By Ross Goodwin and Brad Ball

Closing the Loop on Loyalty

Implement an integrated Customer Value Management System for improved customer loyalty.

Today's customers expect more than ever. They shop at stores noted for high levels of service and expect similar treatment at a discount warehouse. Based on how easy it is to use their microwaves, televisions, phones, and other household appliances, they want a similar experience with their new computer and printer. They drive through fast food places and are impatient if their order isn't ready when they arrive at the take-out window. Similarly, when they call a company's support line they expect their phone call to be immediately answered by someone knowledgeable about their issue.

Along with increased customer expectations, the *new* business environment includes rapid product changes and increased competition. Product life cycles have gone from years to months. Based on the success of one-to-one marketing programs, customers expect flexible, customized solutions. Due to the ease of conveying and obtaining information over the Internet, new competitors arise monthly. On the Web, large and small companies can appear similar. This means barriers to entry are minimal and real-time data is everywhere. These conditions make it likely that how to remain profitable is the number one issue keeping most CEOs awake at night.

Today, what sets great organizations apart is their commitment to drive *customer-valued* action throughout the organization. These organizations have leaders with a vision of creating exceptional value for customers and shareholders. Leaders such as Jack Welch

(General Electric), Lawrence Bossidy (Allied-Signal), and Fred Smith (Federal Express) have created organizations *accountable* for understanding

EXECUTIVE BRIEFING

Leading companies want to align their business around what customers value because it's** the best **leading indicator of profitable market share.** However, **the challenge doesn't lie in collecting customer information, rather it lies in engaging and changing the organization based on the results. This article details how organizations can create an integrated cross-functional and cross-organizational approach for acting on customer's perceptions of products and services. The resultant closed-loop system will deliver superior customer, shareholder, and employee loyalty.

customer needs. They've made the resources available to deliver superior value. They've also designed environments where performance is evaluated based on what customers value and the metrics foster the behavior necessary to implement the CEO's vision.

Great organizations don't rely on tactics such as seminars, 1-800 numbers, Web sites, trade shows, infomercials, newsletters, or direct mail programs to create value. Unfortunately, too many other organizations confuse these tactics with the substance behind a customer-centered vision and strategy.

Hewlett Packard CEO Lew Platt has a vision for "creating customer intensity everywhere." We believe HP, and other organizations also committed to a strategy of delivering what customers' value, will achieve this goal by focusing on three strategies:

A true passion for customers. This encourages employees to embrace an attitude of being in business to serve only the customer. It includes managerial leadership and the commitment to provide the resources employees need to take personal ownership for resolving customer problems. It fosters a culture where employees constantly cement customer loyalty through customer-focused actions and listening skills.

Organizing around customers. This requires corporate and business units to structurally align around the customer. It includes effective internal and external customer communication and a commitment across all parts of the company to become customer-centric.

A deep understanding of customers. Here, qualitative and quantitative data are collected, and knowledge of what customers value is shared throughout the organization. This forms the foundation for key decisions. Corporate and business unit strategies and tactics are driven from what customers value.

Value: The Key Strategy

"Companies succeed by providing superior customer value. And value is simply quality, however *the customer* defines it, offered at the right price."
—- Bradley T. Gale, *Managing Customer Value*, 1994

Industry research shows that the customers' *perception of value* is their primary buying decision factor. It's the best leading indicator of market share, sales revenues, profitability, and sus-

DESIGNING A QUANTITATIVE SURVEY

Consider your company's strategic areas and their implication for your business. Now start to think about which questions to include in your customer value measurement survey. The following may help foster your thoughts.

Customer loyalty–Eliminating dissatisfaction, improving satisfaction and a commitment to customer intimacy are the keys to building customer loyalty. Managerial questions include:

- *Of the respondents who prefer our company, what makes some satisfied and others dissatisfied?*
- *What are our customer's top dissatisfiers, the key points of pain that push them away from us driving them toward the competition?*
- *What can we do to retain our dissatisfied customers?*
- *What are we doing well at such that if we relax our efforts we would see a significant loss in market share?*
- *How can we convert a satisfied customer to a loyal customer advocate who is less vulnerable to the competition?*

Market share growth–Managerial questions include:

- *What is important to our competitor's customers?*
- *What are our competitive strengths and weaknesses?*
- *What can we do to improve our competitive position?*
- *How can we attract customers away from our competitors to gain market share?*

