GAME PLAN

How can marketers face the challenge of managing customer value metrics?

By Art Weinstein and Shane Smith

Theoretical physicist Albert Einstein once said: "Everything that can be counted does not necessarily count; everything that counts cannot necessarily be counted." Since marketers can't measure everything, the challenge is to focus on those metrics that truly matter—those that affect business performance. For example, a leading Florida timeshare focused on four critical areas: business development (BD), customer service (CS), operations (O) and production (P). One key BD metric dealt with pitch-rate conversion of weekly unit purchases; the objective was improvement from one-in-seven prospect closes to one-in-six over the next year.

According to the CMO Council, customer analytics are the top priority among chief marketing officers. More than three out of five (62%) said their focus is on analyzing customer data to improve target marketing strategy (*Mediaweek*, June 6, 2010). Nearly half (46%) are investing in digital demand generation and online relationship building. And improved qualifying and tracking lead conversion was cited by 44% of CMOs. Strong data analysis means better customer-based decisions.

MARKETING ACCOUNTABILITY

Organizations need a solid management information system to access knowledge about the market. Recognize that information is unique among the factors of production. It gains value through additional perspectives, as it is shared for a common purpose.

Marketing departments/CMOs are being held more accountable for their actions. Boardrooms are asking for the return on a marketing expense before approval. Perhaps we can chalk this up to economic pressures, as well as tighter restraints on corporations since the government's involvement with the Troubled Asset Relief Program loans.

Most marketers do not know where to begin to measure their business performance, beyond that of the tactical nature. Those that do have a notion of basic metrics often only measure customer's intent; they cannot convert these figures into meaningful information that relates to the financial health of the organization.

Perhaps this is because the comfort zone for many MBA-trained managers are the traditional metrics—brand awareness, revenues, profits, return on investment (ROI) and market share. In contrast, they are less familiar with newer measures such as customer lifetime value (CLV), recency, frequency and monetary value (RFM) analysis, net promoter scores (NPS) and share of customer. Other executives, particularly in technology markets, entered marketing from non-business tracks such as engineering or production; as such, they may fail to see the marketing and finance interface.

A NEW MINDSET

Becoming customer-driven shifts the focus from the product and brand toward the customer. Measuring production effectiveness and brand equity is still integral to success. This should only be done once the customer-centric strategy is in place. This new reality means the CMO and all marketers in the organization must consider new measurement tools and approaches.

Communication with the finance department is sorely needed. As part of a corporate culture of accountability and transparency, the CMO and the entire marketing team must know what the chief financial officer wants in return (and relevant constraints). The quick answer is financial evidence. Just as international marketers learned the language of their host countries, corporate marketers must learn the financial language of business and tie projected performance to dollar equivalents—not just offer soft measures, such as brand awareness or preference.

Metrics that link financial information directly to customers' actions (or predicted actions) are called for. This allows marketers to demonstrate results in the strategic decision-making process (and provide real input to the executive team), as opposed to only responding to tactical measures (e.g., brand preference or click-through rates). If a measure is already on a strategic level (e.g., brand equity), marketers should consider building a metric that measures the customer more directly (e.g., customer equity).

In a recent *Journal of Marketing Research* article, Sunil Gupta, Donald R. Lehmann and Jennifer Stuart state that customer equity is a proxy for the value of the firm that can be calculated by obtaining the sum of the customer lifetime values of the organization's current and future customers ("Valuing Customers," *Journal of Marketing Research*, 41, 7-18, 2004). CLV is discussed later in this article but can be calculated by all companies with the use of internal records. A simple summation of the average customer's behavior on the frequency of purchases, average spent per purchase and the length of time the customer remains a customer can all be used to calculate this customer value metric.

New customer-centric measures not only help the CMO communicate the marketing agenda to the C-suite, but also play a more active role in shaping future business strategy. The financial evidence that CMOs frequently used came from ROI, but this term was often mismanaged. First, the word "return" is derived from a financial return. Many of the metrics used in the past were not financially linked in a direct manner. Second, "return" is referenced to what the organization earns from the investment (payback). Third, the word "investment" was never quite accepted by the C-suite, when it came to marketing programs/processes.

