Optimize Revenue Through Customer Retention and Delivering Customer Value

An InfoMentis White Paper

How companies can increase profitability by providing customers with what they value.

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Abstract

This white paper is a discussion of how a company can optimize revenue by retaining customers through value creation. The purpose of this paper is to highlight how short-term actions based on signs of declining profits will have long-term effects on customer loyalty and profitability. The job of creating customer loyalty is that of the CEO who sets the tone for the rest of the company. This discussion might be used to support the need for creating customer retention strategies that support long term customer loyalty and growing profits by establishing value.

This paper distinguishes between customer satisfaction and customer value with customer value being the key to creating customer loyalty.

"One of the most important lessons of business – the value of concentrating on the customers you have."

Tom Monaghan, founder, Domino's Pizza

Introduction

How many companies do you know today that are looking for ways to optimize their revenues and increase their profitability? With the rise of dot.com companies and generous funding from venture capitalists, profit was a future desired state and building market capitalization and going public was the name of the game. Today, with the economy's downturn, and going public being something of the past companies are now focusing their attention on profitability.

When companies focus on profitability they first look at their operating expenses, which historically results in headcount reductions and restructuring of company operations. These short-term measures have long-term effects. While certain redundant headcount and other operational expenses may be eliminated these reductions require that the remaining company resources be asked to do more with less. The long-term effects of such measures typically are reduced customer satisfaction and decreased customer retention due to employees not being able to establish value for the customer.

Creating value for customers is critical to every company's success especially during times of austerity. In the old economy, the focus of most companies was internal with respect to their customers meaning they would view customers based on what they had to sell. In the new economy, the focus of companies is more external and is based on identifying customer's needs and what they will buy. Focusing on what customers need is key to growing top line revenues, reducing operating expenses and growing the bottom line. Customers buy value therefore it follows that improving the customer experience will increase customer loyalty or retention.

Customers that are loyal are those that continue to do business with you whether or not you offer the best, lowest price or fastest delivery of your product/service. The reason for this is that these customers perceive they are receiving value, which is what they receive and how they receive it. Focusing on providing a great experience with the right customers over time will improve the bottom line through creating more loyal customers.

Loyal customers can be counted on to build a solid base of revenues as well as to expand profits.

Obstacles to Customer Value Creation

If you ask most executives what their companies do they will say they are in the business of selling a product or service to a particular group of customers in order to increase their revenues and market share. Few will respond that they are in the business of providing value to their customers to create a long-term loyal and profitable relationship that will assure their market share. Interestingly enough, customer loyalty ranked first among the management concerns of CEOs in this year's Conference Board survey, an important gauge of critical issues across a range of industries.

There are a variety of reasons that executives respond one way to a survey and in practice do another. In this paper, we will highlight several of these reasons and why they need to be addressed.

- **There is a greater concern with short-term financial improvements rather than long-term customer loyalty. The issue is that executives concentrate on the symptom rather than the root cause, which is a breakdown in the value creation system.** An example, is when profits are declining CEOs direct their management teams to review their expenses and eliminate non-essential ones which typically results in short-term action of downsizing of headcount often causing a longer term impact to the company's ability to provide value to its customers. Also, monthly reviews focus on financial figures versus focusing on customer value issues.
- **Senior executives are not personally involved with the job of customer loyalty creation, nor is their financial compensation tied to creating customer value.** When CEOs see customer issues as secondary to profits, they often delegate them because they do not view this as their primary responsibility. Those CEOs called loyalty leaders, committed themselves and their companies to a mission higher than profits: creating so much customer value that there would be plenty for employees and investors. These CEOs viewed their

ability to create customer loyalty as a measure of their progress. It was clear to these CEOs that on average most American companies lose one-half of their customers every five years therefore the job of creating value is too important to delegate.

- **No one person within an organization is the focal point for the customer.** There is not a single point of accountability for the customer. The maintenance of the customer relationship is a cross-functional responsibility without the requisite accountability or measurement. Questions about customer value are questions about basic company strategy; therefore the involvement of the CEO is key to its success.

Customers buy value therefore it follows that improving the customer experience will increase customer loyalty or retention.

The Value of Retaining a Customer

In Frederick Reichheld's book "*The Loyalty Effect: The Hidden Force Behind Growth, Profits and Lasting Value* ", his analysis showed that **the cost of acquiring new customers was five times the cost of servicing existing ones.** If for no other reason then achieving a more effective way to service customers, focus on retention would be a worthwhile endeavor. But above and beyond that there are many more reasons to retain an existing customer. Establishing a repeat buyer involves understanding the buying behavior of your customer and their needs throughout the customer life cycle.

The focus of chief executives on growing the company revenues, reducing the operating costs and increasing profitability is possible by leveraging the existing customer base. The key to growing top line revenues and reducing operating costs resulting in bottom line growth is establishing value for the customer. The repeated creation of value for your customers will in turn lead to customer loyalty.

Customers buy value therefore it follows that improving the customer experience will increase customer loyalty or retention. Value is created through seeking to understand the needs of your customer and how cross-functionally your company can fulfill those needs. Although value is often viewed from a financial perspective there are many other ways to demonstrate value such as superior quality, increased speed, and greater productivity. Real value is established by repeatedly delivering what your customer expects regardless who in the organization is providing the service. By providing a great experience with the right customers over time companies experience improved financial performance and more loyal customers.

