The Value Creation Process in Customer Relationship Management

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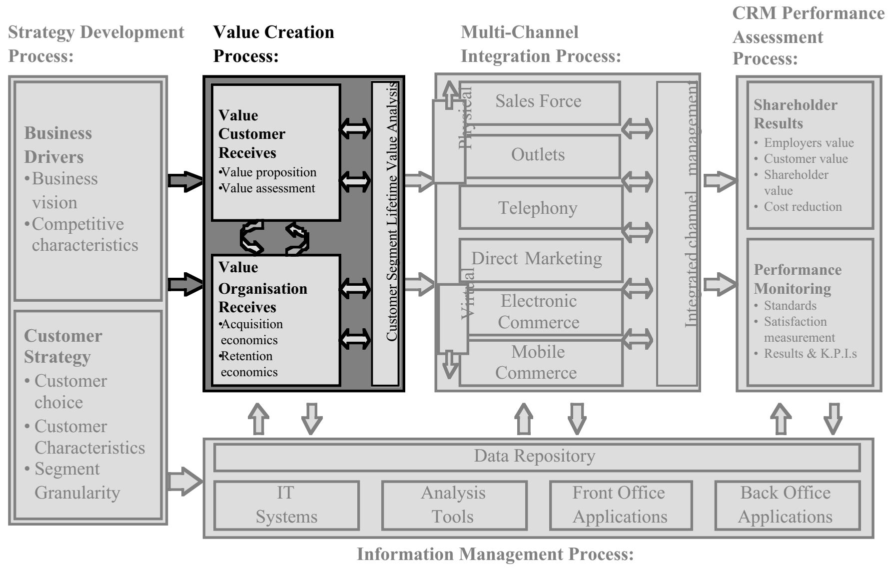
INTRODUCTION

This paper examines the *value creation process* as it applies to the management of customer relationships, with the aim of providing practical guidance for enhancing customer value and thus shareholder value. Value creation can be viewed as one of five key cross-functional processes that together constitute the Strategic Framework for Customer Relationship Management (CRM)[1] shown in Figure 1. The value creation process is a critical component of CRM as it translates business and customer strategies into specific statements of what value is to be delivered to customers and, consequently, what value is to be delivered to the supplier organisation.

Figure 1: Strategic Framework for CRM



Creating customer value is increasingly seen as a key source of competitive advantage. Yet, despite growing attention to this aspect of strategic development, there is remarkably little by way of agreement amongst managers and commentators on what constitutes 'customer value'. Further, companies typically do not specify in sufficient detail the value they seek to deliver to clearly identified customer segments and micro-segments, and *how* they propose to deliver this value.

The value creation process consists of three key elements: determining what value the company can provide to its customers (the 'value customer receives'); determining the value the organisation receives from its customers (the 'value organisation receives'); and, by successfully managing this value exchange, maximising the lifetime value of desirable customer segments.

The emphasis in many companies is on this second element of value. To these companies, customer value means:

- how much money can we extract from the customer?
- how can we sell them more of the existing products and services they are buying?
- how can we cross-sell them new products and services?

However, in today's competitive arena where a growing number of businesses vie for a greater share of a finite customer pool, it has become imperative to consider customer value also in terms of customer benefit:

- how can we create and deliver value to our customers?
- how can we ensure the customer proposition is relevant and favourably attractive?
- how can we ensure the customer experience is consistently positive?

THE VALUE THE CUSTOMER RECEIVES

The value the customer receives from the supplier organisation is the total package of benefits derived from the ‘core product’ and the ‘product surround’, or the added values that enhance the basic features such as service and support. As pointed out by Harvard Business School's Theodore Levitt, competition exists not between what companies produce in their factories but between "what they add to their factory output in the form of packaging, services, advertising, customer advice, financing, delivery arrangements, warehousing, and other things that people *value*". The value the customer attributes to these benefits is in proportion to the perceived ability of the offer to solve whatever customer problem prompted the purchase. This value can be calculated using the value proposition concept and undertaking a value assessment — importantly, working from a customer perspective.

The Value Proposition

The aim of all businesses is to create a value proposition for customers, be it implicit or explicit, which is superior to and more profitable than those of competitors. In specific usage, a ‘value proposition’ is the offer defined in terms of the target customers, the benefits offered to these customers, and the price charged relative to the competition. Value propositions explain the relationship between the performance of the product, the fulfilment of the customer’s needs and the total cost to the customer over the customer relationship life cycle (from acquisition of the product through to usage and ownership, and eventual disposal). As every customer is different and has changing needs, it is crucial that the value proposition for each customer is clearly and individually articulated, and cognisant of the customer’s lifetime value.

A structured method for developing value propositions, originated by consulting firm McKinsey and Co. and further developed by others[2-7] , is comprised of two main parts*:* *formulation of the value proposition* and profitable delivery of this value proposition by means of a *value delivery system*.

