The CRM Value Chain

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The meaning of those three letters, CRM, is hotly contested. For some, CRM is simply a bridge between marketing and IT: CRM is therefore an IT-enabled sales and service function. For others it's little more than precisely targeted 1-to-1 communications.

But both of these views deny CRM its great potential contribution. Because CRM, at its most advanced, answers questions like 'who should we serve?' and 'what should we serve to them?' and 'how should we serve them?' it could, and often should, be positioned as the fundamental strategic process around which the business is organised. CRM decisions impact on marketing, certainly, but also on operations, sales, customer service, HR, R&D and finance, as well as IT. CRM is fundamentally cross-functional, customer-focussed business strategy.

The CRM value chain

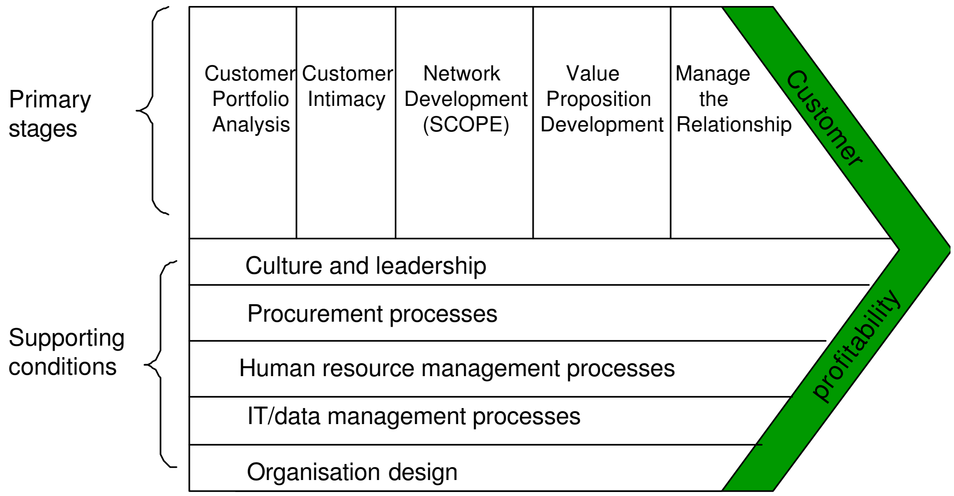
The CRM value chain (figure 1) is a proven model which businesses can follow when developing and implementing their CRM strategies. It has been five years in development and has been piloted in a number of business-to-business and business-to-consumer settings, with both large companies and SMEs: IT, software, telecoms, financial services, retail, media, manufacturing, and construction. The model is grounded on strong theoretical principles and the practical requirements of business.

The ultimate purpose of the CRM value chain process is to ensure that the company builds long-term mutually-beneficial relationships with its strategically-significant customers. Not all customers are strategically significant. Indeed some customers are simply too expensive to acquire and service. They buy little and infrequently; they pay late or default; they make extraordinary demands on customer service and sales resources; they demand expensive, short-run, customised output; and then they defect to competitors.

What is a strategically significant customer?

We've identified four types of strategically significant customer (SSC). Self-evidently, the high life-time value customer is a key SSC. These must be the focus of customer retention efforts. Life-time value potential is the present-day value of all future margins that might be earned in a relationship. Tempting as it may be to believe, not all high volume customers have high LTV. If they demand JIT, customised delivery, or are in other ways costly to serve, their value may be significantly reduced. We know of one company that applied activity-based costing disciplines in order to trace process costs to its customer base. They found that 2 of their 3 biggest customers were in fact unprofitable. As a consequence the company re-engineered its manufacturing and logistics processes, and salespeople negotiated price increases.

Figure 1: CRM value chain



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A second group of strategically significant customers we call 'benchmarks'. These are customers that other customers copy. A manufacturer of vending machine equipment is prepared to do business with Coca Cola at breakeven. Why? Because they can tell other customers that they are supplying to the world's biggest vending operation.

