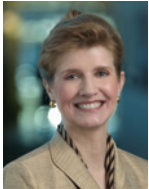




RETURN ON CUSTOMERSM

If You're Just Measuring ROI, You're Only Getting It Half Right

Noteworthy



Business 2.0 magazine named Martha Rogers, Ph.D. one of the nineteen most important busi-

ness gurus of the past century. The World Technology Network named her as "an innovator most likely to create visionary ripple effects." Recognized for the past decade as one of the world's leading experts on customer-based business strategies and growing customer value, Dr. Rogers is an acclaimed author, a world-class speaker, and a founding partner of Peppers & Rogers Group, the world's leading customer-focused management consulting firm. Dr. Rogers' most innovative strategic thinking is embodied in her newest book, *Return On Customer* (or ROC), co-authored with Don Peppers, released in June 2005. It has climbed to the top 20 business books on Amazon, and is ranked in the top ten business best sellers with 800-CEO-Read.

By Martha Rogers, Ph.D., Founding Partner, Peppers & Rogers Group

In this one-on-one discussion with Teradata.com, Dr. Rogers discusses the concepts embodied in her newest co-authored book, *Return on Customer*. Dr. Rogers also teaches these concepts as co-leader of "Growing Your Business by Increasing Customer Value," a three-day executive program at [The Fuqua School of Business at Duke University, May 22-24, 2006](#).

1. As a starting point for our interview, first let's define "customer value." What do you mean by that, and why is it so important to companies today?

Actually, I'd like to start with an example of a company that's really put the concept of customer value in action in a quiet but powerful way. Between 2002 and 2004, Verizon Wireless created 13.2 billion dollars in shareholder value through sales of handsets to new customers. That was what was reported to Wall Street. But also, quietly, in the same period, they reduced their churn rate from 2.6 percent a month to 1.3 percent a month. Now, to make that happen, they undoubtedly had to make decisions that used up money. Those decisions had to impact adversely their short-term reporting – as great as the 13.2 billion dollars was, it could have been bigger. But by sacrificing some short term gain, and investing in choices that helped them increase customer satisfaction, they reduced the monthly churn rate by half! In doing so, they invested in the future of the company and increased company value. That reduction in churn also created shareholder value, of about 10.4 billion dollars.

That's the essence of Return on Customer – ROC.

But that's not how a typical company operates. Most companies measure only a customer's "actual" value, or "What is that customer worth in the predictable future?" For example, measuring what a cell phone customer on a two year contract will pay over the contract. Or how many more months a customer's car loan is worth. Or, in the case of a business-to-business customer, predicting future orders on the frequency and amount of past orders.

But we think there is another very, very important way that customers create value for a company. Customers don't just buy things today. Each day, they also become more or less likely to buy things in the future, to recommend companies to their friends, or to think of an additional product category that a company could help them with. And those choices happen as a result of the way a company handles complaints or provides information today, or as the result of any number of other things that the company may or may not have purposefully orchestrated. And whether or not we're measuring those kinds of results, those results are actually occurring every day for every customer.

You've never seen your business like this before.

For example, if as an organization we don't handle complaints well, the value of our entire organization goes down with every complaint. That's true whether or not we're measuring the complaints or holding our organization accountable for the issues that led to the complaints. If the customer doesn't believe we've handled the complaint well, our organization's value decreases.

It's high time that companies, starting with their CEOs, recognize that it's not our products that account for revenue. Products and brands don't pay us money! **There is only one source of revenue for every company, and that's each and every customer – the ones we have today and the ones we will have tomorrow.**

We're in an age when we can finally measure both kinds of customer value today – what they spend today and, as of today, whether they are more or less likely to spend more tomorrow. So, we need to be doing that and discussing customer value as the best measure of shareholder value.

2. In your book, *Return on Customer*, co-authored with Don Peppers, you talk about customers as being companies' scarcest resource. Why do you refer to customers this way?

Let's look at the resources a company has at its disposal to generate revenue. Of course, the first one that comes to mind is capital, which a company can use to compensate employees, to open branches or plants, to develop products, or to launch marketing campaigns. The truth is, companies can always get more capital. True, it can be expensive, so companies are always interested in the cost of the capital, and on their ROI on that capital. But unless a company is in bankruptcy, getting capital is not that hard.