Formulating the value proposition

Formulating the value proposition involves defining the target customers, the benefits offered to these customers and the price charged relative to the competition, and then expressing this as a formal statement. Some examples of value propositions, based on work by Lanning and Phillips[6], are shown in Figure 2.

Figure 2: Examples of value propositions for various industries.

Company / Product	Target Customers	Benefits	Price	Value Proposition
Perdue (chicken)	Quality-conscious consumers of chicken	Tenderness	10 per cent premium	More tender, golden chicken at a moderate price premium
Volvo (station wagon)	Safety-conscious “upscale” families	Durability and safety	20 per cent premium	The safest, most durable station wagon your family can travel in at a significant price premium
Domino’s (pizza)	Convenience–minded pizza lovers	Delivery speed and good quality	15 per cent premium	A good pizza, delivered hot to your door within 30 minutes of ordering, at a moderate price premium

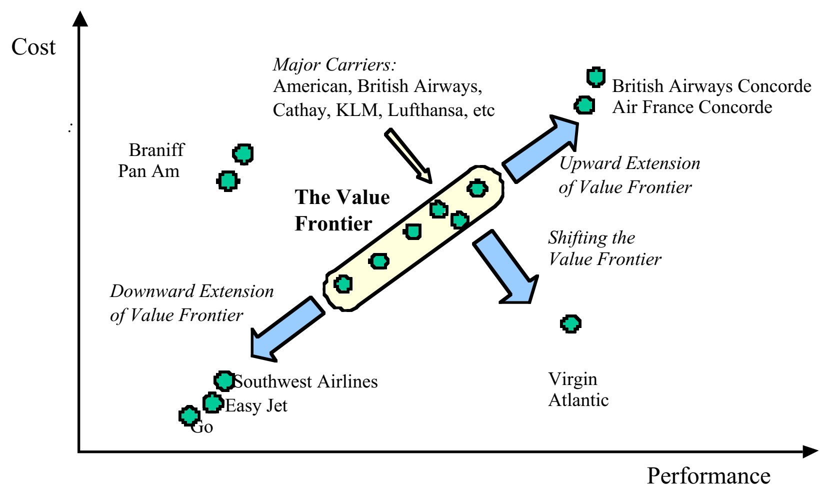
The recommended approach for defining these elements of the value proposition follows a sequence of three steps.

Step 1: Analysing markets based on value

This first step involves understanding the price/benefit opportunities that exist within the market and here the value map can prove a useful tool. Value maps provide a graphical presentation of the relative positions of different competitors in terms of the benefits and price attributes that relate to customer value.

Figure 3 shows a value map for the airline industry based on a study undertaken by New York University [7]. It depicts a value frontier that incorporates the price/benefit positions of the major carriers. If all competitors shared a similar position on the value map, commoditisation and reduced profitability would likely result.

Figure 3: Value map for the airline industry



Researchers in this area suggest three generic strategies for developing differentiated value propositions on the value map.

1. *Extend the value frontier towards the low end of the value map* - the strategy adopted by Southwest Airlines in the USA, and by EasyJet and Go airlines in Europe.

2. *Extend the value frontier towards the high end of the value map* - the strategy adopted by British Airways and Air France with their Concorde fleets. Pursuit of this strategy is often based on technological innovation.

3. *Shift the value frontier* - the strategy adopted by Virgin Atlantic with its 'upper class' service, offers first class facilities and a highly distinctive personality based on a business class fare structure.

High-performance companies characteristically focus on the development of superior value propositions in order to take advantage of new growth opportunities and identifiable, premier customers.

Step 2: Assessing opportunities in each segment to deliver superior value

When a critical review of any market is undertaken it soon becomes obvious that the idea of a single market for a given product or service is highly restrictive. All markets are made up of market segments, or groups of customers with the same or similar needs. Reaching the most profitable and suitable market segments is a matter of evaluating the opportunities (and limitations) in each segment for delivering superior customer value. Even where the offer made to customers is technically identical to competitors' offers, efforts to differentiate the total or 'package' offer in terms of customer segment as well as market segment can reap significant rewards. Many companies that have adopted a market aggregation strategy in the past are now actively addressing new ways of appealing to different customer segments.

Value maps may also be constructed at the market segment level to enable very specific price/benefit opportunities to be evaluated within segments, and thus highlight the most promising market segments and the most appropriate propositions for them. Assessments of potential opportunities for delivering superlative value should involve a rigorous analysis of cost, competitive offers, and importantly, organisational 'fit' on both strategic and operational levels.

Step 3: Explicitly choosing the value proposition

Having identified the target market segments, the next priority is to create a value proposition of winning relevance. The characteristics of the segments that form some markets may vary so radically that different value propositions will be required for different segments. For example, in the automotive industry, the needs and preferences of customers in the luxury segment who buy Rolls Royces are clearly distinct from those of customers in the trendy youth segment that buy Smart cars or VW Beetles. Businesses that justifiably exhibit less marked differences between their product and service offers may benefit from approaching the value proposition issue by developing a generic value proposition for the market as a whole and then developing more specific variants for each specific segment.