Brand image–If handled effectively, the overall impression of a company and its products, whether real or perceived, becomes much larger than the sum of its parts. This difference, or brand equity, directly leads to increased stock prices and subsequent shareholder loyalty. Disney, McDonalds and Intel are examples of companies that successfully manage their brand image. Managerial questions include:

- *Why are some customers attracted to our company and others attracted to the competition?*
- *How does the image and value proposition of our company differ from the competition?*
- *What is the promise of our brand?*

Customer segmentation–Many companies establish "firmographic" segments based on such factors as company size, geographic region, size of budget, number of purchases per year, department, standard industrial classification code, and so forth. Segmentations based on these categories alone provide little strategic insight. For example, strategic customers may have similar lifetime value but radically different needs. Managerial questions include:

- *What are our customer need segments?*
- *How well do we compete relative to the competition in each segment?*

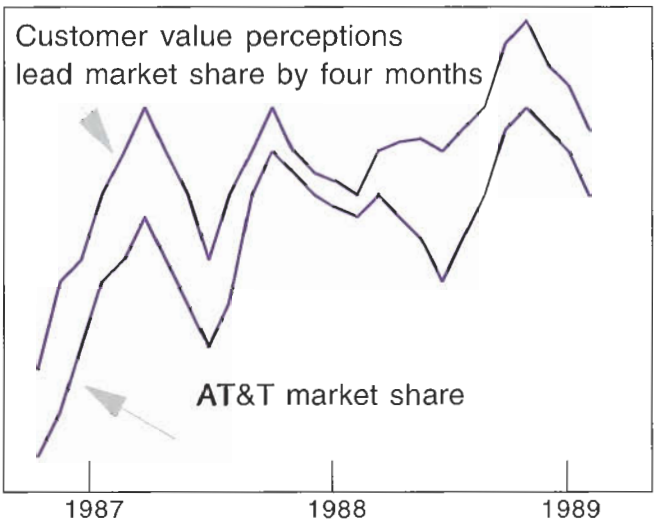
tained competitiveness. (See Exhibit 1.) Value is the perceived worth of a product or service compared to what was paid and lost opportunity costs. This perception of value is formed through all the experiences a customer has throughout a product's life cycle. These experiences start with presales literature, continue through ordering, receiving, and installing, to learning, using, supporting, and finally disposing. (See Exhibit 2.)

Within each of these experiences, depending on customers' needs, a few key "moments of truth" (or interactions disproportionately important) drive the customer's perception of value and subsequent purchase decisions. Customer value management is about understanding the "portfolio value" that appeals to targeted customers, so you can focus on the critical value drivers.

The goal is a short list of manageable items that will significantly impact the bottomline. Through a strong understanding of what customers value, companies will know how to offer better "value" than the competition at the same cost or comparable "value" at reduced cost. The end result of a strategy centered on delivering superior value will be increased customer loyalty and profitability.

EXHIBIT 1

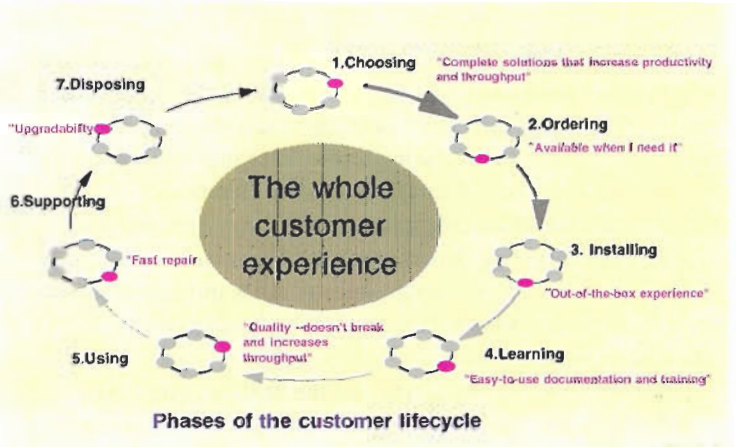
Customer value perceptions



Adapted from: Bradley T. Gale, *Managing Customer Value*, 1994

EXHIBIT 2

Meeting customer needs



Loyalty: The Key Metric

"The new theory sees the fundamental mission of a business not as profit, but as value creation... The new theory also makes loyalty a truer litmus test of corporate performance than profits. Since the only way a business can retain customer and employee loyalty is by delivering superior value, high loyalty is a certain sign of solid value creation." –Frederick F. Reichheld, *The Loyalty Effect*, 1996

While most companies already measure some form of customer satisfaction, that measure does not predict customer loyalty. Customer satisfaction is an *attitude*. High levels of customer satisfaction do not necessarily translate into repeat purchases and increased sales and profits. Customer loyalty is the measurement that directly ties to repeat purchase *behavior*.

