Successful CRM: Turning Customer Loyalty into Profitability

By Bob Thompson
CEO, CustomerThink Corporation
Founder, CRMGuru.com

October 2004

Compliments of:

Table of Contents

Executive Summary

Customer relationship management (CRM) gained recognition in the mid-1990s, primarily driven by its perception as information technology (IT). However, not enough attention has been given to the fundamental drivers of CRM success: strategy, metrics and the organization.

Successful CRM is about competing in the relationship dimension—not as an alternative to having a competitive product or reasonable price—but as a differentiator. If your competitors are doing the same thing you are (as they generally are), product and price won't give you a long-term, sustainable competitive advantage. But if you can get an edge based on how customers *feel* about your company, it's a much stickier—sustainable—relationship over the long haul.

The purpose of this white paper is to take a fresh perspective on how successful CRM really works. The essence is that you can dramatically improve your chances of getting an ROI from your CRM initiative by following three simple steps: 1) Understand the value your customer wants, 2) deliver that value profitably and 3) repeat.

Simplistic? Perhaps. But that doesn't mean it's easy. Most companies have entrenched ways of doing things, focusing on products, rather than customers. Organization inertia and self-interest are also to blame. As GE's former CEO Jack Welch said in 2000, "Bureaucracies love to focus inward. It's not that they dislike customers; they just don't find them as interesting as themselves."

In this white paper, you'll learn why listening to the voice of the customer is so crucial to CRM success—and how genuine customer loyalty impacts corporate profitability. You'll also find out what the latest research indicates about the gap between potential and actual CRM benefits, and the four key drivers of ROI for CRM projects. Plus, you'll learn the unvarnished "truth" about CRM success and failure, minus both the positive and negative spin sometimes promoted by vendors, consultants, analysts and the media.

The bottom line, though, can be summarized as follows:

- CRM can work as a differentiating business strategy.
- CRM delivers a return on investment for two out of three projects.
- CRM produces solid short-term returns but lags in providing full strategic benefits.
- CRM success starts with putting customer interests first. Period.

Said another way, you can succeed with CRM by being SMART: Define a customer-centric **Strategy**; use appropriate **Metrics**; ensure your organization is **Aligned** with your objectives; **Redesign** work processes as needed; and use appropriate **Technology** tools as enablers.

But it all starts by putting your customers first and creating a better relationship with them than your competitors offer.

Differentiate or Else

At a conference in London in May 2004, business strategy guru Michael Porter delivered a simple but powerful message: Effective business strategy means being distinctive. How? Business strategy experts say that you can differentiate based on: 1) the core product/service offering, 2) the price or total cost of ownership or 3) the total relationship and customer experience.

Staying ahead of competitors solely through product leadership is becoming more and more difficult. In an interview with *Fast Company,* Porter stated, “It’s arrogant for a company to believe it can deliver the same sort of product that its rivals do and actually do better for very long. That’s especially true today, when the flow of information and capital is incredibly fast.”

It’s also painfully obvious that every business in an industry can’t compete using the same cost/price model. Generally only one or two companies can achieve the scale and efficiencies necessary to compete based on low price and profitably sustain this strategy over the long term. Would you like to start a price war with Wal-Mart?

The Rise of Relationship-Based Differentiation

CRM is a business strategy to acquire, grow and retain profitable customer relationships, with the goal of creating a sustainable competitive advantage. Product/price-based differentiation is waning because of four broad trends: maturing markets, global trade, efficient manufacturing and the Internet.

Now CRM is emerging as a critical strategy simply because relationships are coming to the forefront of the competitive battleground. CRM should mean creating mutual wins for customers and all the company stakeholders, including employees and business partners. It’s just common sense. Would you willingly continue to do business with a company if you didn’t feel you were a “winner” in the relationship?