Once formulated, value propositions should be carefully reviewed to confirm that they are truly distinctive and appropriate. The checklist in Figure 4 can be used to determine whether a superior value proposition has really been developed.

Figure 4: A checklist to review your value proposition

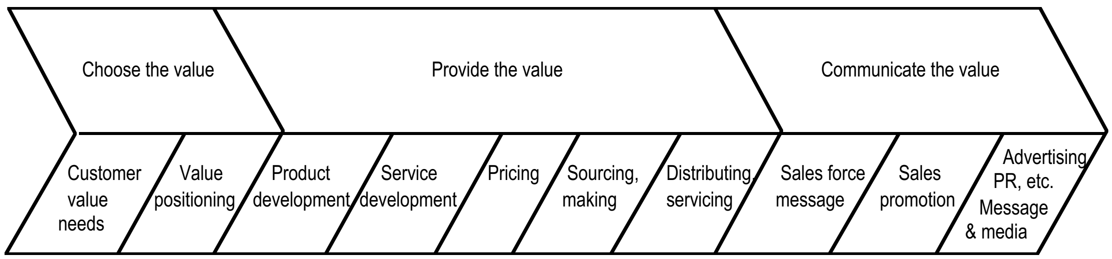
1. Is the target customer clearly identified?
2. Are the customer benefits explicit, specific, measurable and distinctive?
3. Is the price, relative to competition, explicitly stated?
4. Is the value proposition clearly superior for the target customer (superior benefits, lower price or both)?
5. Do we have, or can we build, the skills to deliver it?
6. Can we deliver it at a cost that permits an adequate profit?
7. Is it viable and sustainable in the light of competitors and their capabilities?
8. Is it the best of several value propositions we considered?
9. Are there any impending discontinuities (in technology, customer habits, regulation, market growth, etc) that could change our position?
10. Is the value proposition clear and simple?

Source: based on references 4 and 6

The value delivery system

The means by which the value proposition is delivered represents the other half of the value proposition concept. The importance of having a system, or framework for value delivery stems from the realisation that focusing on the traditional physical sequence of 'make the product/service and sell the product/service' is sub-optimal. The value delivery system emphasises that companies need to shift from a traditional view of seeing their business as a set of functional activities to an externally-oriented view that sees their business as a form
of value delivery. The value delivery system consists of three parts as portrayed in Figure 5: choose the value, provide the value and communicate the value.

Figure 5: The Value Delivery System



Source: based on McKinsey & Co

1. **Choose the value.** Choosing the most appropriate value proposition involves understanding the forces driving demand, customer economics, the buying process and how well the competition serves customer needs, particularly in terms of their products, service and prices charged.

2. **Provide the value.** Developing a product and service package that provides clear and superior value involves focusing on product quality and performance, service cost and responsiveness, manufacturing cost and flexibility, channel structure and performance, and price structure.

3. **Communicate the value.** Engaging in promotional activity to persuade customers that the value offered is better than that of competitors not only involves sales promotion, advertising and the sales force, but also the provision of outstanding service in a way that is recognised and remembered by the target audience.

Much of the success of a value delivery system depends on the thoroughness and innovation with which value is both generated and reinforced throughout the supplier organisation. "Differentiating the winners is the extent to which this value proposition is echoed in the business system, through changes in branch service delivery, new products, systems that provide integrated information to customers and those serving them, relationship pricing, etc. Executing these changes is more difficult than choosing the value but also provides formidable obstacles to imitation" [6].

Value Assessment

To determine if the value proposition is likely to result in a superior customer experience, it is necessary to quantify the relative importance that customers place upon the various attributes of a product. A value assessment based on subjective judgments about the attributes and benefits that are important to the customer can fall prey to the assumption that the supplier and customer attach the same importance to the various product attributes — rarely do they.

Traditional means of customer assessment of value

The most common means of discovering the perceived value of product attributes is to ask a representative sample of customers to rank them in terms of importance on a five, seven or ten point scale. However, where a large number of attributes are concerned, this method is impractical and offers little real insight. An alternative approach is to ask respondents to place a weight from 1 to 10 against each attribute while ranking them on a scale of, say, ‘very satisfied’ to ‘very dissatisfied’. This approach also prone to problems, particularly where respondents: do not know the importance of some features; may be unwilling to disclose their opinions; may rate too many attributes as being very high in importance; or, may be influenced by peer pressure, causing some features to be overrated.

Improving value assessment using trade-off analysis

A more realistic evaluation of customer value can be obtained by asking a representative sample of customers to rank the product’s attributes and then, using an analytical tool such as conjoint analysis[2], or trade-off analysis, applies a weighting system to discover the weight given to different levels of each attribute. Here advanced computer analysis is used to calibrate the importance “weights”, which can then be aggregated to provide an objective measure of the “utility” that customers prescribe to each element of customer value.