Instead, money spent on marketing activities was generally viewed as a business expense. This perception must change in the era of customer centricity and customer value-based metrics.

Today's metrics mantra is customer return on marketing investment (CROMI). The difference in terminology appears minimal semantically, but can be huge to the marketing charge. First, the word "customer" has been added to the return. This puts a focus on the consumer and the value to the organization of individual buyers. Metrics that are able to capture the value of each customer transaction

(as well as relationships) allow management to respond to all changes that occur in the marketplace/market space. This not only helps to guide the marketing team, but it gives them a jump start for gathering business performance documentation, in financial terms.

The second word added is "marketing," which emphasizes the investment in the area of customer focus. "Marketing investment" makes it clear that each dollar spent on improving the customer experience is worthwhile. Enterprise Rent-A-Car evaluates the service experience through the use of a customer satisfaction measurement tool, the Enterprise Service Quality index (ESQi). The ESQi surveys random customers on their recent car rental. Each branch is required to maintain the company-wide standard (at least 80% of customers stating they were "completely satisfied"), which impacts manager bonuses and promotions for all employees at each respective branch.

Based on research by Steven Seggie, Erin Cavusgil and Steven Phelan (*Industrial Marketing Management*, 2007), Figure 1 features a set of seven important questions to ask about your metrics.

THE 5C APPROACH

To understand how to use customer value metrics, there is a five-step process called the 5Cs. These steps are: 1) collect voice of the customer (VOC) data, 2) customer lifetime value, 3) customer retention, 4) customer defection planning and 5) communications.

1. Collect VOC data. The first step in measuring customer value is to gather VOC information. The VOC falls into one of three categories. The first approach is direct from the customer, such as communications with the actual customer or from employees (e.g., sales reps) who deal directly with the customer. Such information is often the most recent and valid.

This method is good at capturing information in real time, so if any adjustments are necessary, the organization has time to rectify the problem immediately. A downside to capturing the customer's voice in real time is that emotion may overpower rational thought. An upset customer can overreact to a situation and thus negatively bias results.

This information is usually collected by the firm, but perhaps it is not recorded and monitored in a systematic and measurable way. The recording of simple customer service comments (i.e., voice, e-mail, etc.) can first be categorized into types of complaints and/or compliments. Once categorized, the types of remarks are tallied to measure which comments are the most frequent. On a more advanced level, an organization can relate this information to customers that have left the firm to determine which categories of remarks have caused the most damage to the firm. Those categories that have resulted in the greatest loss to CLV can then be the focus for management to rectify.

A second approach for collecting the VOC is survey research (questionnaires, depth interviews, focus groups, observational techniques, etc.). Although questionnaires are common and useful, they have some drawbacks. They are lagging indicators, which are often late to the party—since they are sent to the customers after the service experience. (Customers may not remember the exact details of

Figure 1: Designing Better Measures

1. Do your marketing metrics use the same financial language as the rest of the company?

2. Does your company develop forward-looking metrics, taking into account changing competitive dynamics, environmental shifts and internal initiatives (such as new product launches and brand extensions)?

3. Do your marketing metrics adopt a long-term perspective?

4. Do your marketing metrics consider micro-level data (e.g., share-of-customer), as well as macro-level data (e.g., market share)?

5. Can you move your analysis from independent measures (e.g., sales or profits) to causal chains (e.g., value creation, satisfaction, loyalty, market performance)?

6. Do your measures consider relative performance (compared to competitors), as well as absolute numbers (your corporate business performance)?

7. Are your metrics based on subjective measures or objective measures (i.e., key performance indicators)?

Seggie, et. al (2007) "Measurement of return on marketing investment: a conceptual framework and the future of marketing metrics," Industrial Marketing Management, *36, 834-841.*

the service encounter.)

A third approach to collecting the VOC is to use data the organization routinely obtains. This includes purchases, visits to the store or website, online views, etc. Most organizations have sophisticated IT systems in place that coordinate well with marketing reward or affinity programs. These systems are often part of customer relationship management (CRM) systems. Grocery stores are able to recognize that customers who purchase prepackaged salad ingredients are also inclined to purchase salad dressings. Web-based stores are able to track their visitors click patterns to learn what items they viewed, and in what order.