Research shows that loyal customers:

- Stay longer.
- Cost less to service.
- Provide higher margins.
- Purchase across product lines.
- Buy more.
- Demonstrate immunity to the competition.
- Demonstrate less price sensitivity.

Repeat purchases and a willingness to continue the relationship characterize customer loyalty. The most advanced companies in the industry use

customer loyalty measures to gain competitive advantage. The benefits include:

- Provide an early indication of future business performance.
- Complement existing programs by adding a more timely assessment of competitive positioning.
- Provide additional data to set strategic direction for managing the company brand.
- Assist top management with more meaningful performance and accountability measures.

FIEFDOMS, SILOS, AND FINGER POINTING

Will the Customer Value Measurement and Management framework work for you? If your organization is anything like the below example, we say yes.

Traditional organizational structures are built around business product lines, services, or functions such as R&D, marketing, and manufacturing. Metrics often focus on success only within a specific area and disregard the effects on other areas of the organization. The downside of this approach is depicted below.

ABC Company creates a product that exceeds sales expectations but immediately incurs five times the normal failure rate. The results? Marketing holds a beer bash. Six months later service eventually gets the product marketing team into a meeting to explain the failure costs. (Product marketing was too busy to meet earlier due to focusing on the next product release and meeting new sales targets.) At the meeting, marketing concludes the problem is a manufacturing issue. After juggling calendars for months, the three groups have a teleconference to discuss the issue. From manufacturing's perspective, they built the product to meet the marketing department's cost envelope and used R&D's product design. So whose problem is this and who owns it? What are the costs? Whose metrics are impacted? What about the customer issues?

In this scenario, marketing and the business unit obtain their short-term sales forecasts at the expense of service and manufacturing. Eventually the cost overrun will catch up with the business unit and corporation's bottom line. The longer-term effect on customer retention and loyalty won't be felt for months or years.

The example characterizes the challenge associated with cross functional or cross business unit problem ownership and resolution. This challenge becomes more acute when the metrics and corporate organization reward rather than penalize this type of behavior. The value of the business unit CAM is to create and lead cross-functional teams to address the customer issues that fall between the functional and/or business unit's white space and affect all areas of the value chain.

Customer Value Management

The goal of Customer Value Management (CVM) is to define and deliver superior value at superior profits. Stated another way, the goal is to optimize the exchange of value between the company and it's customers. Improving loyalty and profits requires an integrated Customer Value Management System (see Exhibit 3), which consists of these elements:

Entity leadership and customer advocacy function to provide an organizational focus and leadership for the Customer Value Management System, and to link what drives customer loyalty into strategic priorities.

Customer loyalty measurement to obtain statistically significant *quantitative customer* data through survey methodology.

Qualitative customer voice listening posts allow for a view from the street.

Value delivery system includes cross-functional and cross-organizational process centers, functional areas, business teams, and individual contributors.

Internal process metrics are leading indicators of delivered value. A "Balanced Scorecard" approach, which incorporates customer-value-management-based performance metrics, is essential for monitoring progress toward increased loyalty among customers, employees, and shareholders.

Creating Successful Change

Long-term success comes from a specific function chartered to champion the customer and an ongoing cross-organizational effort. Ideally, the function reports to the CEO or a business-unit senior executive. Corporate and business unit sponsorship is the most important factor for success. Without the support of a visionary leader who walks the talk

and insists on it from others, the change process isn't likely to succeed. The structure sends a clear message from senior management regarding the importance of the customer advocacy function and level of authority. Without a specific function overseeing the effort, a company runs the risk of not achieving success due to no clear ownership when the problems start to cross organizational boundaries or require massive efforts to fix.

Ideally, change managers are assigned at the business unit and corporate levels, and are referred to as the Customer Advocacy Manager (CAM). The business unit CAM champions the cross-functional and cross-organizational effort within their entity. This includes influencing the customer-centric strategy, identifying suitable metrics, integrating customer databases, survey design, and related communication and training. The corporate CAM acts as a coach and consultant to the business unit CAMs to foster sharing of best practices, training of practitioners and their sponsors, and helping them to create a customer-centered vision, strategy and management system for success.