This technique is based on the simple concept of trading off one attribute against another. For example, the purchaser of a new car is likely to trade off a number of specific product attributes in agreeing the purchase price and specifications. Vehicle performance, petrol economy, number of seats, safety features, boot capacity, low price, and so on will have factored in his decision. Trade-off analysis can also be used to identify customers that share common preferences in terms of product attributes, and may reveal substantial market segments with service needs that are not fully catered for by existing offers.

Trade-off analysis possesses several advantages over more traditional forms of value assessment, as it:

1. Employs measures of attribute importance that do not rely on direct rating by respondents;
2. Forces a trade-off among very important attributes to determine which are the most important; and
3. Achieves this for each customer separately.

There are two forms of trade-off analysis. The 'full profile' approach presents respondents with a full-profile description of an offer and asks them to rate the offer’s constituent elements. The 'pairwise' trade-off approach asks respondents to rank combinations of variants of two attributes, from the least preferred to the most preferred, and then repeats this for a series of other pairs of attributes.

The 'full profile' form of trade-off analysis is the most commonly used approach, and is often deemed more realistic by researchers as all the product’s aspects are considered at the same time. However, if the number of attributes is large then the judging process used for each individual profile in the ‘full profile’ approach can become very complex and demanding. For that reason other researchers prefer the 'pairwise' trade-off approach.

While these approaches are typically described in detail only in specialist texts on market research[8], numerous company studies have now been undertaken by consultants and market researchers using this form of value analysis. As a result, the commercial acceptance of this approach in businesses has grown greatly.

THE VALUE THE ORGANISATION RECEIVES

The value the supplier organisation receives from the customer has the greatest association with the term 'customer value'. Customer value from this perspective is the *outcome* of providing and delivering superior value to the customer; deploying improved acquisition and retention strategies; and utilising effective channel management. Fundamental to the concept of customer value in this context is understanding the economics of customer acquisition and customer retention. The opportunities for cross-selling, up-selling and building customer advocacy are also integral to this view of value creation.

Customer acquisition and its economics

The importance of customer acquisition varies considerably according to a company's specific situation. For example, a new market entrant to the fast-paced world of e-business will be primarily focused on customer acquisition, while an established manufacturing company operating in a mature market may be more concerned with customer retention.

The customer acquisition process is typically concerned with:

- acquiring customers at a lower cost,
- acquiring more customers, and
- acquiring more attractive customers.

The starting point in understanding customer value from the perspective of the supplier organisation is to determine the existing customer acquisition costs within the utilised channels, and also how these costs vary across different segments or microsegments.

Customer acquisition at Electro plc

To illustrate the economics of both customer acquisition and customer retention we will use an example from Electro plc, a large UK electricity supplier. From the late 1990s, the residential sector of the market was going through substantial changes as electricity companies, for the first time, could now sell electricity outside their traditional geographic boundaries. Electro faced competition within their own territory from other electricity providers, but also could now market their services outside their traditional geography.

Segmentation of Electro's customer base identified four key market segments, each of which displayed different characteristics in terms of socio-economic grouping, expected switching behaviour and customer profiles.

The data needed to undertake an analysis of customer acquisition and customer retention economics at Electro, at the segment level, was collected. This included: the number of existing customers within each segment; annual customer acquisition targets with reference to the total UK customer base; the cost of acquisition (per customer); and estimates of profit per customer per annum for each segment. The likely annual retention rates in the new competitive environment were considered. Different levels of retention for each segment were estimated, and one scenario of the broad characteristics of these segments is shown in Figure 6. Some of the figures stated have been adjusted to protect proprietary information.

Figure 6- Customer Segment Data Template for Electro plc

Segment Number	Segment Name	No. Existing Customers	Acquisition Target for year	Cost of Acquisition	Annual Retention Rate	Profit per Customer per Year
Segment 1	Struggling empty nest super-loyals	421,300	500	£110	96%	£6
Segment 2	Older settled marrieds	618,000	66,000	£70	94%	£9
Segment 3	Switchable middles	497,900	110,000	£55	90%	£18
Segment 4	Promiscuous averages	459,600	220,000	£30	80%	£22

As shown in the table above, the acquisition costs per customer at the segment level were estimated to be:

Segment 1 - 'struggling empty nest super-loyals' - £110;
Segment 2 - 'older settled marrieds' - £70;
Segment 3 - 'switchable middles' - £55; and
Segment 4 - 'promiscuous' - £30.

To give meaning to a comparison of acquisition costs, the expected profitability of the average customer in each segment and the overall profit potential of each segment overall was also considered.

