MEASUREMENT

Managing Strategic Customer Relationships as Assets:

Developing Customer Relationship Capital

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Increasingly, the greatest source of economic value for many companies is a set of intangible assets that, typically, are not reflected on their balance sheets. Whereas for B2C companies these intangible assets are often dominated by brand value, for many B2B companies these assets are a set of relationships with a core group of powerful customers. When these relationships are well-developed and ongoing, they produce sustainable returns to shareholders. Our continuing research at the Columbia Business School Center for Strategic Customer Management is designed to explore the issue of customer relationship capital (CRC). We believe that CRC is the primary source of economic value for many B2B companies.

The notion of customer relationship capital raises several important questions. First, how does a firm systematically create customer relationship capital? Second, most companies are managed as a portfolio of businesses defined by products and / or technologies; if a firm's main assets are long-term customer relationships, how should it be managed differently? Rather than optimizing resources across products, presumably companies would optimize the economic value of their core customer relationships over the long-term. Product life cycle management accepts that, over time, products lose their ability to generate premium returns; if managed appropriately, customer relationships returns may be more sustainable over the long-run. Finally, where should a company invest its marginal dollar—in developing enhanced customer relationships, or in expanding product functionality and capacity?

Customer Relationship Capital: Creating and Acquiring the Future Customer Wallet

Customers can be managed for three quite different outcomes: maximizing revenue in the near-term, maximizing profitability in the short to intermediate-term and optimizing the asset value of customer relationships – customer relationship capital – over the long-term.

Most sales people manage customers for short-term revenues. They sell into the customer's "wallet of today" and focus on securing as high a share as possible of this wallet. In today's increasingly competitive environment – with a progressively more sophisticated customer base that wants lower costs, greater service and more control – this strategy most often results in declining margins and commoditization.

During the past decade, the practice of key account management has led to a shift in focus from revenue to profitability. In an increasing number of

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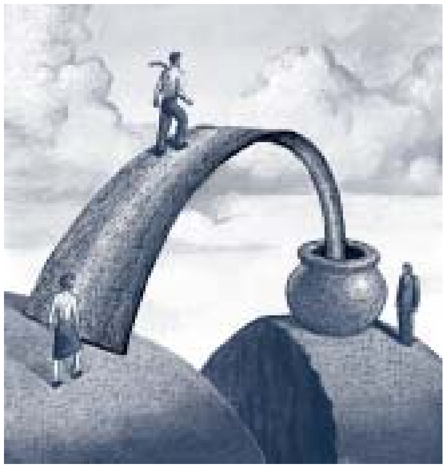
corporations, key account management has become a critical focus of company strategy as other major functions such as manufacturing, logistics and product development have become aligned around the customer. The ability to better manage the trade-offs between functions has allowed firms to deliver greater value and / or lower prices. The result has been higher shares of customer wallets and increased profitability.



However, increasingly, buying power and market influence is being concentrated in an ever-smaller number of strategic customers. Going forward, we believe that companies will have to think beyond today's revenue and profitability. They will have to take the long view and manage their strategic customer relationships as assets. They will attempt to maximize the net present value (NPV) of future profit streams from these customers, thus shifting to the enhancement of long-term customer relationship capital.

How Can Companies Effectively Manage Customers as Assets?

In our ongoing research and consulting work we have interacted with a select group of strategic account managers. These SAMs have already begun to manage systematically their companies' strategic customers as assets. For example:

"I view myself as a custodian of this client relationship. Our firm has had a relationship with this client for almost a century. I hope that when I am no longer managing this relationship I will have turned over to my successor something that is worth a lot more to the firm. This relationship is one of our 'crown jewels' and it would be very difficult to replace it if we were to jeopardize it in any way."

Global Relationship Partner, Major Professional Services Firm

In the following sections, we summarize the key questions and dilemmas with which these SAMs wrestle, and the processes their companies use to enhance the value of their customer relationships. In our experience, SAMs who have grown relationship value with their strategic customers have focused on six customer management processes (see Figure 1). These processes, which impact all functions within the company, provide a practical framework for managing and enhancing customer relationship capital.

1. Identify Customer Potential

The starting point for any attempt to build customer relationship capital is to select the right customers! If customers are assets, then selecting and investing in the right assets will likely yield superior returns.