However, we cannot make more customers. There are a finite number of people on this planet who are interested in or need any given product or service. That's true even in industries, such as telecommunications, where there *seems* to be an infinite number of customers. There may be tens of millions, but they're still finite.

Given that customers are a finite resource – and that customers are the only source of revenue – the only ways to grow a company are to keep existing customers longer, to increase the amount of services or products each customer uses, or to win customers away from competitors. That means we must think of our businesses not only in terms of the ROI on our capital investments, but also in terms of Return on Customer – ROC.

For example, let's say I develop a marketing campaign for a million customers and spend a dollar per customer in the course of the campaign, thus spending a million dollars. I get a one percent response to the campaign – that's 10,000 customers. And each of those customers spent \$125.00 with me as a result of the campaign. Well, I've just earned back my initial million dollar investment, plus an extra \$250,000.00. Sounds like a real success ... and it is, if you only focus on the ROI of the capital investment for the campaign.

But we've only looked at the reaction of one percent of the campaign target audience. Maybe another ten to fifteen percent were positively impacted and didn't spend today, but will tomorrow. Maybe the campaign had a neutral effect on another large percentage. **But what if a measurable percentage also looked at the campaign message and thought, based on this messaging, what this company offers is completely irrelevant to me?** In fact, some of what the company offers might be relevant, but just wasn't part of that particular campaign. And yet, the company has lost those customers – forever used them up, really, to make money from other customers. **Are companies even measuring that kind of loss? If customers were merely .05% less likely to buy in the future, as a result of, say, an irrelevant message, the campaign would cost more in customer value than it would generate in customer revenue.** We might, in that case, look at that ROI on the capital investment quite differently, because it's too costly in terms of ROC. Just as we used up capital to create the campaign, we've used up some customers as a result of the campaign.

3. So the profitability/value of these customers – the return on customer – is a vital business measurement. Is "Return on Customer" a calculation, a methodology, or a metric?

Well, yes. ROC is a metric, a managerial tool, and a way of life.

ROC is a metric that is very similar to ROI, except it measures the return we get on the customer resource we have to use to make money, instead of the return on capital investment we have to use to make money. But the calculations are similar: As long as a company has accurate lifetime value measures for that company, ROC is a fairly straightforward calculation.

Right up front in our book, *Return on Customer* – on page 7, in fact – we give the actual ROC equation. Now, that being said, it is true that getting accurate lifetime value measures is challenging, but we address that in Appendix 2. In the meat of our book, we discuss in depth the philosophy behind ROC, and how we realized it should be a vital part of a company's measurements, both for itself and for reporting.

You've never seen your business like this before.

So while ROC is literally a financial metric, it is also a managerial tool that can be used to evaluate the real effectiveness of campaigns, programs, and other business and financial decisions, like the one I used as an example in your last question. But ROC is also a way of business life. If a company's leaders manage based on ROC – as well as ROI – then they will have a different, more in-depth take on the decisions they must make day-to-day, and will focus more on their primary responsibility – creating company value.

For example, companies usually make technology purchasing decisions, or other investments designed to increase customer value, based on ROI. What if they included ROC in that decision-making? What if they looked not just at what capital they'd get back from their investment, but also what customer value they'd get back? Or how the technology would help them not to use up customers unwisely, but instead to help them grow customer value?

Focusing on just ROI makes companies a slave to short-term numbers, because that's what Wall Street demands, and the reason Wall Street demands those short-term ROI numbers is because they don't have anything better to ask for to use in evaluating companies. We suggest that ROC could be better.

What if account managers, salespeople, campaign managers, and even CEOs, were all given credit for this quarter's numbers, but also debited or credited for what they lost or gained for their companies in long term value, in ROC? No one could hide behind the short-term revenue. That would likely change everyone's behavior. That would drive decisions based on doing the right things now, from the customer's point of view – decisions that would not only derive revenue from customers today, but also drive keeping customers and growing their value for a lifetime.

That's what I mean by ROC as a way of life. If you build this philosophy into the DNA of every person at your company, then basically you have to take the customer's point of view and that means practicing the Golden Rule of business: Treat customers the way you would want to be treated if you were the customer. And that's crucial, because if you don't practice the Golden Rule of business this quarter, then you will pay a penalty at sometime in the future in lost customer value. But if companies aren't held accountable for customer value, it's too easy to let that slip quarter to quarter.