In *Customers Are People: The Human Touch*, author Jon McKean states that in competitive markets, where customers have a choice between similar products and pricing, “Seventy percent of customer decision-making is based on how customers are treated.” Yet paradoxically, McKean continues on to say that his research finds: “Over 80 percent of customer initiatives are focused on how to ‘sell the customer better’ through matching products to customers, rather than investing more resources in treating customers better.”

Does relationship-based differentiation really work? Tesco thinks so. With humble beginnings as yet another low-cost grocery retailer in the U.K. market, Tesco has grown into the market leader in a few short years by using data-driven customer insight to manage millions of relationships, creating a loyal bond. If you investigate the success of IBM in computer technology, Nordstrom in retail clothing, HSBC in banking, Ritz Carlton in hotels and Singapore Airlines in air travel, you’ll find that all of these companies turned customer relationships into a differentiator.

Loyalty and the Bottom Line

Frederick Reichheld, author of *The Loyalty Effect* and *Loyalty Rules,* found that loyalty leaders grow, on average, more than twice as fast as the industry average across a wide variety of industries. And they do it more cost-effectively. The reason for this so-called “loyalty effect” is that loyal customers tend to spend more, cost less to serve and refer others.

The net result is that loyalty leaders are head and shoulders above their competitors in growth and profitability. Leading examples, according to Reichheld, range from Harley Davidson to Chick-fil-A to Enterprise Rent-A-Car.

The key question: How does a company create loyal relationships? And remember, we’re talking about relationships where customers have real choices. Don’t include monopolist industries (as is the case with some utilities or government services) or customers “trapped” behind high exit barriers (such as database software or factory equipment that can’t be easily replaced).

Reichheld and other loyalty experts have studied this issue for years and concluded that loyal attitudes and behavior are driven by the customer’s *perception of value*, which is an amalgamation of *what* the customer receives; *how* it’s sold, delivered and supported; and *how much* it costs—the price or total cost of ownership. Experts in customer psychology say that customers’ emotional states influence about 50 percent of the value they perceive. Jim Barnes, author of *Secrets of Customer Relationship Management: It’s All About How You Make Them Feel*, sums it up by saying, “Value is created every time a customer is made to feel welcome, important and valued.”

Simple Metric, Powerful Insight

Loyalty guru Reichheld has found one simple metric to be highly related to growth in most industries: the willingness of a customer to recommend the company (supplier or brand) to a friend or colleague. Using a 0 to 10 scale, a “net promoter” score is calculated by taking the percentage of customers giving the company a score of 9 or 10 (“promoters”) and subtracting the percentage giving the company a score of 6 or below (“detractors”).

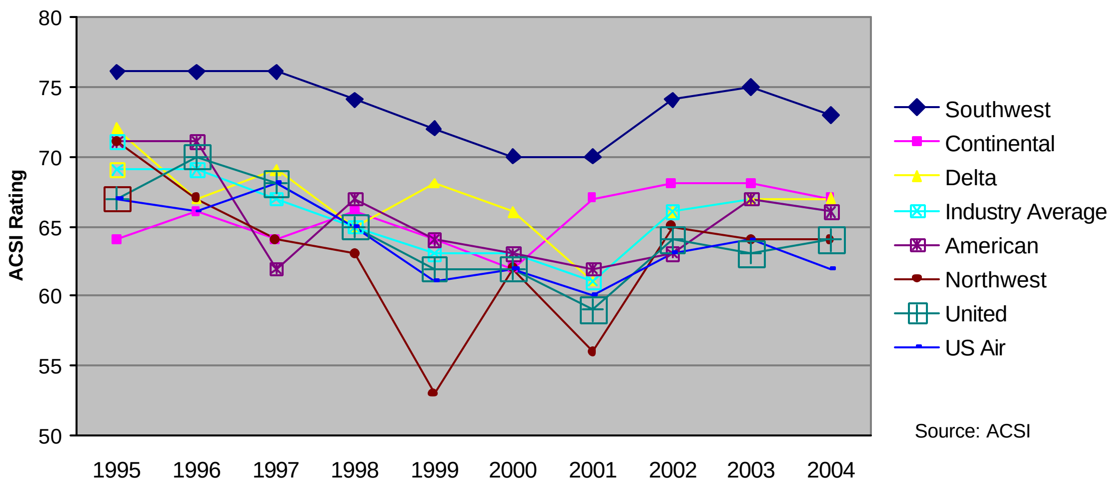
For example, over the past three years, Southwest Airline’s net promoter score was two to five times higher than its major competitors. During that same period, Southwest grew at about 5 percent per year, while the rest of the industry was in decline.

