IVEY BUSINESS JOURNAL
IMPROVING THE PRACTICE OF MANAGEMENT

Winning customer loyalty is the key to a winning CRM strategy

By Darrell K. Rigby, Frederick Reichheld and Chris Dawson

Reprint # 9B03TB01

IVEY MANAGEMENT SERVICES • March/April 2003

Ivey Business Journal Online
is published by Ivey Management Services
a division of
the Richard Ivey School of Business.
For subscription information,please contact:
Tel: (519) 661- 4215
Email: ibjonline@ivey.uwo.ca
or visit
www.iveybusinessjournal.com

Winning customer loyalty is the key to a winning CRM strategy

Form follows function, and the one practice that illustrates this truism best of all, perhaps, is customer relationship management. For example, when choosing a CRM technology, realign your organization and processes to fit your customer strategy, and then choose the appropriate technology. As these authors maintain, tailoring the technology to the company's business processes and culture is just as important as tailoring the business processes to the strategy.

By Darrell K. Rigby, Frederick Reichheld and Chris Dawson

Darrell K. Rigby is a director of Bain & Company in Boston and the founder of the firm's annual management tools survey. Frederick F. Reichheld is a director emeritus of Bain & Company and a Bain fellow. He is the author of The Loyalty Effect (Harvard Business School Press, 1996) and Loyalty Rules! (Harvard Business School Press, 2001) Chris Dawson is a vice-president in the Toronto office of Bain & Company. He leads Bain's Canadian loyalty practice.

Customer Relationship Management (CRM) is wildly popular, very expensive and hard to resist. Yet many executives remain unhappy about CRM and its lack of results. A Bain & Company survey has shown that 72 per cent of executives planned to use CRM by the end of 2001. Still, CRM ranked fourth from last out of the 25 tools we tracked for executive satisfaction. Tellingly, one in five executives had abandoned CRM altogether, saying that it drove away valuable customers.

Why are so many executives unhappy about a management tool that's so popular? Why do so many CRM projects fail?

We've spent the last decade analyzing customer-loyalty initiatives, successful and unsuccessful, at more than 200 companies in a wide range of industries. Based on our research, we believe CRM fails because most executives don't know what they are buying or how to get the most out of this powerful tool. Most of the time, they're so enthralled by the fancy technology that they don't start at the beginning-by deciding who their target customers should be. Yes, CRM software can help to answer that question. But CRM cannot eliminate the hard work it takes to create a customer-focused organization that wins customer loyalty over the long term.

Why is winning customer loyalty so crucial? Several years ago, in The Loyalty Effect, Bain & Company documented the outstanding financial results you can achieve by cultivating customer loyalty: A five-per-cent increase in customer retention increases profits by 25-95 per cent. The reason? It costs so much to acquire customers that many of these relationships are unprofitable in the early years. Only later, when the cost of serving loyal customers falls and the volume of their purchases rises, do relationships generate big returns. That finding prompted a lot of executives to search for ways to keep their customers loyal.

Their enthusiasm is not surprising, especially now. With the arrival of the Internet, it's harder than ever to keep a customer. They have far more choices, and a couple of clicks allow them to check out the competition for a better deal. Churn has gone up. In fact, a company with a seemingly impressive 90-per-cent retention rate will lose more than half of its customers in five years. When times are tough, who wouldn't want to increase profits and reduce costs, just by keeping more of the customers you already have?

CRM is a powerful tool-in the hands of someone who knows how to use it-but it can backfire when used improperly. Many executives, for instance, have used

CRM to gather information on all their customers, so that they can tailor their offering to the needs and desires of each one. Unfortunately, micro marketing to a segment of one suffers from several flaws. For one thing, catering to a segment of one is wildly expensive. Second, companies learned more about their customers than they wanted or needed to know. They got bogged down in data, and therefore couldn't use the information effectively.

As we describe in this article, the proper use of CRM will lead to solid, lasting and profitable customer relationships.

You need to make sure that your company's job descriptions, performance measures, compensation systems and training programs back up your customer strategy-rather than undermine it.

Start with your strategy

For all its power, CRM cannot replace a sound, customer-focused strategy. In fact, you'd better have one in place before you even consider buying CRM software, because if your strategy is not customer-focused, CRM will not help you.

To develop a customer strategy, you need to start by asking a deceptively simple question: Who is your target customer? Successful businesses, like Dell and Wal-Mart, know exactly which customers they want and how valuable they are; they relentlessly seek to exceed those customers' expectations. On the other hand, if you don't know who your most attractive customers are, you may wind up a Kmart not a Wal-Mart, a Compaq not a Dell, trying to appeal to too many segments and failing to capture the most attractive ones.