Successful change management requires leaders with strong facilitation and influencing skills. It also requires understanding your company's informal values and beliefs, and how they impact successful implementation of a customer-centered organization. Once an organization is customer-centered, it tends to foster customer advocates at the individual level.

Measuring Customer Loyalty

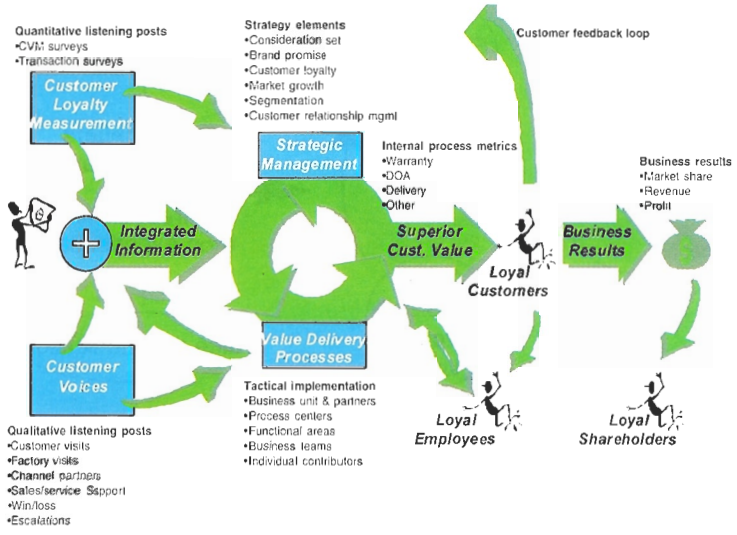
The customer loyalty survey mechanism will measure what customers value to gain strategic insights that will be used to increase customer loyalty. This is your quantitative listening post.

The questions and whom you ask determine the window through which you ultimately view the customer landscape. Unfortunately, many companies' approaches lead to incomplete data and a subsequently flawed "customer picture." That's why it's crucial to measure all customers. Sample the entire market of your customers and those of your competitors. (See Exhibit 4, page 30) Design your survey questions around key attributes of customer requirements pertaining to what they value.

The entire design of your survey is key to the rest of your efforts. Each respondent should rate your company and, at minimum, the best other vendor for

EXHIBIT 3

An integrated customer value measurement system



all attributes. Your questions should measure the respondent's direct, *experience-based* beliefs and indirect, *non-experienced* ones. For example, measuring satisfaction alone of your product or services will not tell you how your customers perceive your value relative to the competition. By measuring both types of beliefs, you will greatly increase your competitive insight about what critical few value delivery and value communication areas to focus on improving. You should also specifically target the "purchase or buy" decision makers and their influencers.

Use of a consistent and common survey framework across relevant businesses will give you additional insights by allowing for meaningful comparisons of performance ratings and driver importance. Business unit product family surveys could be contrasted and compared to the overall survey and against each other. The consistent survey framework also allows businesses with multiple products to see which ones detract from their overall brand image. It's difficult to gain these strategic insights without using a common and consistent approach.

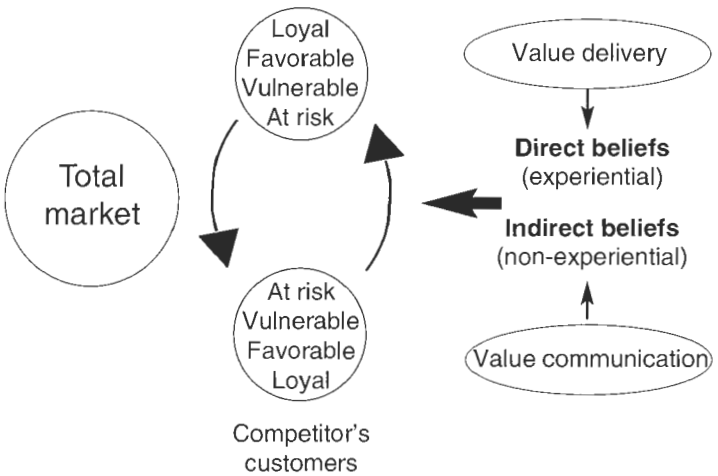
Survey Insights

A properly designed survey that effectively measures what customers value yields strategic insight into these areas of customer value management:

Basic requirements–Inclusion in the consideration

EXHIBIT 4

Measure all customers



set requires a minimum viable total value package of products *and* services aligned with the brand promise.