In a Bristol Group/CRMGuru study in 2003, Southwest had a “recommendation” rating of 67 percent, meaning that two-thirds of respondents said that they were highly likely to recommend the airline to their friends and colleagues. This was more than double the industry average and nearly seven times higher than struggling United. This referral behavior is a key reason why loyalty matters: Genuine feelings of loyalty drive referral behavior (think “free marketing”) to propel growth—and do so very cost-effectively.

Over the past decade, the American Customer Satisfaction Index (ACSI), an organization supported in part by the University of Michigan Business School, has emerged as a valuable source of consumer insight. The ACSI model links customer expectations, perceived quality and perceived value to an overall score (ACSI), which, in turn, is linked to consequences such as customer complaints and loyalty. ACSI leaders—those in the top 50 percent in ACSI rankings—have been able to build market value more rapidly over the past decade. A case in point is Southwest, which has made more profit and created more market (stock) value over the past decade than the rest of the airline industry combined.

Any way you slice it, achieving high levels of customer satisfaction and loyalty compared to your competition is a powerful engine for growth and profitability.

American Customer Satisfaction Index: Airlines



Source: ACSI

The Customer View of Value

To be successful with CRM, you must start by understanding your customers and do the best job you can of listening to their needs. As Michael Dell said in his book, *Direct From Dell: Strategies That Revolutionized an Industry*, "If you're constantly getting feedback from your customers, and you're willing to listen, you can make the most of the opportunities implicit in those needs."

In CRMGuru's research, customers speaking about a great relationship use terms that imply the relationship is win-win. Only about 20 percent of the time do customers talk about the functionality of the product or service—or about the price. There seems to be an implicit assumption that these are competitive but not differentiating factors. Common phrases used to describe loyal supplier relationships include:

- Easy to do business with
- Responsive and proactive
- A service and a value just for me
- Consistent performance over time
- They ask me questions
- Great expertise

Gerald Zaltman, professor of marketing at Harvard Business School and author of *How Customers Think: Essential Insights into the Mind of the Market,* reached similar conclusions from a massive study of consumer behavior. He found that similar phrases emerged from consumer interviews about their "ideal company," such as: "I want it to be easy, pain-free"; "they (the supplier) want to take care of their customers"; and "I like the teamwork and cooperation."

Are your customers saying these things about your company? Every company has happy and loyal customers. Learn from them! Ask your most loyal customers why they continue to do business with your company. You may be surprised how seldom your customers mention your product/service or price. Learn what they *do* value, then work with other not-so-loyal customers to find how to get them to feel the same way.

Heeding the Warning Signs

There are many ways to identify whether your organization is at risk of customer defections. An analysis of purchase or payment trends showing that customers have stopped buying a service or have reduced their purchase amount might be a tip off. Your frontline staff can let management know about customer complaints or changes in the relationship. You can do research with focus groups, online surveys and secret shoppers. Or, if you're dealing with thousands or even millions of customers, sophisticated analytical software tools can identify at-risk customers, based on a combination of factors, such as purchase patterns, usage and service calls.

Here's a personal example. I had been paying $50 a month for several years to a DSL provider, before having a service issue. But I was too busy to make a service call and feared a long frustrating experience on the phone. After four months of my not using the service, another DSL provider mailed me a start-up promotion, and I switched. To me, it was simpler to go to a new service than to make even one call to the company I'd been doing business with for several years.