The third group of SSCs are 'inspirations', customers who inspire change in the supplying company. These may be customers who find new applications, come up with new product ideas, find ways of improving quality or reducing cost. They may be the most demanding of customers, or frequent complainers, and, though their own LTV potential is low, they offer other significant sources of value. One insurance company modified its claims process to satisfy one particular car fleet operator; this process eventually became the company's default standard.
The final group of strategically significant customers we call 'cost magnets'. There are customers who absorb a disproportionately high volume of fixed cost, thus enabling other, smaller customers to become profitable. One oil-seed processor, for example, has two major customers, a manufacturer of snack foods which buys oil in bulk and a retail multiple which buys consumer packs. Although they account for 60% of oil-seed processing time, they absorb 85% of fixed costs between them.

<u>Five steps to profitable relationships</u>

The five steps in the CRM value chain are customer portfolio analysis, customer intimacy, network development, value proposition development and managing the relationship. Although we don't discuss them here, at each stage of the value chain there are concepts, tools and processes to help create and implement successful strategy.

Very briefly, the CPA step analyses the customer base to identify customers to target with different value propositions. The second step involves the business in getting to know the selected customers as segments or individuals and building a customer data-base which is accessible to all those whose decisions or activities impact upon customer attitude and behaviour. Step three involves building a strong network of relationships with employees, suppliers, partners and investors who understand the requirements of the chosen customers. Step four involves developing, with the network's compliance, propositions which create value jointly for the customer and company. The fifth and final stage is to manage the customer relationship. The focus here is on both structure and process.

From observation of failure it is clear that CRM solutions cannot be transplanted into any organisation in the absolute certainty that the business will flourish. For success to happen, CRM needs a supportive culture: it's unlikely to yield dividends in companies which only pay lip service to customer focus. Neither will it succeed in organisations wedded to product-based structures or reward systems based on sales volume. Similarly, if IT, human resources and procurement processes are not aligned with the CRM agenda, it's unlikely to flourish. For example, we know one IT company which is trying to implement CRM strategy whilst still recruiting up-and-at-'em salespeople who are quota driven. Another company is in the throes of a cost-reduction programme and procures least cost inputs to its manufacturing process without due regard to the impact on customer satisfaction and buying behaviour.

Customer Portfolio Analysis

CPA, the first step in the CRM value chain acknowledges that not all customers have equal value to the company. CPA asks the question: 'who are our SSCs?' The answer can be pitched at sector (e.g. food retailing), segment (e.g. food retail multiples) or individual (e.g. Tesco) levels. Companies which have no customer history on which to base their analysis can use segmentation approaches to identify potential SSCs. When CPA has sorted the actual or potential customer base into different groups, they can be taegeted with different value propositions. An important consideration is to analyse and sort by profit potential, not by volume, whether that is by sector, segment or individual.

One CPA tool sorts customers into 4 strategic groups: sack, re-engineer, nurture and invest. Sackable customers are those who have no present or future profit potential or life-time value. The 'invest' group contains customers who are both valuable currently and have significant future potential. The 're-engineer' group contains customers who are not presently profitable but who could become so if the relationship were re-engineered. Options may include reducing the level of customer service, disintermediation, or telesales, rather than face-to-face sales representation. The final segment 'nurture' contains those customers who are currently profitable but have little future potential. The task here is to address, possibly in consultation with those customers the reasons for pessimism. It may be that they can jointly find solutions which suggest a more profitable future relationship.

Customer intimacy

Choosing customers to serve is one thing. Getting to know them well is altogether different. Most companies collect customer data. Some industries are overwhelmed with information – scanner data, loyalty card data, complaints files, market research, geodemographic data. The challenge is to use the data to better understand the who, what, why, where, when and how of customer behaviour. Mining data intelligently is, of course, a source of huge competitive advantage, and it enables a more refined CPA to be undertaken.