Customer loyalty–The key to profitable growth is building customer loyalty in your targeted segments. First, stop defections by removing the dissatisfiers that push your customers toward the competition. These "points of pain" often result from a failure to execute well in the business basics, such as an excessive call center response time. Next, improve satisfaction in the key attributes of the customer value propositions used to differentiate your products and services from competition in the targeted customer segments. Finally, reduce customers' vulnerability by moving them up the loyalty ladder beyond the reach of competitors. Typically, this requires a deep commitment to the execution of a customer intimacy strategy creating the best possible solution to meet customer needs. In his book on the subject, Fred Wiersema points out that this strategy establishes and maintains close win-win customer relationships.

Market share growth–Share growth is obtained by improving your competitive position and in winning your competitor's customers. However, research shows it costs five times as much to replace a customer as it does to keep one.

Brand image–A company's brand image–the "Promise of the Brand"–is the largest asset it owns. Every key "moment of truth" that your customers experience either reinforces or detracts from your brand image. Continuously reinforcing the company's brand image should be an ongoing business fundamental.

Customer segmentation–Your survey questions can yield important strategic insights into new segmentation categories and emerging markets. The strategic insight you can gain will allow you to segment based on what customers need and what's important to them.

Integrating Survey Results

By including questions pertaining to your organization's strategic priorities, the survey results can help drive the strategic planning process. It's also best to get the management team to agree on the organization's strategic priorities before designing the survey or seeing the results. For example, many management teams believe their primary goal is to attract new customers and facilitate sales. By agreeing on the priorities beforehand, the survey results are less likely to be misdirected toward supporting "hidden agendas" or maintaining the status quo.

Given that research shows more than 80% of profits typically comes from less than 20% of customers and that it costs five times as much to replace a customer as it does to keep one, companies in mature markets will give a higher priority to customer retention than customer acquisition. An exception is high-technology companies in discontinuous markets requiring rapid development of innovative products.

In the new math of value management, former business success strategies such as cost reductions, core competencies, reengineering core processes, empowered learning organizations, and fast cycle time are shifted into the business fundamentals of meeting basic requirements. Getting to market quickly with a minimum viable product and services, aligned with the promise of the brand, is required *just* to be in the consideration set. This gets us on the playing field, but doesn't mean we will win. To win we must add the superior value needed to retain current customers and acquire new ones.

The survey results also can help align the management team around what customers value. Unfortunately, the management team's perception of the value drivers often is not closely aligned with the customer's reality. You can help gain the management team's attention and commitment to action by having them take the survey first. Then,

compare their perception of the customers' perspective with the actual survey results.

Based on the strategic prioritization of the survey results, the value improvement areas should be condensed down into one simple, easy to understand slide. The senior management team can use this slide to communicate to all levels of the organization. It will show how people, resources, money, and time should be prioritized. The message should be simple enough that everyone in the organization understands it and can articulate it to others. Exhibit 5 shows the recommended strategic prioritization for mature markets.

The slide can be used as a crude resource allocation tool during business cycles. During business down cycles, cost-cutting efforts should be prioritized toward the top of the pyramid. It can be used as a tool to evaluate the effectiveness of organizational effort. If more check marks are at the top than the bottom of the pyramid, the organization is achieving less than optimal effectiveness due to over-investing in lower priority strategies. For example, the management team cannot effectively pursue a strategy of raising the loyalty of vulnerable customers without first removing the dissatisfiers plaguing them.