My original DSL provider lost $50 per month multiplied by several years—almost pure profit—when it lost me as a customer. Sadly, it should have known from its systems that I was paying my bills but not using the service. Sooner or later, that would have to stop. A simple solution would have been to monitor usage patterns and send an automated email or schedule a phone call to ask me, "How's it going?"

This simple example illustrates why you need leading indicators of the health of the relationship you have with your customer. Don't wait for a complaint or satisfaction survey! Instead, consider all of the activities your customers engage in when they are *successfully* using the product or service you provide. The right list of indicators will be a cue to potential defections or opportunities to improve that relationship.

Relationship Health Indicators

RightNow® Technologies, which provides on-demand CRM solutions, puts this theory into practice very effectively. To stay in better alignment with its customers, the company created a "customer-success indicator" (CSI) measurement process. This creates an overall "health score" for its customers, based on a number of factors that indicate whether the customer is effectively using RightNow's solution.

For example, one category is the last time a customer used RightNow's free Tune Up consulting service. More recent is better. Other scores represent the version of the RightNow software the customer is using; the customer's attendance at RightNow events; the customer's use of integration; and usage volume on the customer's RightNow implementation.

Taken as a whole, the CSI program helps customers achieve success by optimizing the usage and value they receive from RightNow's solution. RightNow wins, too, because the company has found a strong correlation between the CSI score and the likelihood that customers would renew their contract. Not surprisingly, since this CSI process has been implemented, RightNow says it has reduced its churn (defection) rate dramatically.

A case in point is Invitrogen, which provides biotechnology for scientists in research labs and such organizations as the National Institutes of Health. Invitrogen uses the RightNow system to provide technical support to customers, generally scientists or doctoral researchers. In such an environment, customers can have very technical or complex questions. According to Kira Sevene, Assistant Project Manager for Invitrogen Technical Service, the core differentiator at Invitrogen is the service it provides. Going out of its way to serve the customer earned Invitrogen an award for "most helpful or responsive customer support" by *The Scientist* magazine.

Invitrogen began using RightNow's CSI system about a year ago. Sevene called it "an awesome tool," because it helped Invitrogen focus on areas that needed improvement. In general, Invitrogen Technical Service felt that having metrics broken down in a form that was easy to understand and use was very helpful. RightNow's CSI report follows an easy-to-understand traffic-light metaphor, with red meaning attention is needed; yellow serving as a warning; and green meaning that things were OK.

Sevene says Invitrogen is very pleased with the support the company received from RightNow and regards proactive initiatives such as RightNow's Tune Up program, as "over and above the call of duty." When asked to describe the company's relationship with RightNow, Sevene said, "We feel like we are their No. 1 customer." It's easy to see why, considering the effort RightNow puts into monitoring and facilitating the successful use of its solution.

Return on Customer Relationships

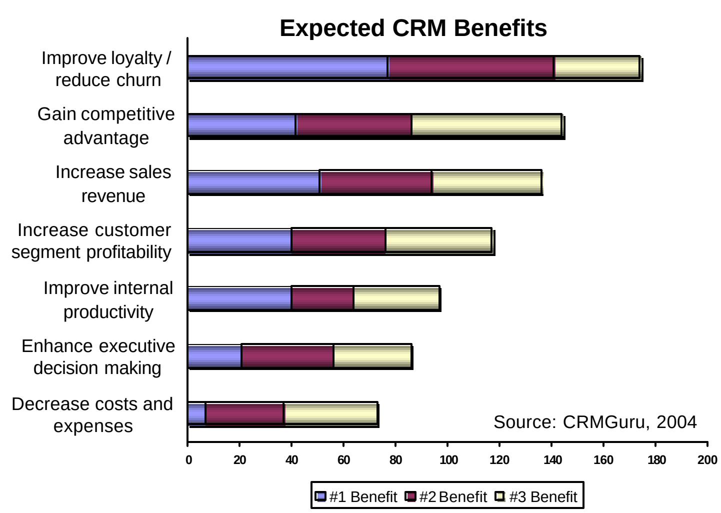
Companies are in business to make money. CRM, if it is a successful *business* strategy, should help your company grow profitably and create a competitive advantage. But the linkage between CRM implementation and business success has been the subject of much research and controversy over the past few years. In short, media/analyst reports tend to exaggerate the failures and vendors, the success.