In combination, the three VOC sources give a complete profile of the customer. The more sound sources of information that are available, the more likely the organization is able to truly understand customer preferences.

This helps companies design winning strategies to delight customers. The "What to Measure" sidebar on page 38 delves deeper into the issue of what type of information to collect.

2. CLV. The CLV formula is the projected measure of a customer's worth to a company. Based on this computation, organizations can focus strategic decisions and communicate them to the value providers (employees). CLV implies a quantifiable, financial value for each customer who is treated as a business investment. The more customers are attracted and retained by the organization, the higher the cumulative investment will grow. Customers who are lost to the organization represent a loss of investment. Prospects that have not done business with the company can be viewed as money left on the table (lost revenue opportunities).

By using the information collected from the VOC, forward-looking projections of what a customer is worth financially to the organization can be established. In other words, past knowledge can be used to predict future outcomes. Let's consider this simple illustration of CLV:

- Each customer who bought from us in the past has stayed with us for an average of Y years.
- Each year, he visits our store and purchases from us, on average, T times.
- Each time he purchases from us he spends an average $ dollars.
- There are N customers who fall into this category.

Therefore, Y * T * $ * N equals not only value of the past and existing customer base, but can also be used to represent the future customer value. By this definition, CLV can be viewed as the net present value of the likely future profit stream from an individual customer. Combined with all customers, this stream represents the entire value of customers to the organization.

To determine the CLV of a customer, one follows four basic steps. The first step is to collect data from the organization's customers. This marketing information includes purchase history, the amount spent, the number of purchases made in a specified period, the cost of generating business (product, marketing, etc.) and profit margins. Note: Not all customers are alike. Companies should segment their customer base by customer type to determine the higher value customers. An RFM approach can be valuable here.

The second step is to determine the customer's likelihood of retention. How long does a typical user in a particular segment remain a customer? Depending on the

Figure 2: Food for Thought

1. Why is it important to measure customer value?
2. Explain why a customer equity perspective is preferable to a brand equity perspective.
3. To whom (within the company) is customer valuation important?
4. How does your company measure the value of customers?
5. In what ways does your company capture online customer data?
6. Does your company collect VOC data?
7. How might CLV be utilized within your company?
8. Using the 5C Approach described in this article, develop an outline of how to proceed for an upcoming managers meeting.
9. What key performance indicators (KPIs) should be on your marketing dashboard?

type of business, this may be months or years. The length of time that a customer remains with a company is easy to determine with CRM programs, since this information is routinely monitored. If there is no CRM system in place, a simple research survey can be conducted.

The third step is to determine a financial discount rate used for current investments. This can easily be obtained from your finance department. In fact, this part of the process offers an excellent opportunity for the marketing and finance areas to work together to achieve organizational objectives. (The importance of such collaboration will be discussed later as the fifth "c" of customer value metrics: communication.)

The fourth and final step of measuring the CLV is the calculation. While the formula may appear complicated, it is a basic calculation of the aforementioned collected information. The company will determine the revenue the customer brings in over a designated time period minus the costs of product, customer service, marketing expenditures and other costs to calculate a margin. This margin is then projected out over a predetermined period of time, and the discounted cash flow is then applied to recognize the time value of money. The result is a financial value that can be used to estimate what each customer is worth to the company.

3. Customer retention. Once we understand CLV, we know what it costs to keep a customer as well as how much it will cost us if we lose an account. We also need to understand who our most profitable customers are, and which customers are least profitable. Customer retention plays a key role in making strategic decisions.

Using the CLV metric, we can apply customer-retention analysis to all types of customers. Knowing that we have customers of varying attributes, we may recognize that some are worth keeping, while others should be fired. Yes, you are allowed to fire a customer if that account costs more to service than it generates in revenue and/or that client is difficult to work with (e.g., has a bad attitude, harasses your employees, is frequently late paying invoices, etc.). Best Buy's "angel-devil" strategy focused on reducing its 20% of devil customers (those who use rebates, return purchases, buy loss leaders and seek the lowest price) and nurture its angel customers, segmented as high-income men (Barrys), suburban moms (Jills), male technology enthusiasts (Buzzes), young family men (Rays) and small business owners (Mr. Storefront).