The profit per customer per annum in Segment 1 (the 'struggling empty nest super-loyals') was £6, making a break-even of 18.3 years. As this segment comprises elderly people, many of the customers will die before they break even! In the case of Segment 4 (the 'promiscuous averages'), the profit per customer per annum was £22, making a break-even of 1.36 years. This segment is highly attractive in terms of acquisition economics, especially if CRM strategies to successfully retain customers are put in place.

Unfortunately, many organisations operating in consumer markets still do not differentiate their CRM activities at the segment level. They contact each prospect with the same frequency (as Electro had done since their establishment) instead of applying a level of effort consistent with the cost of acquisition and profit potential. Their unrefined use of resources not only leads to wasted investment but can cause annoyance among customers who are either being oversupplied or undersupplied with attention. This situation highlights the importance of understanding acquisition economics at the segment level.

Acquisition across different channels

Having determined the acquisition costs for different segments, the next step is to consider how acquisition costs may vary across different channels. The advent of web sites and electronic communication channels has enabled companies to acquire customers at a fraction of the cost of using more traditional channels such as direct mail.

RS Components, a leading international supplier of electrical components and other products understands extremely well the cost and customer service benefits of employing the internet in conjunction with more conventional channels. The company deals with its customers through physical branches, a call centre and, more recently, a highly sophisticated and personalised web site. It should be stressed, however, that the choice of channel(s) must be appropriate to the type of business and customer base concerned.

Improving acquisition

Equipped with a sound understanding of how acquisition costs vary at both the segment and channel levels, companies can then seek to acquire more attractive customers at lower cost. In many instances customer acquisition can be improved through acting on insights drawn from the value proposition and the value assessment. More refined promotional campaigns and the encouragement of customer referrals can also attract customers who meet the target criteria. First Direct, the leading UK bank, boasts the highest levels of advocacy in the retail banking sector. Approximately one-third of all its customers join as a direct result of customer referral — with the added bonus of reducing its average customer acquisition cost.

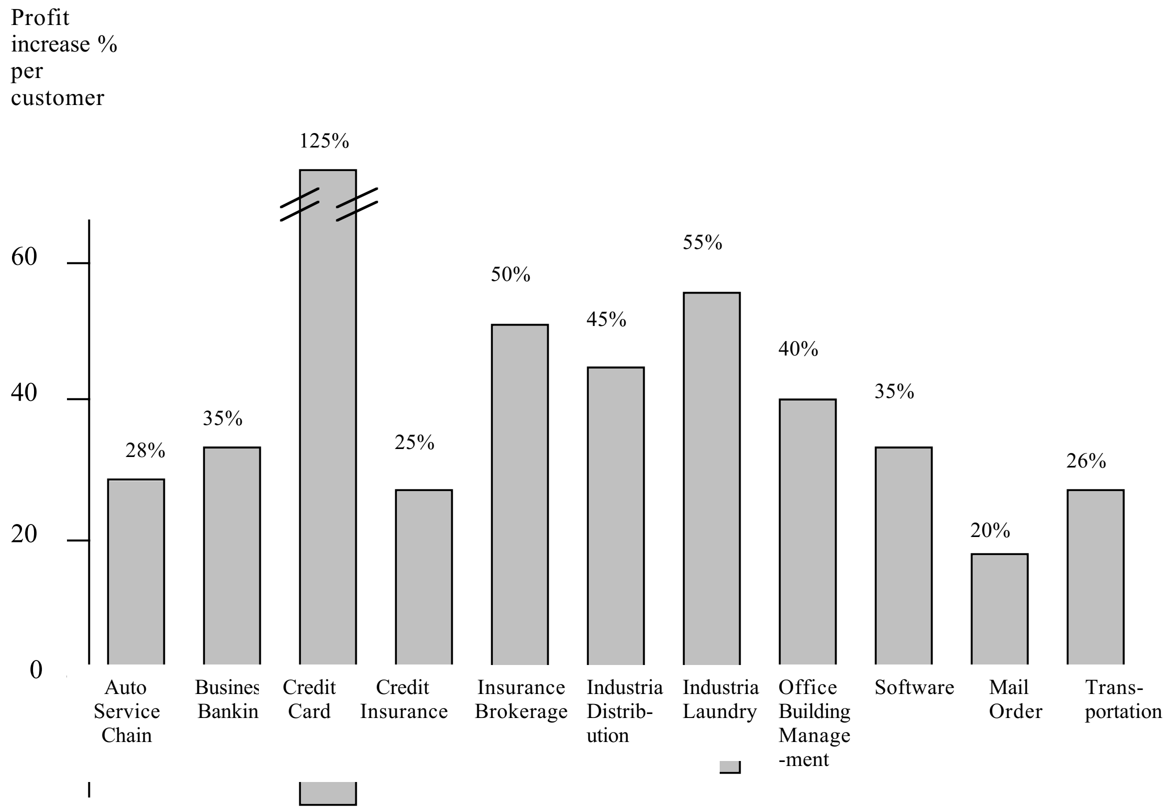
Customer retention and its economics

Writers and researchers have suggested that it costs around five times more to get a new customer than it does to keep an existing one. Despite this finding, many companies have traditionally focused their marketing activity on acquiring new customers, rather than retaining existing customers. This may be due to the historical convention in many companies that rewards customer acquisition to a much greater extent than customer retention, or it may be caused by a lack of understanding of why customer retention can be such a boon to commercial profitability.