The "truth," based on comprehensive CRMGuru research conducted over the past three years, is that 65 percent to 70 percent of CRM projects are in fact "successful," if you measure success by ROI or customer perception. However, the study also reveals that many CRM projects tend to deliver more tactical benefits and fall short on realizing full strategic advantages.

Taking the Long View

As discussed earlier, companies like Southwest have profited from relationship-based differentiation, creating a positive spiral of profitable referrals. But this is not tied to any IT-specific CRM program. Quite the opposite. When CRMGuru interviewed Southwest management, we learned that Southwest spends conservatively on technology and doesn't use the term "CRM" to define customer-focused initiatives. CRM is, in fact, integrated into the very fabric of how Southwest does business; it doesn't need to put a label on it.

Other researchers have studied the benefits of more formally defined CRM programs. In 2002, Werner Reinartz, associate professor of marketing at INSEAD in France, published the report, *Measuring the CRM Construct and Linking It to Performance Outcomes*. He found that CRM activities did have a positive impact on a company's performance. Is CRM a competitive strategy, such that companies can attain a real differentiation? In a CRMGuru interview earlier this year, Reinartz answered, "Yes, absolutely. I'm convinced about this, and I've seen quite a few examples of companies doing it very well vs. not very well, and you can see the differences."



What benefits are customers expecting from their CRM projects? As indicated in this chart, a CRMGuru online study of more than 1,000 projects found the top four expected benefits were increasing loyalty, gaining a competitive advantage, increasing sales and increasing profitability. Improving productivity and executive decision-making ranked lower, and cutting costs/expenses was dead last.

As you'll see later in this section, actual benefits have a distinctly different profile.

Theory versus Reality

CRMGuru (in conjunction with High-Yield Marketing and Mangen Research Associates) conducted a detailed study of 448 CRM projects in 2002. Projects varied in external investment, from zero (internal process changes or training only) to millions of dollars in software and integration services for large enterprises. Overall, 51 percent of projects received a payback in 18 months or less, and about 32 percent gained payback in less than a year.

As you might expect, this study found a distribution of success, not a clear demarcation of absolute success or failure. Measuring by ROI attained, results varied from little or no success in about one-third of the projects, to average success in another one-third, to superior-performing projects in the remaining one-third. Success measures were developed by analyzing common CRM benefits, such as reducing churn rate, increasing share of wallet, increasing customer satisfaction, increasing customer acquisition rate and reducing front-office staffing costs.

Our conclusion was that about two-thirds of CRM projects are successful, because they are delivering an average or better ROI. Customer perceptions matched this finding closely; about 70 percent said they felt their projects were successful.

We also analyzed project activities and found four broad factors were driving ("explaining" in a statistical sense) 72 percent of the ROI.

1. **Customer-centric strategy**. Higher ROI was related to companies that tended to listen to their customers in a variety of ways, such as using customer satisfaction data, analyzing churn or attrition data and getting customers involved in the planning process. This is a good example of how a listening process, done effectively as one element of a CRM program, is extremely important if you want to get a measurable ROI.
2. **Frontline training and support**. Successful companies provided new skills and training to employees, explained the value of the CRM program, in terms of both the technology used and the other aspects of the customer relationship process, and ensured employees were on board with the program.
3. **Organization change**. The companies that attained higher ROI changed the roles and responsibilities of how people did their work and the design of the workflow and the organization structure—or they changed the way they motivated employees. Frontline training and support and organization change are closely related, in that both pertain to the people side of CRM.
4. **Appropriate use of metrics**. The companies that measured their current performance and their achievement against their specific CRM project goals tended to perform better than those that used much more informal types of assessments of their progress.