As you're developing your customer strategy, you need to ask some other penetrating questions:

- Who are your most profitable customers? What drives that profitability?
- Why do they buy from you, and not your competitor?
- What percentage of the population do these profitable customers represent? Can you find more customers like them?
- What do you have to do to make these profitable customers do more business with you?
- How are you going to manage the less profitable customers to cut the cost of serving them?

We're talking about customer segmentation analysis. Until you know who your profitable customers are, you can't make proper use of the powerful tool that is CRM. It can help you in many ways-for instance, in analyzing customer revenue and cost data; in identifying current and future high-value customers; or in capturing data on consumer behaviour related to products and services. But the CRM software is no substitute for the hard job of crafting a unique strategy for acquiring and building relationships with customers, and then retaining them. Some companies work out their customer-focused strategies without any help from the new software. Wal-Mart, for example, figured out exactly who its customer was long before CRM software was created.

Or consider the case of *The New York Times*. When the paper wanted to expand, it spent years researching core customers and saw a lot of potential in readers outside New York City. Then, in an effort to appeal to these non-New Yorkers, the *Times* improved local distribution to allow for earlier delivery, and customized weather reports and TV listings. The effort has paid off handsomely. *The New York Times* is growing in a relatively flat industry, and it has a customer retention rate of 94 per cent in an industry that averages 60 per cent. All this occurred long before the *Times* acquired CRM, which it's now using to automate some processes.

Focus your organization on the customer

Even the most insightful customer-focused strategy will go nowhere unless your organization is set up to reflect and support that strategy. In fact, knowing whom your customer is-and what he or she wants and needs-will inform your decisions on shaping your organization. You need the right people in the right place, with the right incentives, to deal properly with the customer.

Here's an example of what we mean. Say you're a bank, and you've set up a 1-800 number for customer service. When the customer calls, your CRM system identifies the caller and sends the unprofitable ones to a call centre, while the high-value customers are switched to a customer representative. But if that person doesn't have the authority or the competence to deal with the profitable customer's inquiry, the CRM investment is wasted.

Technology can't replace effective human interaction. You need to make sure that your company's job descriptions, performance measures, compensation systems and training programs back up your customer strategy-rather than undermine it.

Dealing with the human component may not have the sex appeal of buying a fancy $100-million software system or taking over a company. It boils down to the basics: What does the salesperson say to the customer? Once again, CRM technology can help you institute the best customer-focused process. It can process transactions more quickly; for instance, provide better information to your front line, and manage logistics and the supply chain more efficiently. Technology won't, however, replace hard work on the sales floor.

Sometimes an organization's own reward system can defeat the hard work of its best employees. A case in point is a major Canadian drug retailer. It discovered that the second most significant driver of a store's profitability (after the proximity of a competitor) was the tenure of the store-manager/pharmacist. Why? Half of the stores' profits were generated by just over 10 per cent of customers-the ones who purchased drugs they needed to take every day. These customers liked dealing with a pharmacist they knew. More important, they trusted him; they valued his advice. Yet the retailer's analysis revealed a serious problem: The store's compensation system was destroying that link between customer and pharmacist. The store rewarded success by transferring the pharmacist/manager to a bigger store somewhere else.

No CRM system will show you that the human connection drives loyalty. What's more, CRM could potentially lead an executive to replace the human connection with a technological one.

The insurance company USAA, on the other hand, understands the value of orienting the organization to retain the loyalty of profitable customers. The premier insurer of military personnel and veterans, USAA was historically organized into six regional units, each comprising large functional departments (claims, underwriting, policyholder services, etc.) Today, in response to a greater understanding of what customers value, those six units have been broken into 110 teams, each of which focuses on the specific needs of smaller and more uniform segments of customers. Within these teams, the thousands of phone reps were split into groups of 10 or 12. The members of each group work out their own schedules and vacations, solve problems together, and are evaluated together. Team members know the regional idiosyncrasies of the insurance business. They also know their customers-and each other-better than they did under the old system. Customers value the "small company touch." And USAA's former CEO, Bob Herres, believes the small-team structure is a key reason USAA has been able to grow and maintain one of the highest retention rates in the industry, while shrinking its bureaucracy.

Think technology: How much CRM do you need?

Once you've built a customer-focused strategy and backed it up with the appropriate organization, ask yourself how much CRM technology you need. More is not necessarily better. In fact, successful CRM operations are very often low-tech. Think about how you can motivate and mobilize your employees, for example. The key is to strike the right balance between people and software. Tailoring the technology to the company's business processes and culture is just as important as tailoring the business processes to the strategy.