The profit impact of customer retention improvement

While most companies recognise that customer retention is important, relatively few understand the economics of customer retention within their own firm. Until fairly recently, there was little research that critically evaluated the relative financial benefits of customer acquisition versus customer retention. In 1990, a partner at consulting firm Bain & Co and a professor at the Harvard Business School, Fred Reichheld and Earl Sasser, published some revealing research, which demonstrated the financial impact of customer retention [9]. They found even a small increase in customer retention produced a dramatic and positive effect on profitability: a five percentage points increase in customer retention yielded a very high improvement in profitability in net present value (NPV) terms. Increasing the customer retention rate from, say, 85% to 90% represented a net present value profit increase from 35 per cent to 95 per cent among the businesses they examined, as shown in Figure 7.

Figure 7: Profit Impact of a 5 % Increase in Customer Retention for Selected Businesses



Source: Bain & Company

These findings have been very influential in drawing attention to the critical role customer retention has to play within CRM strategy.

Customer retention at Electro plc

Returning to the Electro plc example above, we considered the realistic potential improvement that can be made in customer retention through a CRM strategy based on improved service, given the relative attractiveness of the four segments and used the views of several executives experienced in this area to come up with the following improvement targets: Segment 1 - 1%, Segment 2 - 2%, Segment 3 - 5%, and Segment 4 - 9%, based on a segmented service strategy. Using these increases in retention rates for each segment we then modelled the increase in 'gross' profit in five and ten years with a segmented service strategy and compared it with the base case.

This modelling shows a significant increase in overall gross profit, before costs of improved service, of 48% at year 5 (from £21.7 m to £32.2 m) and 71% at year 10 (from £23.8 m to £40.6 m. The results within each of the four different segments varied significantly because of differences in improvement in retention rates and other inputs to the model.

Although few organisations undertake advanced evaluation of segment profitability, the broad approach is straightforward - understand the profit potential in each segment (gross profit less costs) of a segmented service approach and selectively manage the segments to maximise profits.

In considering CRM initiatives, it should be emphasised that the costs are not always substantial. The most attractive CRM initiatives are those that are of high value to the customer but are of low cost to the supplier. Organisations should first consider a reallocation of the existing expenditure such that greater emphasis is placed on those segments which have the greatest potential for increasing net present profitability. This involves no significant increase in costs. The organisation can then identify where additional incremental expenditure should selectively be placed on the most relevant market segments. The objective is to ensure the overall cost-benefit of increased expenditure is significantly enhanced lifetime profitability.

The impact of retention on profitability

Why should retention have such a great effect on profitability? Reichheld and Sasser suggested a number of reasons to explain their findings:

- Acquiring new customers involves costs that can be significant and it may take some years to turn a new customer into a profitable customer.

- As customers become more satisfied and confident in their relationship with a supplier, they are more likely to give the supplier a larger proportion of their business, or ‘share of wallet’.

- As the relationship with a customer develops, there is greater mutual understanding and collaboration, which produces efficiencies that lower operating costs. Sometimes customers are willing to integrate their IT systems, including planning, ordering and scheduling, with those of their suppliers, and this further reduces costs.

- Satisfied customers are more likely to refer others, which promotes profit generation as the cost of acquisition of these new customers is dramatically reduced. In some industries, customer advocacy can play a very important role in acquiring new customers, particularly when there is a high risk involved in choosing a supplier.

- Loyal customers can be less price-sensitive and may be less likely to defect due to price increases. This is especially true in business-to-business markets where the relationship with the supplier becomes more valued and switching costs increase.

Despite these findings, recent research by the author suggests that managers have been slow to implement changes in marketing activities to emphasise customer retention. A survey of the marketing practices in 225 UK organisations revealed that the greatest proportion of marketing budget - 41 per cent - was spent on customer acquisition, while only 23 per cent was spent on customer retention. Given that the majority of firms surveyed in this sample were in mature industries, the research raises grave concerns that the economics of customer retention (and customer acquisition) are poorly understood and hugely under exploited.

The study also investigated which measures managers consider to be important and which they use to evaluate their relationship marketing activities. The findings suggest that, although many organisations say they understand the importance of customer retention and its links with profitability, very few measure the economic value of their customer retention strategies. Customer acquisition and customer satisfaction are much more frequently measured than are customer retention and profit per customer.