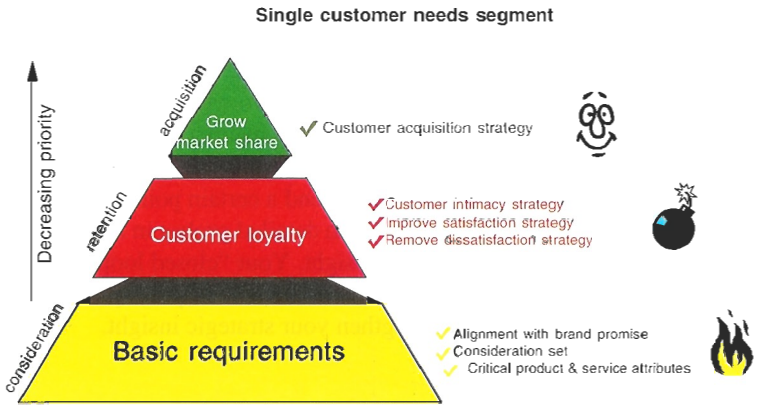
Hearing the Customer's Voice

Along with directly measuring what drives customer loyalty, you will want a systematic way to collect, collate, and analyze the verbatim responses of your customers and non-customers. Qualitative listening posts complement the quantitative data to provide an important "word on the street" view of what customers think. These listening posts can include customer call center data (pertaining to sales, service, and support), online requests (via e-mail and the Internet), sales call reports, customer and non-customer interviews, and focus groups.

The challenge is to synthesize the information into non-contradictory actionable data. New customer contact software exists that enables organizations to track and integrate the information generated by the various listening posts. If you need to work within the confines of legacy systems, we suggest you identify two or three listening posts that are easily accessible, global in scope, real time, and capable of generating the information required. Focus on these and add additional voices once you have a well-established process flow and adequate personal resources.

EXHIBIT 5

Strategic priorities



Taking Action

Customer loyalty measurement will surface key attributes as the top loyalty drivers. Your organization will make improving these areas a strategic priority and want to know what specific actions can be taken. Often the survey results won't tell you because detailed actionable "drill-down" questions weren't asked.

The solution is to use the customer anecdotal information gleaned from the customer listening posts to identify detailed tactical actions. This will provide the customer details or "face" to the results, to make what needs changing real. This approach will assist the business unit CAM in selling the need for changes to the organization. When the business unit CAM can supplement the quantitative survey results with quotes from customers and non-customers, it's more likely that the need for change will be accepted. The results can also be used to establish goals with detailed actionability and accountability

Linking your quantitative survey results to the customer listening posts will answer the question "what do I do to improve?" However, it won't tell you how far to go. For example, today it's fashionable for companies to talk of delighting customers in the hopes of creating customer advocates. However, no organization has the time, money, or resources to delight customers in all value dimensions. Organizations also can't address every customer voice issue that arises from customer feedback. By linking your qualitative and quantitative customer feedback process, your organization can pinpoint its strategic change priorities and allocate scarce resources to the critical few.

For example, consider delivery time. Many

customers consider this attribute a key experience. For some high-value industrial products, a two-week delivery time represents the norm. Quicker delivery may actually be perceived negatively because it requires earlier payment that may not be budgeted. Exhibit 6 shows that in some countries, a delivery time of less than two weeks reduces the perception of value. For consumer products, an analysis of warranty period may show a similar decrease in value beyond a certain point. A properly designed survey with detailed probes in key areas can provide this insight. Your "closed loop" process will allow continual refinement of your quantitative survey to strengthen your strategic insight.

Linking Value to Profit

By combining the costs and predicted sales revenues, you can determine the maximum profitability for a single value dimension. Exhibit 7 shows that this point occurs for a two-week delivery time. Efforts to improve the delivery further represent a waste of scarce resources because it won't help to create customer advocates or provide a competitive advantage. For consumer products, a similar analysis could determine the optimum point for warranty period or call center response time.

By linking value improvement to loyalty and profitability, you can also gain insight in how to convert what your organization considers a cost center to a profit center. For example, an organization may view the critical processes associated with the customers' key moments of truth as cost centers. A good example is technical support. Many organizations want to reduce these costs. However, spending more money on this process may instead increase competitive advantage and profitability.

Taking this concept further, today's competitive advantage arises from a *strategy* of optimizing the customer's perception of delivered value across all key dimensions simultaneously. The end result is competitively superior loyalty and profitability *metrics*. Your organization will sustain its competitive advantage by having a deeper understanding of your customers than the competition and by using this knowledge to allocate resources optimally in hundreds of difficult to copy ways. This way, your company can marshal a more effective and efficient use of scarce resources in the generation of a competitively superior total value package.

Establishing the link to profitability is a critical success factor. Top management faces ever-increasing pressures to improve profitability by reducing costs. A value improvement strategy that increases costs will not be able to gain the buy-in of top management unless a clear and credible link between value improvement, loyalty and profitability has been established. That is, there must be an exchange of value between the company and the customer.

