Four Customer-Centricity Best-Practices and Three Customer-Value Metrics for Customer-Relationship Success

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The current economic downturn and the barrage of media choices require a different relationship with customers—and a different way of monitoring that relationship.

Changes in the way customers receive and process information via social-networking sites, mobile phones, and the Internet, combined with shrinking margins, deteriorating customer loyalty, and increased demand for marketing accountability, suggest the need for a new approach to customer-centricity.

A. G. Lafley, CEO of Proctor & Gamble, signaled this reconfirmation best with his resounding cry, "The customer is boss."

Studies confirm that point of view:

- According to a 2009 study by Heidrick & Struggles, the number-one focus for C-level executives this year is the customer—acquiring new ones, increasing retention, and improving their lifetime value, in that order.

- A study by MarketingProfs indicates many marketers are focused on some form of customer acquisition or retention as their most important marketing objective.

- And a study conducted some years ago by Deloitte and Touche found customer-centricity makes sound business sense. It found that customer-centric companies were 60% more profitable, two times as likely to exceed return on shareholder equity, and twice as likely to exceed goals for pre-tax returns on assets, sales growth, and market share compared with less customer-centric counterparts.

Still, a recent study by SpencerStuart with over 200 chief marketing officers found that only 33% believed their success to be tied to having a customer orientation; moreover, 92% of the CMOs said they must "own" the brand to be successful, compared with 41% who indicated they must "own" the customer relationship.

Finding, keeping, and growing the value of customers is the reason for Marketing's existence. Accordingly, Marketing has the responsibility to take the lead for driving customer-centricity within the organization. So how can organizations accomplish this?

Four Best-Practices

There are four best practices that stand out regarding customer centricity: passion, reversing value chain, building relationships and experiences, and fostering purchase readiness.

1. Passion. Organizations that are committed to customer-centricity are passionate and sincere that the "customer is boss." They believe that the customer is vital to their success and see the world through their customers' eyes. Marketers inside customer-centric organizations understand what customers want and expect. They leverage and value customer data and have a methodology for capturing customer insights and sharing this data across the organization.

2. Reversing the value chain. Organizations that are committed to customer-centricity reverse the value chain to deliver what customers truly value. Customers' needs, wants, and priorities are the catalysts for developing products and services and selecting channels.

3. Building relationships and experiences. Organizations that are committed to customer-centricity focus on creating mutually beneficial relationships designed to maximize the customer's product and service experiences.

4. Fostering purchase readiness. Organizations that are committed to customer-centricity analyze, plan, and implement a carefully formulated customer strategy that incorporates programs that create a state of purchase readiness and focus on creating and keeping profitable and loyal customers.

Implementing these four practices is not an easy task. It requires a process and the right tools for capturing customer insights. For many companies, that means organizational change.

The key to the process is stronger collaboration among Marketing, Product Development, Service, and Sales in order to ensure that the right products are available at the right price in the right channel. And that requires a different set of metrics for most marketing organizations. Although most marketers track something related to opportunity development (e.g., qualified leads), and something related to customer satisfaction, metrics that demonstrate how marketing strategies resonate with customers and tie back to the bottom line are often not developed. Even if they are developed, the right metrics for gaining valuable insight into customers are often missing from the marketing dashboard.

Three Customer-Value Metrics

People often ask us, "What customer metric should we use?" There really isn't a "one size fits all" list for every company all of the time. It's almost impossible to come up with one set of metrics that will be in place forever. However, there are three broad customer value metrics that have financial implications for every organization and therefore should be carefully monitored. Let's quickly examine each of these broad organizational customer value metrics to understand how they can be monetized for every organization.

1. Churn/Attrition Rate

Securing new customers is even more challenging in today's environment. As a result, more companies are focusing on and investing in keeping customers than in acquiring new ones.

- Acquiring new customers can cost five times more than satisfying and retaining current customers. A 2% increase in customer retention has the same effect on profits as cutting costs 10%.

- The average company loses 10% of its customers each year.

- A 5% reduction in customer defection rate can increase profits 25-125%, depending on the industry.

(Commonly accepted statistics related to customer retention and churn include "Leading on the Edge of Chaos," Emmett C. Murphy and Mark A. Murphy.)

Data also shows that companies with high retention also grow faster. The key is knowing how many are defecting and why, as well as how many are staying and why. The reasons customers leave and why they stay are often different, so it is important to work both sides of the equation. Calculate your churn rate by measuring the number of customers who discontinue a service during a specified time period, divided by the average total number of customers over that same period. This metric, along with the reasons why customers are leaving and staying, is a fundamental step.

2. Customer Retention Equity/Lifetime Value

In most businesses, customers are the most valuable assets a company has. Most surveys across industries show that keeping one current customer is five to seven times more profitable than attracting one new one (source: "Companies Don't Succeed—People Do!" by Graham Roberts-Phelps). The profits generated during the retention phase are often referred to as customer lifetime value or customer retention equity. Here is a simple way to calculate customer retention equity:

1. Determine the average retention rate of your customer base.

2. Compute the average expected relationship duration of a customer with this retention rate.
3. Determine the average per period margin and costs that are associated with retaining this customer.
4. Multiply the period net profits by the number of periods the relationship lasts.

Let's see if we can work an example:

- Suppose that for the past four years your retention rate for a set of customers has been 60%, 61%, 62%, and 61% over a four-year period. This equates to an average retention rate of around 61%: (60+61+62+61) / 4 = 61.

- Analysis reveals that the expected relationship duration for the average customers is 1/(1-average retention). In this case, that's 1/(1-.61), or 2.56 years.

- After analyzing the historical data over the same four-year period, the firm has determined that the average margin is $7,500 and the average costs over this period total $750. This equates to a net margin of $6,750.

- Expected retention equity is $17,280 ($6,750*2.56).

Calculating customer retention equity (lifetime value) really helps to understand why it makes sense to invest in keeping customers. It's a very interesting way to get a handle on your customer portfolio and to segment your customers.

3. Share of Wallet and Potential Wallet Value

Many organizations use "share of wallet" as a way to improve their understanding of where added value may exist among their customers.

The wallet of a customer is defined as the total amount that the customer can spend in a specific product category. The share-of-wallet, then, is how much the customer spends with a particular seller.

The simplest way to calculate share of wallet is to measure how much of a customer's total category spending you own vs. what the customer spends in that category, and then compute the resulting ratio.

By understanding the total wallet and the share-of-wallet, you can identify which customers are the most "loyal" and which customers have the greatest growth potential. Both the ratio and the actual difference are important: The first tells us the share of wallet, the second the potential value.

How does an organization reduce churn/attrition rate and improve customer retention equity and share of wallet? Improving the strength of the relationship with its customers, increasing the satisfaction across all touch points, and optimizing customer experiences will directly affect each of those three customer-value metrics.

And they represent real opportunities for Marketing to make an impact and a difference, because Marketing can positively influence all three. Touch-point effectiveness, the strength of the relationship, and customer experience are all within Marketing's sphere of influence and scope of responsibility.

Therefore, those marketing organizations that drive strategies, performance targets, and metrics related to relationship strength, touch-point effectiveness, and customer experience will be in a better position to demonstrate an impact on the three customer value metrics.

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