

Logistics and customer value

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Earlier in Chapter 1 the mission of logistics management was defined simply in terms of providing the means whereby customers' service requirements are met at lowest cost. In other words the ultimate purpose of any logistics system is to satisfy customers. It is a simple idea that is not always easy to recognise if you are a manager involved in activities such as production scheduling or inventory control which may seem to be some distance away from the marketplace. The fact is of course that everybody in the organisation has a stake in customer service. Indeed many successful companies have started to examine their internal service standards in order that everyone who works in the business understands that they must service someone – if they don't, why are they on the payroll?

The objective should be to establish a chain of customers that links people at all levels in the organisation directly or indirectly to the marketplace.¹ Xerox is a company that has worked hard to implement the idea of the internal customer. They have even extended the idea to the point of linking bonuses to an index of customer satisfaction. In organisations like Xerox, managing the customer service chain through the business and onwards is the central concern of logistics management.

The marketing and logistics interface

Even though the textbooks describe marketing as the management of the 'Four Ps' – product, price, promotion and place – it is probably true to say that, in practice, most of the emphasis has always been placed on the first three. 'Place', which might better be described in the words of the old cliché, 'the right product in the right place at the right time', was rarely considered part of mainstream marketing.

There are signs that this view is rapidly changing, however, as the power of customer service as a potential means of differentiation is increasingly recognised. In more and more markets the power of the brand has declined and customers are more willing to accept substitutes; even technology differences between products have been reduced so that it is harder to maintain a competitive edge through the product itself. In situations like this it is customer service that can provide the distinctive difference between one company's offer and that of its competitors.

Two factors have perhaps contributed more than anything else to the growing importance of customer service as a competitive weapon. One is the continual increase in customer expectations; in almost every market the customer is now more demanding, more 'sophisticated' than he or she was, say, 30 years ago. Likewise, in industrial purchasing situations we find that buyers expect higher levels of service from vendors, particularly as more companies convert to just-in-time logistics systems.

The second factor is the slow but inexorable transition towards 'commodity' type markets. By this is meant that increasingly the power of the 'brand' is diminishing as the technologies of competing products converge, thus making product differences difficult to perceive – at least to the average buyer. Take, for example, the current state of the personal computer market. There are many competing models which in reality are substitutable as far as most would-be purchasers are concerned.

Faced with a situation such as this the customer may be influenced by price or by 'image' perceptions but overriding these aspects may well be 'availability' – in other words, is the product in stock, can I have it now? Since availability is clearly an aspect of customer service, we are in effect saying that the power of customer service is paramount in a situation such as this. This trend towards the *service-sensitive* customer is as apparent in industrial markets as it is in consumer markets. Hence companies supplying the car industry, for example, must be capable of providing just-in-time deliveries direct to the assembly line; similarly a food manufacturer supplying a large supermarket chain must have an equivalent logistics capability, enabling it to keep the retail shelf filled whilst minimising the amount of inventory in the system. The evidence from across a range of markets suggests that the critical determinant of whether orders are won or lost, and hence the basis for becoming a preferred supplier, is customer service. Time has become a far more critical element in the competitive process. Customers in every market want ever shorter lead times; product availability will overcome brand or supplier loyalty – meaning that if the customer's preferred brand is not available and a substitute is, then the likelihood is a lost sale.