Using our metric, Verizon Wireless's ROC was 60-something percent. The average telco company's ROC is somewhere around 20 or 30 percent.

Now, who would you rather work for, invest in, or buy from? The company with the greater ROC, of course. When companies are only motivated by short-term ROI, it drives bad decision making, or sometimes unethical decisions, or even illegal decisions. Short-term thinking never drives brilliant behavior. And yet we have a way to get out of all that and engage in decision making that drives a positive rate of change in customer value and therefore in company growth, and that's through ROC.

4. Once a company has a metric for customer value ... what should they do with it? How do a measurement and a philosophy come together to result in increasing company value?

After a company has figured out its lifetime value accounting measures and used those as a basis for calculating the rate of change of customer equity, it can then use the results of that calculation to drive decisions, such as where to put resources in the company, how to drive the right behaviors from employees, and how to make decisions that will enable the company to provide the greatest value to and from its customers.

In an ideal world, a company would be there for each of its customers exactly when needed, and otherwise not bugging them, but only offering products or services in the exact configuration that the customer needs, with messaging that's always relevant to the customer's interests at the moment. That's the basis of the 1to1 Learning Relationship. ROC can help a company get closer to that ideal.

5. What role does technology in general – and data warehousing in particular – play in a company's success in achieving a dynamic Return on Customer? How can Return on Customer and data warehousing evolve and grow together?

Unless your company is a mom and pop store, we believe it's not easy or even possible to achieve ROC without comprehensive data management. You have to have a way to capture everything that a customer is comfortable with your company knowing about her – and that will be different for each customer, based on privacy issues. But if a company knows as much as possible about each customer, then the company can calculate the customer's value and predict her needs, and that comes from a 360-degree view of each customer across all products, geographies, customer touch points, branches, and so forth. With all this information linked, a company can make intelligent decisions and take steps to build customer value and actually track and manage the rate of change of that value.

You've never seen your business like this before.

6. How can a company get this Return on Customer/data warehousing evolution started? What's the first step on the long journey toward this ideal?

A company needs to begin immediately educating share/stakeholders on how ROC benefits customers and the company in the long run. It's important to share good examples of companies who manage ROC increases – for example, Royal Bank of Canada, and Tesco in the U.K. come to mind. Tesco, for example, has 11 million members for its loyalty card, and uses the checkout data from those cards to send 5 million mass-customized variations on quarterly customer mailers. That's incredibly specific customer messaging that goes far beyond lower prices. Their mantra is “Nobody tries harder for customers,” which again is built into their company DNA.

7. Return on Customer as an economic measure must include costs as well as revenue. What are some best practices for allocating costs to customers? How can various areas of a company – such as finance and marketing – come together to work toward Return on Customer?

ROC is a unifying opportunity for a company. We've been very gratified to have good reviews from accounting journals as well as CIO Magazine. With ROC, the CMO is not just a person constantly asking for money for campaigns, technology, and support, but someone who helps drive customer value to the firm. It also means that the company can come full circle

and realize products and services are simply opportunities to provide value to customers, which in turn of course grows customer value. On the specific question of how to allocate costs, we cover that in several appendices in our book on the economics of customer equity and specific equations.

Companies who are interested in ROC must be fiscally sound to start with. This approach is really for companies which are already doing good business, but want to get better, and who are willing to make a high level of commitment to using ROC as well as ROI to measure success in growing customer value both now and in the future. The specifics truly vary from company to company; no two companies approach ROC or use the results in exactly the same way.

But the unifying theme is that we've had so many clients over the years who have come to us for advice on how to make the case that spending capital on customers is not a stupid thing to do – that, in fact, it's the way to spur organic, long-term company growth. About two-and-a-half years ago, we had an epiphany as we wrestled with this issue for clients and realized that we were making the case based on projected ROI. Now we understand that capital spend and return is not the problem. The problem is understanding the rate at which we create or destroy value with some customers in order to create value from other customers. To bring our discussion full circle, that's when we realized you can nearly always borrow or raise more capital, but **you can't create more customers**, and that therefore, ROC is as essential as ROI in understanding how to grow customer – and company – value in both the short and long term.

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