The link to profitability is a key element in operationalizing the value-exchange optimization concepts articulated by Alan Grant and Len Schlesinger. In their 1995 *Harvard Business Review* article, they define, "operational excellence as the ability to deliver the targeted value exchange efficiently and effectively."

Value Delivery System

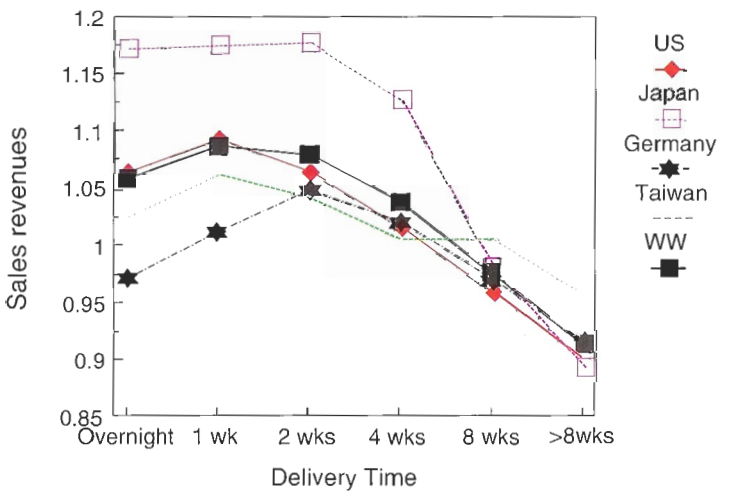
All businesses operate as a value delivery system whether it's consciously understood or not. Today's businesses rely on a network of partners, distributors, alliances, technology developers, field engineers, and suppliers who together deliver value to target customers. Increasing customer loyalty depends on actively managing the "whole customer experience" in the pursuit of delivering superior value, loyalty, and profitability. Within the framework of the customer value management system, value-exchange optimization provides the context for value delivery system improvements.

Internal Process Metrics

Many organizations monitor an overwhelming amount of metrics. Unfortunately, these are often

EXHIBIT 6

Sales revenues vs. attribute performance level



historical in nature, internally focused, not linked with the planning system or strategic priorities, or correlated with the customer's perception of value.

"All organizations start with an almost overwhelming network of financial measures in place. Add to that measures driven by past problems, shifting emphasis of new managers, and the new corporate programs...The result is a collection of largely unrelated and unmanageable measures, leading in many cases to 'measurement gridlock'."

—Geary Rummler and Alan Brache, *Improving Performance—How to Manage the White Space in the Organization Chart*, 1991

Many of these monitoring efforts don't contribute to meeting business goals. If your organization is in this situation (and many are), we recommend evolving the existing measurement system into a more customer-focused and predictive one. First, identify and then monitor the performance level of the handful of internal process metrics, which represent key drivers of customer loyalty.

Internal process metrics are leading indicators of the customer's perception of delivered value. A customer's perception of your company–relative to the competition–determines their loyalty and is a leading indicator of market share, revenues, and profitability. Although they lag internal metrics, customer loyalty metrics are still required to provide quantitative, unbiased closed-loop feedback into the business unit's strategic management system. They yield the deep understanding of customers necessary to determine which processes to monitor and performance levels needed to maintain competitively superior customer value in a constantly changing business environment.

Once identified, the key internal process metrics are superior at identifying fine-grained and early changes in delivered value. They can be monitored monthly or quarterly with a high degree of precision. By partially substituting for survey metrics, they have the added advantage of reducing survey costs and the glut of surveys customers receive. The customer value surveys need only be fielded as frequently as necessary to monitor changing market conditions. We recommend yearly ones in slowly changing markets and bi-yearly ones in more rapidly changing markets.