Customer loyalty is an integrated system, and there are a number of economic effects that are created as loyalty weaves through a business as follows:

- Revenues and market share grow through repeat buyers
- Sustainable growth that enables a company to attract and retain the best employees.
- Motivated, long-term employees become interested in learning how to reduce costs and improve quality, which further increases customer value and productivity.
- Increased productivity and loyal customers create greater efficiencies and generate cost savings that is hard for competitors to match.
- Loyal investors begin to act like partners as they see cash flow back into the business, which lowers the cost of capital and increase market capitalization.

According to Frederick Reichheld, **making loyalists out of just 5% more customers would lead, on average, to an increase in profit (value) per customer of between 25% and 100%.** Reichheld advises companies to attract and keep customers in one of the following groups:

- Customers that are inherently more loyal because they prefer long-term relationships.
- Customers that are inherently more profitable because they spend more, require less service, and pay their bills on time.
- Customers that find your products and services more valuable, a better fit, than those of your competitors.

Customer satisfaction and customer value are distinctly different (although related) concepts, and the latter is more strongly linked to and predictive of customer behavior. **Indices of customer satisfaction are about *attitudes*, while customer value is about *behavior*.** Satisfaction measures indicate how customers feel about products and services, while measures of customer value are indices of how customers will act. An example, of this is when GM's Cadillac Division surveyed its customers and happily found out that 90% of them were satisfied or highly satisfied with their recent purchase of a new Cadillac, figures comparable with those reported by purchasers of Japanese automobiles. But Cadillac was quite dismayed to learn that only about 30-40% of these new Cadillac owners would buy another Cadillac, compared with more than 80% of Japanese auto purchasers. GM had simply been asking about customer satisfaction, not about customer value – about attitudes, not about behavior.

"The CEO has to play a personal role in strategic planning, but my number 1 personal priority is to have personal contacts with our customers."

William J. Avery, Chairman, CEO and director, Crown, Cork & Seal Company, Inc.

Growing Customer Revenue and Profitability

There are **three actions that companies called loyalty leaders do** in order to leverage their customer base to achieve customer value creation.

First, the CEO must set the tone for the creation of customer loyalty. We have often heard that "it starts from the top". If the CEO delegates this responsibility it will not be deemed a top priority and will not be taken seriously by employees. According to Frederick Reichheld in his recent article "Lead for Loyalty" in the Harvard Business Review, he said, "Outstanding loyalty is the direct result of the words and deeds – the decisions and practices – of committed top executives who have personal integrity."

There are six principles that Reichheld identified that loyalty leaders have in common. These principles start at the top and permeate all its relationships, both internally and externally. The six principles of loyalty are:

- **practice what you preach** (it's not just about value but reinforcement of that value through actions)
- **play to win-win** (create a win-win with your employees who deliver the value)
- **be picky** (be selective in choosing your customers)
- **keep it simple** (hold employees responsible and accountable for loyalty and give them clear and simple guidelines to be able to create it)
- **reward the right results** (reward your loyal customers and those employees who create value for them)
- **listen hard, talk straight** (ask questions, seek to understand and communicate the answer clearly)

Second, in customer centric companies, cross-functional responsibility is critical to create customer value. No one person is responsible for delivering value and service to customers but rather everyone is. This approach often requires teamwork that crosses organizational boundaries. In a customer centric organization, employees are given the authority and tools to treat customers right and to marshal whatever resources they need to address the problem. Customers and problems don't always respect the organization chart.

Third, it is not acceptable to have just customer satisfaction; it is imperative to create customer loyalty. Customer satisfaction alone is not a predictor of customer loyalty because it fails to predict how customers will actually behave. Satisfaction scores measure only past experience not the customer's intentions. Interestingly enough, most studies regarding the correlation between customer satisfaction and customer loyalty indicate that a high customer satisfaction rating of more than 90% often indicates a loyalty rating barely reaching 50%. However, there is a very strong correlation between customer loyalty, as measured by retention rates and company profitability.

Studies have shown that doing these things will result in the following:

- A 5% reduction of customer defection can result in profit increase of 25-100%
- A 2% increase in customer retention equals cutting operating cost by 10%
- It costs at least 5 times more to obtain new customers than it is to retain (and resell to) customers you already have

Summary

The ability of a company to create value for its customers is the key to long-term customer loyalty. Creating loyalty and establishing value goes beyond just having a satisfied customer. What becomes most critical is the behavior of the customer with regards to whether they will buy from a provider time after time. Establishing a repeat buyer involves understanding the buying behavior of your customer and their needs throughout the entire customer life cycle. It is critical to ensure that there is a point of accountability within the company for taking care of the customer. It is the job of the CEO to focus the entire organization on customers versus delegating this responsibility to some one else.

There are innumerable reasons why companies do not focus on long-term customer loyalty but instead focus on short-term profitability. These reasons ironically do not sustain profitability, which is the ultimate goal of growth-oriented companies. CEOs in the new economy are now realizing the effects of actions they took in the old economy. Those CEOs who considered it their job to be personally involved with creating customer loyalty are reaping the benefit of their decision.

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About the Author

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Sally is the author of customer retention curricula including programs on customer account management, customer segmentation, negotiation skills, defection analysis, customer profitability analysis and retention strategies. A high-tech industry veteran with more than 20 years experience both domestically and internationally in management and front line positions, Foster has led and grown high performance technology organizations to achieve outstanding bottom line results and exceptional customer loyalty.