Develop the Network

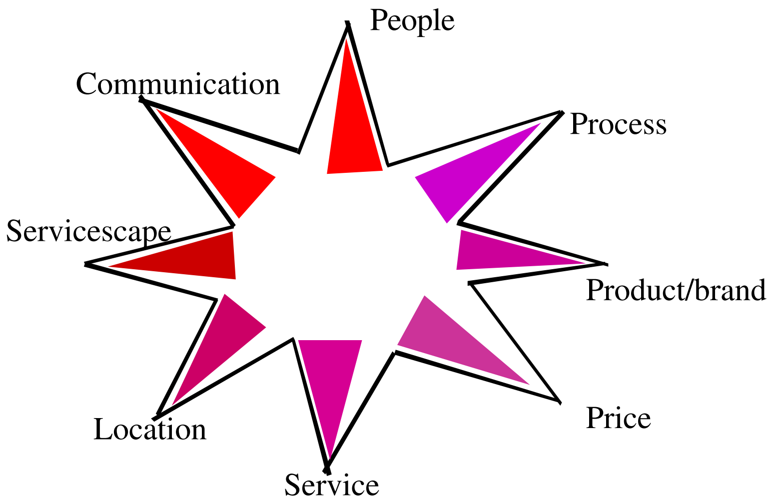
Company does not compete against company. Network competes against network. For example, Sainsbury does not compete against Tesco. Their respective networks compete. Tesco's network, which includes partners such as Royal Bank of Scotland (for its retail banking offer) and Privilege Insurance (for its insurance offer) currently seems to be performing better than Sainsbury's. A company's network position i.e. its connectedness to other parties who co-operate in delivering value to the chosen customer, is a source of great competitive advantage. An innovative software house partnering with IBM, for example, enhances its network position. IBM also benefits, as well as their joint customers.

Networks consist of partners like these, employees, suppliers and owners/investors. CRM is not a quick fix; it requires owners and investors who will commit to the long-term investment in the people, processes and technology to implement CRM strategies. Employees will probably need reorienting and reskilling, if not redeployment. There is clear evidence that employee performance in moments of truth with customers influences customer satisfaction and purchasing intention. It only takes a short leap of faith to link employee satisfaction to customer satisfaction to business performance. Suppliers also need to understand who the customer is trying to serve. According to the consultants A T Kearney, companies are going to continue vendor reduction programmes over the next several years, as they try to build closer relationships with fewer partner vendors. CRM is becoming twinned with SRM, supplier relationship management. Kearney reckons 20% of current in-suppliers will be de-listed by 2003. For CRM to succeed, the network of suppliers, employees, owners/investors and partners must be aligned and managed to meet the needs of the chosen customers.

Value proposition development

By the fourth step of the CRM value chain, you will know who you want to serve and will have built, or be in the process of building, the network. Now the network has to work together to create and deliver the chosen value(s) to the selected customers. Great value is found more effective and more efficient solutions of customer problems. Although it is traditional to focus on the product as the main source of value, many companies are finding that people, process and service offer more competitive advantage as products become more commoditised. How things are done with and for customers - process - is particularly important. There may be small processes, such as how complaints are handled; or big processes, such as how new products are jointly developed with customers. The value star (figure 2) illustrates sources of customer value in a retailing context.

Figure 2: The value star (retail example)



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Managing the relationship

For relationships to succeed with strategically significant customers, companies are having to re-invent structures and process. On the way out are hierarchical structures and product managers. Replacing them are flatter organisations with empowered front-lines and customer or market managers. We encourage companies to replace their single marketing strategy with a trio made up of a Customer Acquisition Plan, Customer Retention Plan and Customer Development Plan. Each of these has different metrics from those found in run-of-the-mill marketing strategies. New measures include customer acquisition costs, customer retention rates, share-of-customer and customer development targets alongside more conventional measures such as customer satisfaction and sales volume, and additional measures relating to the performance of network members..

Final thoughts

CRM is widely misunderstood by marketing management and seriously misrepresented by software houses. Companies are being sold front-office and back-office solutions, but are missing out on the fundamental, strategic benefits that CRM can provide. CRM at its most sophisticated has the potential to integrate all business processes around the requirements of strategically significant customers, a fact that most IT solutions fail to acknowledge.