The author's research identified that many organisations are not placing the optimal amount of effort on acquisition and retention activities in terms of their marketing expenditure. Another study of 200 large UK organisations showed there is a significant misallocation in the amount of money spent on customer acquisition and customer retention. The study identified three categories of organisation - "acquirers", "retainers" and "profit maximisers through CRM". "Acquirers" spent too much on customer acquisition activities at the expense of customer retention activities. The majority of firms, 80% of them, were in this category. "Retainers", by contrast, spent too much on customer retention activities at the expense of customer acquisition - this group represented 10% of firms. The "profit maximisers through CRM" represented only 10 per cent of firms in their survey. This last category considered they have identified the appropriate balance in spend between acquisition and retention activities.

We are not suggesting that new customers are unimportant; indeed, they are essential for sustained success. However, a balance is needed between the marketing efforts directed towards existing and new customers. Also, customers vary in their attractiveness for retention. Some customers are likely to yield greater long-term profitability than others and marketing strategies should reflect this fact.

A framework for customer retention improvement

Given the dramatic impact that improved customer retention can have on business profitability and the fact that many organisations continue to place too much emphasis on customer acquisition at the expense of customer retention, there is a strong need for a structured approach which organisations can follow to enhance their retention and profitability levels. Three major steps are involved in such an approach: the measurement of customer retention; the identification of root causes of defection and key service issues; and the development of corrective action to improve retention.

Step 1: Measurement of Customer Retention

The measurement of retention rates for existing customers is the first step in improving customer loyalty and profitability. It involves two major tasks - measurement of customer retention rates and profitability analysis by segment.

To measure customer retention, a number of dimensions need to be analysed in detail. These include the measurement of customer retention rates over time, by market segment, and in terms of the product/service offered. If customers buy from a number of suppliers, share of wallet should also be identified.

The outcome of this first step should be a clear definition of customer retention, a measurement of present customer retention rates, and an understanding of the existing and future profit potential for each market segment.

Step 2: Identification of Causes of Defection and Key Service Issues

This step involves the identification of the underlying causes of customer defection. Traditional marketing research into customer satisfaction does not always provide accurate answers as to *why* customers abandon one supplier for another. All too often customer satisfaction questionnaires are poorly designed, superficial and fail to address the key issues - forcing respondents to tick pre-determined response choices.

The root causes of customer defections should be clearly identified, for it is only by understanding them that the company can begin to implement a successful customer retention programme. Often this research task needs to be undertaken by very experienced market researchers.

Step 3: Corrective Action to Improve Retention

The final step in the process of enhancing customer retention involves taking remedial action. At this point, plans to improve retention become highly specific to the organisation concerned and any actions taken will be particular to the given context. Some key elements include: marshalling top management commitment; ensuring employee satisfaction and dedication to building long-term customer relationships; utilising best practice techniques to improve performance; and developing a plan to implement customer retention strategy.

Increasingly, organisations are recognising that enhanced customer satisfaction leads to better customer retention and profitability. Many organisations are now reviewing their customer service strategies to find ways to boost retention rates as a means of improving their business performance. This often entails a fundamental shift in business emphasis from customer acquisition to customer retention. Achieving the benefits of long-term customer relationships requires a firm commitment – from senior management and all staff - to understanding and serving the needs of customers.

CUSTOMER SEGMENT LIFETIME VALUE ANALYSIS

The discussion above suggests that a balance is needed between the marketing efforts directed towards existing and new customers. This balance will vary greatly depending on whether the business is a startup such as a 'dotcom' or a mature 'bricks and mortar' company. However, in general, marketing expenditure is unbalanced with too much attention being directed at customer acquisition and too little at customer retention.

To enable a decision on the relative amount of emphasis that needs to be placed on them, an understanding of both acquisition and retention economics at the segment level is critical. To calculate a customer's real value a company must look at the projected profit over the life of the account. This represents the expected profit flow over a customer's lifetime. The key metric used here is *customer lifetime value* (CLV), which is defined as the net present value of the future profit flow over a customer's lifetime.

It should not be assumed that companies will wish to retain *all* their customers. Some customers may cost too much money to service, or have such high acquisition costs in relation to their profitability, that they will never prove to be worthwhile and profitable. Clearly, it would be inadvisable to invest further in such customer segments. It is likely that within a given portfolio of customers, there may be some segments that are profitable, some that are at break-even point and some that are unprofitable. Thus, increasing customer retention does not always yield increases in customer profitability. In some instances, increasing the retention of such unprofitable customers will decrease profitability. It should be recognised, however, that unprofitable customers may be valuable in their contribution towards fixed costs and considerable caution needs to be placed in the allocation of fixed and variable costs to ensure that customers who make a contribution are not simple discarded.