Consider Enterprise Rent-A-Car, which has 45,000 employees and more college recruits than any other U.S. company. Enterprise counts on its employees to implement the company's customer relationship strategy, so it takes great care in hiring and retaining employees. The company targets people who want a "real-life MBA," and tests both the IQ and the emotional intelligence of job applicants. Recruits start out in the branches serving customers and giving them the personal touch-like a ride home-that has made Enterprise the largest car-rental company in North America. What's more, profit sharing and a generous compensation scheme have contributed to an employee retention rate that has helped Enterprise to grow 20 per cent per year in a relatively flat market. That careful selection of employees paid off after the 9-11 disaster, when stranded travellers flooded car-rental outlets across the nation. Although Enterprise does not have a system for one-way trips, branch managers waived the penalties and offered customers one-ways. Three days later, it became company-wide policy. Enterprise will surely win the loyalty of customers it helped in those dark days.

our research shows that the prime driver of customer loyalty is the loyalty of the company's employees

Some companies mix it up. Wal-Mart is a great example of a company that uses a blend of high-tech solutions and high-touch employees-like flesh-and-blood greeters-to increase customer loyalty. Wal-Mart lets technology work behind the scenes. Its CRM data warehouse is one of the largest in the world, tracking exactly what the customers purchase. As a result, Wal-Mart stocks more of the most popular merchandise, and clusters items that people tend to buy at the same time. But Wal-Mart does not use the technology to build profiles of individual customers by gathering addresses and phone numbers. Instead, Wal-Mart leaves that job to its local employees, who know their regular customers and understand their needs.

On the high-tech end is a company like Square D, a market leader in electrical distribution, industrial control and automation products, systems and services. After realigning its business processes, the company literally brought all 16,000 of its employees into the digital age. It streamlined the processing of customer queries by consolidating all of its call centres in one information centre. Among other innovations, sales engineers now utilize "middleware" technology to create proposals, via a plug-and-play menu, on the basis of what the factory can actually deliver on time in a cost-effective way.

1The level of CRM technology you choose, then, ought to depend on your company's strategy and its processes. Above all, don't fall into the trap of buying an expensive high-tech CRM solution just because it's there. Consider the case of Mshow, a company that produces training and marketing programs via the Internet. The company invested $300,000 to equip its sales force with a "killer app" designed to boost their performance. In reality, however, the sales force never intended to use the software. So Mshow pulled the application, spent more time figuring out what would help the sales force, and installed a more suitable system.

You're building a relationship

Customer Relationship Management is, above all, about building a relationship with your most valuable customers. You need to know your customers well enough to determine what kind of relationship they want to have. Do they want an open relationship? Or would they prefer to be anonymous? If your customers wish to be left alone, don't make the mistake of pestering them with questions and offers of more goods or services. They'll sense they're being manipulated rather than managed.

Getting to know your customer doesn't necessarily mean investing in the biggest and most powerful data-gathering tools available. Building loyalty doesn't mean asking customers for their phone number every time they buy something from you. Good relationships and trust are built over time, with give and take on both sides, and not too much pressure.

Here's a suggestion: Profile your best customers. Find out who they are and what they buy. Then map what we call "the customer corridor"-the entire life cycle of a valuable customer at different stages of his relationship with your company. This map will tell you a lot about the kinds of customers you have. If you use it as a jumping-off point to conduct limited focused research, it can help you to identify your customers' unmet needs, without launching a full-scale investigation.

Technology won't create loyal customers

CRM software can help increase customer loyalty in many ways. It can track customer defection and retention levels. It can tell you how satisfied your customers are. But in the end, technology is not the answer.

In fact, our research shows that the prime driver of customer loyalty is the loyalty of the company's employees. When Bain analyzed the auto service business, for example, it found that the highest rates of customer loyalty were in local garages, because they had the highest rate of employee retention. Although most customers felt that mechanics at the chain outlets possessed better training and equipment, they liked dealing with the local guy, the guy they knew. Customer loyalty hinges, as it always has, on committed teams of high-calibre employees-the kind who exceed the customers' expectations, rather than just grudgingly meeting them.

If CEOs expect their employees to do what's needed to cultivate strong bonds with profitable customers, they must understand what loyalty is. Loyalty demands that profits be earned through the success of the company's partners, not at their expense. Furthermore, loyalty can be earned only when leaders put the welfare of their customers and their partners ahead of their own self-interest. This doesn't mean sacrificing financial gain. In fact, the loyalty leaders we surveyed in the 1990s enjoyed robust stock price appreciation; their stock price grew at twice the rate of their competitors'.
Still not convinced? Think of managing in a downturn. That's when leaders must rally their partners to fight rather than switch; customers, employees, dealers and suppliers must join together to find a solution. Unless leaders have built relationships based on loyalty to something more fundamental than today's earnings or stock price, then nothing will keep partners or customers from jumping ship the instant a better opportunity comes along.

So, then, how do you achieve the promise of CRM profits? Start with customer strategy, realign your organization and processes to fit the strategy, and then choose the CRM technology that's appropriate for your strategy and your processes. It's not simple, and it takes a lot more than a 90-day technology fix. But it works.