The Hunt for CRM "Failures"

The media has covered the issue of CRM "failure rates" extensively over the past few years. The source dates back at least to 2001, when Gartner famously predicted that CRM failure rates would rise from 65 percent in 2002 to 85 percent in 2004, then drop back to 50 percent in 2007. Since then, these figures have taken on a life of their own. I've read numerous articles and reports that start with a sentence like this: "As we all know, CRM projects fail at the rate of 50 (percent) to 80 percent," quoting sources from Gartner, MetaGroup, Accenture and elsewhere.

More recently, Gartner was reported to predict that over the next five years, 55 percent of all CRM projects would fail to meet their objectives. A recent *Wall Street Journal* article said, "Some studies show that half of CRM projects never work out, despite the hundreds of millions of dollars companies sometimes spend on them."

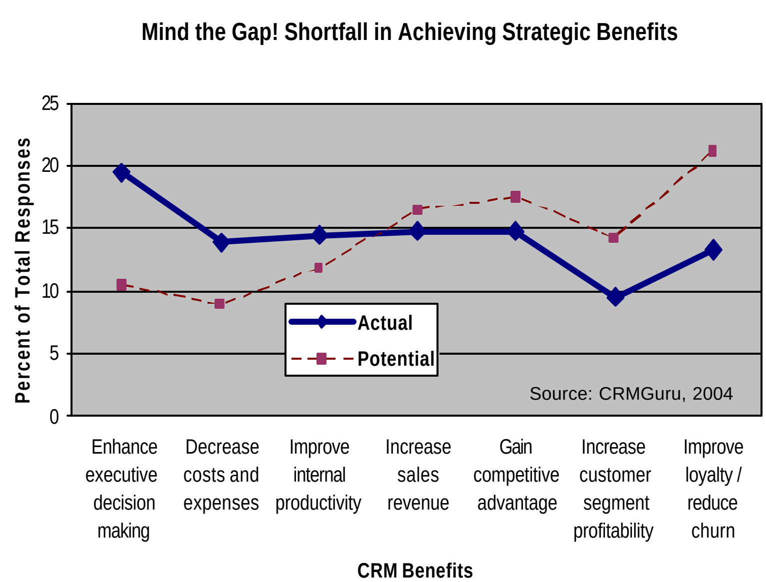
These numbers are very hard to pin down, given that in our research, we haven't found a consistent definition of success or failure. Customer satisfaction numbers are tossed around casually in the CRM industry with vendors, analysts and other third parties working from their own sets of statistics. The unsolved mystery: How can most vendors report satisfaction rates in the 90th percentile or above, when 50 percent or more of projects are failing? The numbers just don't add up.

The only conclusion that I can reach is that the parties involved are spinning the numbers to serve their own vested interests. Nothing sells research reports, or catches the reader's attention, like reports of catastrophe: "CRM fails again: Film at 11." And no vendor has an incentive to admit that all installations didn't go well, because it would lose the game of "liar's poker." This leaves business leaders and IT buyers with the impossible task of sorting out fact from fiction.

CRMGuru's position is that if you measure success in terms of ROI, or by customer perception of success, the success rate is nearly 70 percent. While 30 percent failure is hardly cause for celebration, it's a solid conclusion reached after studying over 1,000 projects during a three-year period. Furthermore, we have found that about 50 percent of projects are achieving a payback in 18 months or less. Should we label all the rest failures?

Strategic Promise Unfulfilled

As discussed earlier, we asked survey takers to rate *potential* CRM benefits. Later in the same survey, when we asked respondents to describe the types of benefits they were *actually* receiving, the results were quite interesting, because they were far more tactical than the strategic benefits outlined above.



For example, improving executive decision-making was the top actual benefit, picked by nearly 20 percent of respondents, yet it was near the bottom of the list of potential benefits. Improving productivity and cutting costs also were rated higher as actual (vs. potential) benefits.