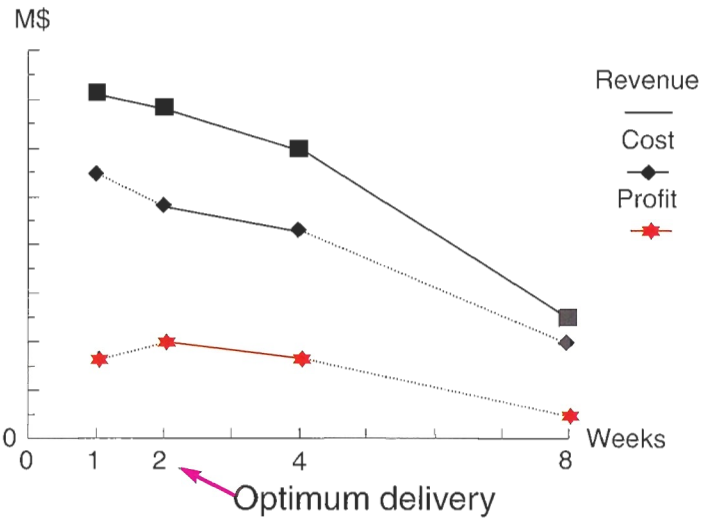
The Balanced Scorecard

The Balanced Scorecard concept as articulated by Robert Kaplan and David Norton measures performance across businesses key dimensions. It expands measurement from financial measures only to include predictive customer, internal process, and organizational growth and learning measures. An integrated customer value management value system for improved customer loyalty and profitability creates a set of inputs vital in the use of the Balance Scorecard. (See Exhibit 8, page 34.)

The result will monitor strategic priorities, while creating more alignment between business objectives and needed behavior. It gives a business an effective "control panel" to know early on if it is meeting critical objectives. The planning and measurement system will also work more effectively together, to support timely, informed decision making and a shared vision about organizational priorities.

EXHIBIT 7

Defining superior value at superior profit



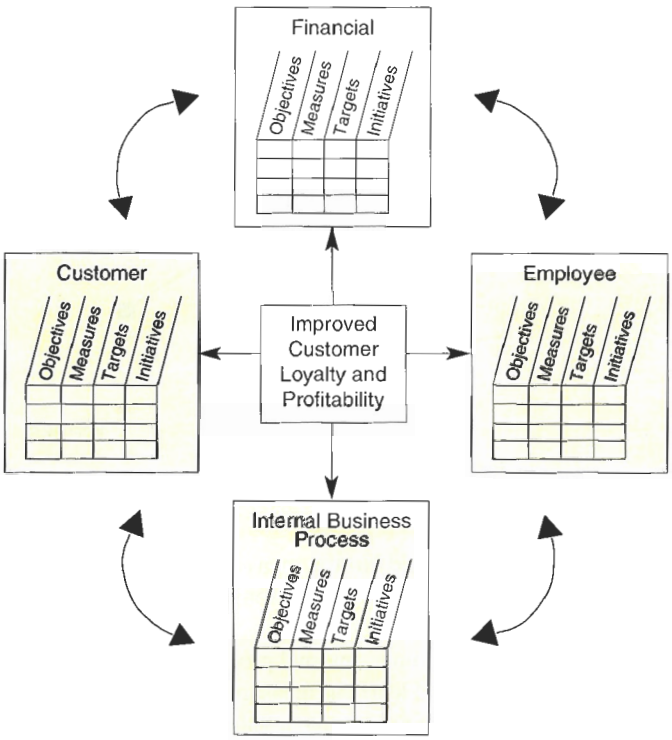
Conclusion

By implementing what we have described in this article, your business will know how to deliver superior value, loyalty, and profitability. Use of the integrated customer value management system for improved customer loyalty and profitability will optimize the exchange of value between the company and the customer.

For many companies, the challenge of aligning a customer focused strategy within and between the organizational fiefdoms is a daunting task. However, the business payback makes the effort more than

EXHIBIT 8

The balanced scorecard



Adapted from: Robert S. Kaplan and David P. Norton, *The Balanced Scorecard*, 1996

worthwhile. Creating a system to assess and monitor customer assets will allow organizations to thrive in the new business environment. ■

Additional Reading

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About the Authors

Ross Goodwin is the Customer Loyalty Manager for Hewlett-Packard Corporate Quality in Santa Rosa, California. He is leading the implementation of a company-wide measurement to assess competitive position in customer loyalty. He also consults HP businesses on competitive assessment of customer loyalty and use of customer and market knowledge in strategic planning and entity management. Previously, he was a divisional Customer Value Manager and turned a tactical customer satisfaction program into a division-wide customer value strategy. Ross began his career with Hewlett-Packard in 1980. Ross earned a B.S. in Mathematics and Physics from Sonoma State University and an MBA from the University of California at Berkeley.

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Authors' Note

The authors will be presenting an expanded version of the findings reported in this article at the 11th Customer Satisfaction and Quality Measurement Conference co-sponsored by the American Marketing Association and the American Society for Quality, to be held in Anaheim, March 1999.