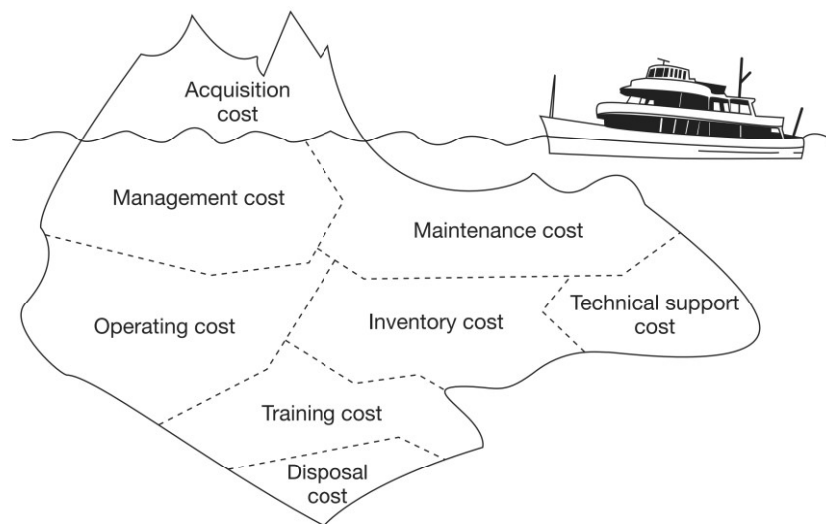
Delivering customer value

Ultimately the success or failure of any business will be determined by the level of customer value that it delivers in its chosen markets. Customer value can be defined quite simply as the difference between the perceived benefits that flow from a purchase or a relationship and the total costs incurred. Another way of expressing the idea is:

$$\text{Customer value} = \frac{\text{Perceptions of benefits}}{\text{Total cost of ownership}}$$

'Total cost of ownership' rather than 'price' is used here because in most transactions there will be costs other than the purchase price involved. For example, inventory carrying costs, maintenance costs, running costs, disposal costs and so on. In business-to-business markets particularly, as buyers become increasingly sophisticated, the total costs of ownership can be a critical element in the purchase decision. 'Life-cycle costs', as they are referred to in the military and defence industries, have long been a critical issue in procurement decisions in those markets. Figure 2.1 shows the 'iceberg' effect of total costs of ownership where the immediate purchase price is the only aspect of cost that is visible, whereas below the surface of the water are all the costs that will arise as a result of the purchase decisions.

Figure 2.1 The total cost of ownership



In the same way that the total cost of ownership is greater than the initial purchase price so too the benefits that are perceived to flow from the purchase or the relationship will often be greater than the tangible product features or functionality. For example, there may be little difference between two competitive products in terms of technical performance, but one may be superior to the other in terms of the customer support that is provided.

One way to define 'competitive advantage' is simply that the successful companies will generally be those that deliver more customer value than their competitors. In other words, their ratio of benefits to costs is superior to other players in that market or segment.

Logistics management is almost unique in its ability to impact both the numerator and the denominator of the customer value ratio. This point becomes clearer if we expand the ratio as follows:

$$\text{Customer value} = \frac{\text{Quality} \times \text{Service}}{\text{Cost} \times \text{Time}}$$

Source: Johansson, H.J., McHugh, P., Pendlebury, A.J. and Wheeler, W.A., *Business Process Reengineering*, John Wiley & Sons, 1993.

Each of the four constituent elements can briefly be defined as follows:

- Quality:** The functionality, performance and technical specification of the offer.
- Service:** The availability, support and commitment provided to the customer.
- Cost:** The customer's transaction costs including price and life cycle costs.
- Time:** The time taken to respond to customer requirements, e.g. delivery lead times.

Each of these four elements requires a continuous programme of improvement, innovation and investment to ensure continued competitive advantage.

One company that has built a global leadership position in its markets is Caterpillar, marketing machines and diesel engines for the construction and mining industries. Caterpillar has for many years focused on developing not just its manufacturing capabilities and innovative products but also its customer support and responsiveness. Underpinning these initiatives has been a continuing emphasis on creating superior logistics and supply chain management capabilities. Caterpillar has developed a world-class reputation for customer support, in particular its guarantee to provide 48-hour availability of parts no matter how remote the location. In the industries where Caterpillar's equipment is used, the cost of 'down-time' can be significant, hence the importance of responsive service. Through close partnership with its worldwide network of dealers and distributors and through advanced inventory and information management systems, Caterpillar offers levels of customer support – and thus customer value – that few companies in any industry can match.