Begin by organizing the data into customer types. For example, a large retailer may notice that certain customers from a specific zip code have a higher CLV than most other customer types. Therefore, the marketing department could direct its attention toward targeted residents in that zip code. In contrast, the retailer may also realize that another zip code produces consistently lower returns. Research may find that these customer groups can be made more profitable with additional or alternative marketing initiatives. It is also possible, however, that this group will never bring revenue to desirable profitable levels, and marketing management may decide to no longer target this group (i.e., not spend promotional budget toward them and divert those resources elsewhere).

BRIEFLY

- Marketers can't measure everything, so the challenge is to focus on those metrics that truly matter—those that affect business performance.
- Becoming customer-driven shifts the focus from the product and brand toward the customer.
- Metrics are an important part of the strategic process to understand: 1) how successful the organization is now, and 2) what it needs to do to become even more successful.

Custom Research Inc., a Minneapolis-based marketing research firm, dramatically cut its customer base, yet increased revenues and profits by dedicating personnel and resources to high-volume, high-margin clients via individualized partnership plans called "surprise-and-delight" marketing initiatives. Simultaneously, they systematically eliminated dozens of low-volume, low-margin accounts that were no longer a good fit for their new strategic direction.

When necessary to part ways with a client, try to make it as positive an experience as possible. For example, an ad agency might advise a client that one of its strategic partners (perhaps a smaller or newer firm) can do a better job servicing his account since they specialize in digital media.

4. Customer defection planning. Focusing on the return on investment in the customer (ROIC), a manager can build a financial model that rewards keeping current customers satisfied and minimizes dissatisfaction. To accomplish this, one must collect data first. John A.

WHAT TO MEASURE

Top executives, board members and shareholders are now demanding accountability for new and established marketing programs. A major issue for debate in an organization is what metrics to collect and evaluate (measures are industry- and company-specific). The choices are wide-ranging–from a single metric such as net promoter score to literally hundreds of potential marketing and performance variables.

The sole measure may require the collection of multiple inputs to obtain the necessary data for analysis. For example, in evaluating customer lifetime value, you will need to know: the average amount spent per purchase, number of purchases made per year, average gross profit margin per customer, customer acquisition costs, marketing expenditures per customer, discount rates and customer retention rate.

Database marketer Arthur Hughes prefers to keep it simple by stressing three key measures of business performance: return on investment, profitability and lifetime value. He recommends using all three of these measures, particularly in direct marketing applications.

A leading book on the subject by Paul Farris and colleagues claims that there are dozens of marketing metrics that matter (*Marketing Metrics: 50+ Metrics Every Executive Should Master*, Wharton School Publishing, 2006). These relate to the marketing mix, profit margins, customer profitability, share of market, the Web and other key areas in business.

We prefer the handful approach: choosing a few powerful measures that make the most sense for a given organization within the context of a customer value metrics framework (the 5C approach).

In line with this more parsimonious thinking, Flora Kokkinaki and Tim Ambler concluded in a 1999 Marketing Science Institute working paper that marketing metrics can be summarized into six key categories:

1) **Financial**: turnover, contribution margins and profits

2) **Competitiveness**: share of market, advertising and promotion

3) **Consumer behavior**: customer penetration, loyalty and new customers

4) **Consumer intermediate**: brand recognition, satisfaction and purchase intention

5) **Direct customer**: distribution level, intermediary profits and service quality

6) **Innovativeness**: new products launched and the percentage of annual revenue from new products.

Goodman developed the Market Damage Model (*Strategic Customer Service: Managing Customer Experience to Increase Word of Mouth, Brand Loyalty, and Maximize Profits*, AMACOM, 2009). Using data collected from the VOC, we first determine the number of customers who have problems. Second, we must estimate the number of customers who actually have made a complaint. Third, of those that did complain, it must be determined the percentage of customers that wound up satisfied, mollified or remained dissatisfied. With this information in place, marketers are now able to account for the total number of customers at risk (of not remaining a client) with the organization.