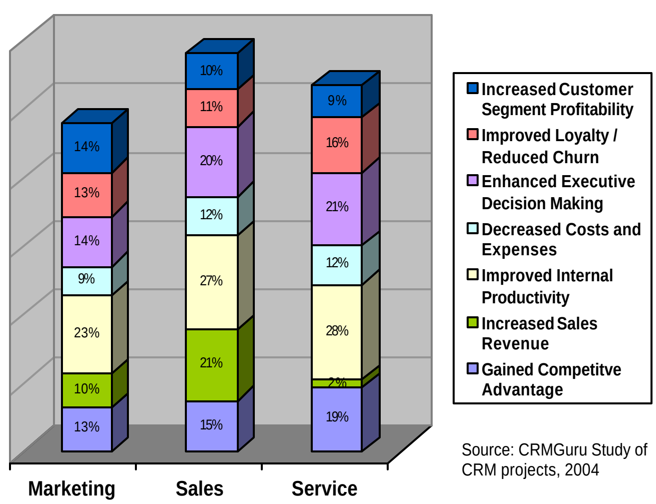
More strategic benefits, such as gaining a competitive advantage, reducing churn or increasing profitability in various customer segments, ranked a bit lower. The difference may explain some of the discontent with CRM programs; although they're viewed as strategic initiatives, they're delivering tactical benefits, at least in the short run.

Impact of Application Type and Deployment Option

One other element we addressed in the research was the types of applications that tend to drive a higher ROI. We assessed this by asking what kind of benefits marketing, sales and service applications provide. When we looked at just the responses for *major* performance improvements, we found that marketing, sales and service all showed a wide range of benefits across seven different benefit areas. But sales, by and large, had a slight lead over the other two in terms of the value that people believed the application was generating for the company. The most obvious benefit was increased sales revenue, but respondents also saw improved internal productivity and an increased ability for executives to make decisions.

These three areas are not easily separated. Marketing processes have to flow into sales, which must flow into service. Academic research (Reinartz) has found that companies that get the most value out of their CRM programs viewed CRM as one strategic initiative and worked hard to integrate functions across marketing, sales and service, to generate a 360-degree view of the customer. From a systems point of view, that's what being customer-centric is all about.

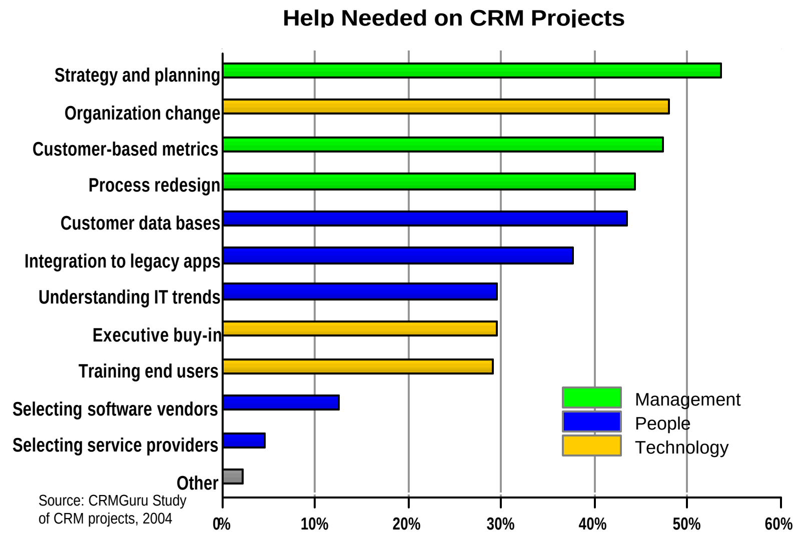
Performance Improvement by Application Area



One increasingly popular CRM deployment option in the last few years has been the Application Solution Provider (ASP), generally defined as using another company to provide the systems and applications for use over the Internet. Digging a little deeper into our 2004 survey data, projects involving these "on-demand" solutions scored significantly better in success ratings, business performance improvement, payback period and software vendor satisfaction. This is growing evidence that ASP vendors are delivering a better ROI, in a more customer-centric way. I believe this is in large part because of the nature of the subscription-based ASP model, which gives more control to the customer but also more real-time feedback to the vendor on how its solution is being used.

