual value** *and* **lifetime value**.)

Predictive analytics A wide class of statistical analysis tools designed to help businesses sift through customer records and other data in order to model the likely future behaviors of other, similar customers.

Product competence The first two qualities in a frictionless customer experience—reliability and value—are referred to as product competence, as contrasted with the second two qualities—relevance and trustability—which are referred to as customer competence.

Proxy variable A metric that allows an enterprise to rank its customers by value, or to estimate the likely importance or priority of a customer, in the absence of any actual financial calculation.

Privacy policy A written document detailing how a company will share (or not share) data collected from its customers. At a minimum it should explain to customers, in simple language, what kinds of data the company collects from them, how the data will be used or not used, and the customer's rights to refuse the collection or use of such personal data.

Real-time analytics Instant updates to customer data and the improved insights revealed by such data, allowing services and customer treatments to be calculated and rendered immediately through automation, particularly important for online and in-app mobile interactions.

Recency, frequency, and monetary value (RFM) Many direct marketers use a proxy variable called RFM, for *recency, frequency,* and *monetary value*, to rank-order their customers in terms of their value. The RFM model is based on individual customer purchase histories and incorporates three separate but quantified components:

1. *Recency*. Date of this customer's most recent transaction.
2. *Frequency*. How often this customer has bought in the past.
3. *Monetary value*. How much this customer has spent in the most recent specified period.

Recognition, recognize (*See also* **identify)** The ability to identify an individual customer as that customer through any shopping or buying channel, within any product purchase category, across locations or geographies, and over time. These individual data points are linked for a universally recognized, or identified, customer.

Relationship equity *See* **customer equity**.

Relationship governance Defines who in the enterprise will be in charge of decisions with respect to how different customers ought to be treated, with the goal of optimizing around each customer rather than each product or channel.

Relationship manager *See* **customer portfolio manager**.

Return on Customer (ROC, pronounced *are-oh-see*.) A metric directly analogous to return on investment (ROI), but specifically designed to track how well an enterprise is using its customers to create value. ROC with respect to an individual customer or group of customers for any financial period is the sum of the profit or cash flow received from that customer(s) during the period plus any change in the customer's LTV during the period, divided by the customer's initial LTV.

SaaS (Software as a Service) A business model based on cloud computing in which software is centrally hosted by the vendor and accessed by customers on the vendor's own computer servers, usually on a subscription basis. Sometimes referred to as on-demand software.

Sales force automation (SFA) Automating the sales force by connecting members to headquarters and to one another through mobile apps, computer connectivity, contact management, ordering software, and other mechanisms.

Satisfaction gap The difference between what customers really want and what they're willing to settle for.

Scope of information The range of information an enterprise has about an individual customer, as contrasted with the *scale* of the enterprise's production operation. Economies of scale make it possible to reduce unit costs for an enterprise's product, while economies of scope make it possible to increase the value generated by an enterprise's customer.

Second-party data Customer data that a marketer collects directly, but then sells to others. It may include data from websites, apps and social media, in-store purchase history, survey responses or other sources. (*See also* **first-party data** *and* **third-party data**.)

Share of customer (SOC) For a customer-focused enterprise, share of customer is a conceptual metric designed to show what proportion of a customer's overall needs are being met by the enterprise. It is not the same as share of wallet, which refers to the specific share of a customer's spending in a particular product or service category. If, for instance, a family owns two cars, and one of them is your car company's brand, then you have a 50% share of wallet with this customer, in the car category. But by offering maintenance and repairs, insurance, financing, and perhaps even driver training or trip planning, you can substantially increase your share of customer, even if the customer continues to drive another brand.

Social media Interactive services, mobile apps, and Web sites that allow users to create their own content and share or discuss their own views for others to consume. Blogs, microblogs (e.g., Twitter), Facebook, and LinkedIn are examples of social media that facilitate making contact, interacting with, and following others. YouTube, Tik Tok, Instagram, and Snapchat are examples of social media that allow users to share creative work with others. Even Wikipedia represents a form of social media, as users collaborate interactively to publish more and more accurate encyclopedia entries.

Social networking The applications and technologies allowing individuals to connect instantly with each other, often and easily, online in groups. For a business, social networking involves using technology to initiate and develop relationships with and within connected groups (networks), usually joined together or united by some specific goal or interest.

Software as a service *See* **SaaS**.

Super-growth customers Customers with high actual value as well as high unrealized potential value.

Supply chain A company's back-end production or service-delivery operations.

Switching cost The cost, in time, effort, emotion, or money, to a business customer or end-user consumer of switching to a firm's competitor.

Third-party data Customer data that a marketer allows another company to collect about its customers, usually by allowing the company to drop its own cookies on the marketer's website visitors' computers. (*See also* **first-party data** *and* **second-party data**.)

Total shareholder return (TSR) The sum of the change in capital value of a listed/ quoted company over a period (typically one year or longer), plus dividends during the period, divided by the capital value at the beginning of the period.

Trajectory The path of a customer's financial relationship through time with the enterprise.

Transparent customization Providing a customer with a customized product or service without necessarily telling the customer about the customization itself. When, for example, a hotel remembers that you prefer a hypoallergenic pillow on your bed, and ensures that your room has such a pillow, it is engaging in transparent customization.

Treating different customers differently (TDCD) A concise definition for the kind of business activity facilitated the technology underpinning the management of customer experience and relationships.

Trust platform A business that uses interactive technology to connect willing buyers with willing sellers, while relying on crowd-sourced feedback to ensure mutual trust. Uber and Airbnb are examples of trust platforms.

Trusted agent A person or organization that makes recommendations and gives advice to a customer that furthers the customer's own interest, even when it occasionally conflicts with the enterprise's own self-interest, at least in the short term.

Turnover *See* **customer churn rate**.

Unrealized potential value The difference between a customer's potential value and their actual value (i.e., the estimated amount of a customer's potential lifetime value that is not likely to be realized as actual lifetime value without some change in the customer's behavior).

Value skew The degree to which the actual values in a customer base vary from the average. If just 10% of customers create 90% of total value, for instance, this would be a steep skew, while if 60% of customers were required to account for 90% of the value, it would be a shallow skew.

Value of the customer base *See* **customer equity**.

Value creators Companies that have a **Return on Customer** higher than their cost of capital, regardless of current income.

Value destroyers Companies that have a **Return on Customer** below zero, regardless of current income.

Value harvesters Companies that have a **Return on Customer** above zero, but below their cost of capital, regardless of current income.

Value stream A compilation of related products and services a company could offer to an existing customer in order to get a greater share of customer from each customer already acquired.

Voice of the customer (VoC) A customer survey or some other direct interaction with a customer designed to reveal the customer's level of satisfaction or happiness, either with respect to a recent transaction or as a general statement.

Word of mouth (WOM) The content or value of information about a customer experience that the customer shares with other customers. WOM can be positive or negative in value.

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