Knowing the total number of customers at risk and the value of each of those customers, managers can now recognize the total financial impact of dissatisfied customers. Also, by knowing the financial impact of the potential loss of these customers, the manager can determine if selected improvements made to retain these customers are worthwhile. For example, if one solution for retaining lost customers is to implement a $2 million CRM system, and that system will help in increasing CLV to an additional $5 million, then this marketing decision can be seen as a positive investment. However, if the CLV calculations indicate the financial impact of the new CRM system is only $1 million, then the manager may decide to allow for the customers' departure. It must be understood, however, that the $2 million investment may last many years—and every year it remains effective may contribute to a positive marketing return within the company.

Managers can also use data collected via VOC to determine what specific areas are causing dissatisfaction to their customers. Most organizations will have a number of areas that are causing these "pain points" with the customer. With some basic research, the company can determine which problems are the most severe, as well as locate those problems that occur most frequently. Goodman also developed a model that he termed "market at risk calculation." In this model, managers determine the types of problems experienced by customers, the frequency of those problems and the severity of the problems. Armed with this knowledge, executives can determine the percentage of customers that may potentially be lost. Combining this with the

CLV can be a sobering experience, as it represents just how costly dissatisfied customers can be to the company.

Marketing managers should also calculate the impact of existing customers on revenue generation within the firm. Highly satisfied customers will remain loyal and not defect; many are also strong advocates for the business and attract additional customers through word-of-mouth promotion and social media. In effect, this saves the company money, as delighted clients are an extension of the organization's marketing arm—reducing the need for some advertising, sales promotion and sales force expenses.

5. Communications. CLV models demonstrate that the value of the customer can be quantified. Attaching a value to a customer allows marketers to better make strategic decisions. Furthermore, putting a financial value on the customer also builds the credibility of the marketing department. The actions of the marketing manager are being held to ever-higher accountability standards. In past dealings, the C-suite, the CFO, the accounting department and other interested parties have all had issues with the subjectivity of reports generated by marketing. The ability to measure the customer's value in financial terms allows marketers to speak the numbers language of business.

In addition, financial accountability brings credibility to the marketing function; this leads to additional input in the boardroom. No longer is the measurement of the customer viewed only as a tactical decision. Metrics can now be made at the strategic level, using a customer valuation perspective. Communications across the organization improve when all executives and staff are working from the same page in the same book. As an example, the average Publix Super Markets shopper is worth about $300,000 in CLV ($100 per week, 50 weeks per year, 10-year life and giving five referrals). Store management, assistant department managers, pharmacists, customer service personnel, stocking associates, cashiers or baggers can gain a new appreciation and shared understanding of the long-term value of a single grocery shopper when presented with this pertinent and eye-opening information.

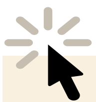
YES, YOU ARE ALLOWED TO FIRE A CUSTOMER IF THAT ACCOUNT COSTS MORE TO SERVICE THAN IT GENERATES IN REVENUE AND/OR THAT CLIENT IS DIFFICULT TO WORK WITH

BUILD THE FOUNDATION

Doing business today requires a new level of marketing accountability. Superior customer value means knowing customers' behaviors and buying patterns. Metrics are an important part of the strategic process to understand: 1) how successful the organization is now, and 2) what it needs to accomplish to become even more successful in the years ahead.

This article discussed key customer value-based metrics and offered a five-step framework for implementation. Smart customer value managers will embrace this challenge and use metrics as a sound planning tool to improve business strategies. Figure 2 on page 36 provides a framework to get the metrics conversation started in your organization. Ideally, plan on dedicating at least a half-day retreat for a substantive discussion on this vital issue. Realize that a strong metrics foundation provides a basis for analyzing business situations, identifying best practices, overcoming marketing challenges and exploiting business opportunities. MM

ART WEINSTEIN is professor and chair of marketing at Nova Southeastern University, Fort Lauderdale, Fla. **SHANE SMITH** is an assistant professor of marketing at the University of Tampa. They can be reached at Art@huizenga.nova.edu and SSmith@ut.edu, respectively. This article is adapted from Dr. Weinstein's new book, *Superior Customer Value: Strategies for Winning and Retaining Customers*, 3rd Edition (CRC Press, 2012).



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