Framework for Success

CRM technology spending is growing, although not as rapidly as in years past. Still, while technology continues to improve, companies struggle with the softer side of CRM.



In our 2004 study of CRM projects, strategy and planning topped the list of areas where people said they needed help to be more successful with their CRM programs. In general, as you can see in the chart, top concerns were management-related issues, such as metrics and process design.

Dealing with organization change was the No. 2 issue. Over the past few years, it has consistently been cited (in research by benchmarking firm Insight Technology Group and others) as one of the top three CRM project issues.

These days, the technology issues are not so much about selecting vendors or solution providers but, rather, data and integration. Data quality and cleanup of existing database take longer than planned. Despite the advance of web services and XML to move data between disparate applications, integration continues to be an issue. It's well worth solving, because integration is a core capability of successful cross-enterprise CRM programs.

SMART CRM is Good Business

As you consider how to be successful with CRM, use the acronym SMART to take advantage of what we've learned from studying hundreds of projects.

S Define your **Strategy** for customer value, including both the value you deliver to customers and what you expect to receive in return.

M Use appropriate **Metrics** to guide your customer-centric journey. Don't forget to include the emotional side of relationships in your measurement process.

A Ensure proper organization **Alignment** with the visions and objectives of your CRM program. People must be motivated to do the right jobs to serve customers. Are they?

R If necessary, **Redesign** business processes to change how work gets done, before you spend time automating to improve efficiency. Don't "pave the cow paths."

T Finally, use **Technology**. Easy-to-use and affordable software options abound. Just make sure you're a good "carpenter" before buying the latest "hammer."

Putting customers first is good business. If you work at CRM, it can deliver the ROI and differentiated relationships you'll need to succeed in today's competitive marketplace.

About the Author

Bob Thompson is CEO of CustomerThink Corp., an independent customer relationship management (CRM) research and publishing firm, and founder of CRMGuru.com, the world's largest CRM industry portal.

Mr. Thompson specializes in CRM strategic planning and research. Since 1998, Mr. Thompson has researched the leading industry trends, including how CRM concepts can be applied to such business partners in the extended enterprise as distributors, resellers and agents. In January 2000 Mr. Thompson launched CRMGuru.com, which has become the world's largest and fastest-growing CRM industry portal with more than 200,000 members. He is frequently published and quoted in industry publications such as *BusinessWeek*, *InformationWeek* and *Computerworld* and speaks at conferences and seminars worldwide.

Throughout his career, Mr. Thompson has advised companies on the strategic use of information technology to solve business problems and gain a competitive advantage. Before starting his firm, Mr. Thompson had 15 years of experience in the IT industry, including positions as business unit executive and IT strategy consultant at IBM.

For more information, please visit www.crmguru.com or contact Mr. Thompson by email at bob@crmguru.com.

About the Sponsor

RIGHT NOW TECHNOLOGIES

RightNow (NASDAQ: RNOW) provides organizations with industry-leading on demand CRM solutions to build customer-focused businesses. RightNow's acclaimed technology, comprehensive services and commitment to customer success deliver high returns on investment for its customers.

More than 1,100 organizations worldwide use RightNow solutions including British Airways, British Telecom, Cisco Systems, Continental Tire North America, The Dow Chemical Company, John Deere, Nikon and the Social Security Administration. Founded in 1997, RightNow is headquartered in Bozeman, Montana, with additional offices in North America, Europe and Asia.

For further information, visit www.rightnow.com or send an email to info@rightnow.com.