Modelling customer lifetime value

Research has highlighted the need for managers to adopt a stronger focus on customer retention and measuring CLV. However, there is currently a lack of available analytical tools to help identify CLV for customer segments in a specific business. Some companies are now starting to build comprehensive frameworks and models that enable them to measure CLV at the segment level. We have developed one framework, the 'Retentiongram Model' [10] to undertake such modelling. This model, which derives its name from a unique graphical representation method, is used to visually depict the trade-off between acquisition and retention strategies in specific businesses. It enables the profit impact of changes in customer retention, customer acquisition and other variables to be measured at the aggregate, segment, micro-segment and individual customer levels. The model allows a trade-off to be made in the allocation of scarce organisational resources between strategies concerned with retaining existing customers and strategies concerned with attracting new customers for a specific organisation. Choices can also be made about the relative emphasis to be placed on strategies for different customer segments.

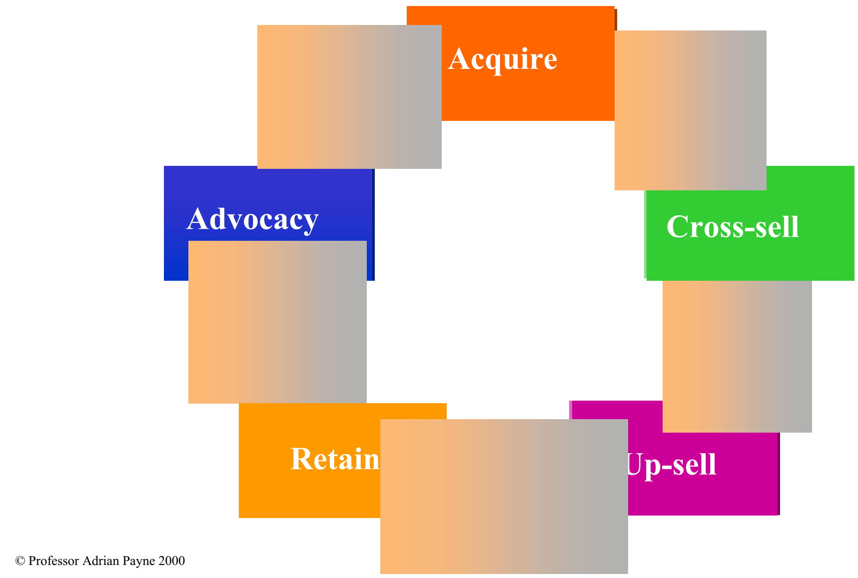
Modelling future profit potential

Such models are important in helping organisations determine customer value in terms of CLV. However, few organisations have reached the stage of understanding their existing acquisition economics and retention economics, let alone gone beyond it. Those that have can move on to modelling *future profit potential* for each market segment. Modelling of future profit potential takes into account that individual consumers may be persuaded to buy other products, or more of an existing product over time. Corporate customers, for example, tend to buy from a range of suppliers. By enhancing its predictive modelling capability the supplier organisation may be able to increase 'share of wallet' as well as market share, especially through more creative exploitation of alternative channel structures such as the internet.

Building profit improvement

In seeking to further increase profitability, companies need to develop integrated programmes that address customer acquisition, customer retention and other related activities that can improve customer lifetime value. One framework for reviewing such profit opportunities is the ACURA model shown in Figure 8.

Figure 8: The ACURA framework



ACURA Is an acronym for: acquisition, cross-sell, up-sell, retention and advocacy. Rarely do companies systematically build CRM strategies that focus on all elements within the ACURA framework. Whilst companies seek to improve customer acquisition and customer retention, they also need to exploit cross-selling and up-selling and advocacy opportunities. Companies such as McDonalds and American Express are excellent at cross-selling and up-selling; and Virgin and First Direct excel at creating advocacy within their customer bases.

CONCLUSION

Understanding and undertaking the value creation process is crucial in transforming the outputs of the strategy development process in CRM into programmes that both *extract and deliver* value. An insufficient focus on the value provided to key customers, as opposed to the income derived from them, can seriously diminish the impact of the offer in terms of its perceived value. Only a balanced value exchange will ensure that both parties enjoy a good return on investment, leading to a good (long-term and profitable) relationship.

Achieving the ideal equilibrium between giving value to customers and getting value from customers is a critical component of CRM and requires competence in managing the perception and projection of value within the reality of acquisition and retention economics. To anticipate and satisfy the needs of current and potential customers, the supplier organisation must be able to target specific customers, and to demonstrate added value through differentiated propositions and service delivery. This means adopting an analytical approach to value creation, supported a dynamic, detailed knowledge of customers, competitors, opportunities, and the company's own performance capabilities.

Increasingly sophisticated technologies provide essential aids in developing and deploying 'intelligence' for competitive advantage. Many companies have achieved greater organisational efficiency and market place effectiveness through automating the business processes that deliver value to their customers (as well as suppliers and employees). However, such innovations do not negate the vital role fulfilled by employees. Indeed, excellent customer care remains the key determinant of winning and keeping customers.

REFERENCES

The reader wishing to explore issues within this paper further may wish to consult some of the following.

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