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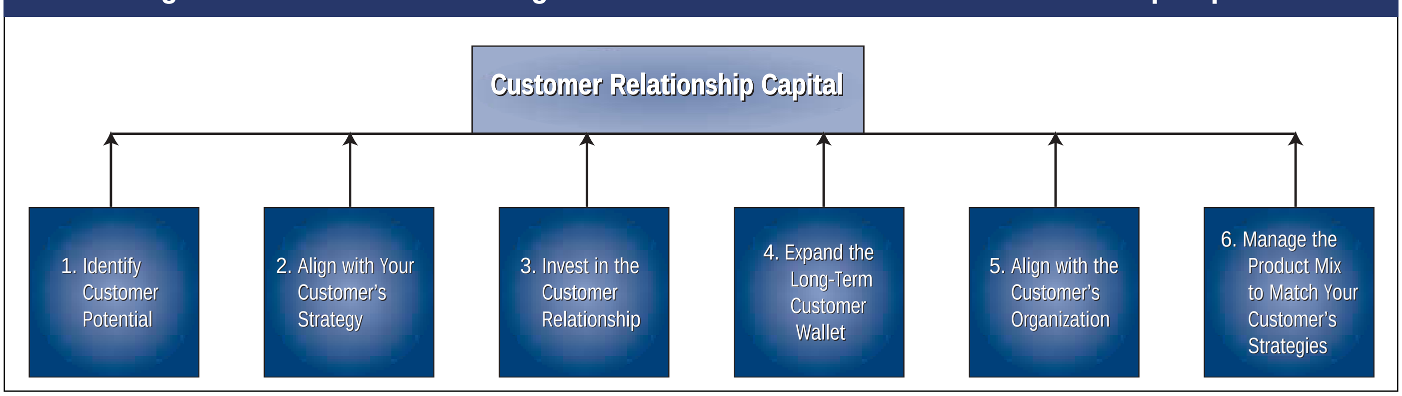
"The customer business is our business. It drives the demand for everything we do and shapes the perception of how much we want to 'invest' in this customer. I view each of our strategic customers as a separate market, and the SAM is a market manager with a full set of business decisions to make. For example, in one of our accounts we were quite willing to give up some share of wallet because we were not convinced that the new product line would be anywhere near as successful as their market research showed. Meanwhile, one of our competitors has over-invested in capacity that is unlikely to see a return in the near-term. Since our customers' success or failure has such a critical impact on our own business, we spend a lot of time and effort validating the customer's future investment plans. In my experience, effective strategic account management is about investing in building relationships with the future market-place winners. The SAM is very close to these customers and is in an excellent position to make this decision. Without the close customer dialogue, we do not have the foundation of a strategic partnership. However, it is also important not to lose one's objectivity about the customer's future prospects and learn how to say no to those important customers."

Vice President, National Accounts, Major Technology Company

Figure 1. Six Customer Management Processes Drive Customer Relationship Capital



The cornerstone of any effective strategy to enhance customer relationship capital is to develop a "view," based on intimate customer knowledge, of which organizations are the "customers of the future." Effective allocation of sales, marketing, plant and equipment, R&D and other resources is only possible once customer potential has been established. Think about your organization. Do you have a process that carefully selects the "customer of the future?" Do you consider the likelihood of one of your strategic customers being acquired or merged out of existence? For a firm that embraces the concept of customer relationship capital, a process to pick future winners should be a top priority of the senior management team.

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2. Align with Your Customer's Strategy

When a supplier gets very close to a customer, it can impact that customer's strategy. The objective of these close business and personal relationships is to build a "joint future"—a common set of business objectives, built on a platform of mutual dependence and collective reward if success is achieved.

"Each year the customer invites us offsite for developing its strategic plan. We are acutely aware of the linkage between our two companies and have an active interest and concern in how it formulates its approach to our common market. In many cases, we have conducted our own market research and evaluated this customer's options. Much of the time our data is supportive of its preferred actions; in these cases we make strategic resource allocation decisions that support the directions it wishes to pursue. On the other hand, it is not at all unusual for us to challenge the customer's findings. Often, its management has deferred to our position and has scrapped a strategy that had significant internal support on its side. Sometimes this can offend their internal champions, but we make the point that we cannot afford to have them fail, as our own success is so closely tied to theirs. In some cases, we have argued against its strategic directions that would have allowed us to sell more product. When we do that, it really gets their attention."

Strategic Account Manager, Major Manufacturing Company

Building a partnership with a successful company provides the supplier with the opportunity to access the most attractive customer wallets in an economic way. Helping your customer grow its own business is the lowest cost method of enhancing your own revenue growth. Successful builders of customer relationship capital implement rigorous customer relationship review processes supported by focused customer plans—often involving joint investments with the customer and extensive customer feedback. In the process of securing detailed understanding of the customer's strategy, they build "share of mind" with customers so that the supplier is essential to growth plans.

Of course, not every customer wants a relationship of mutual dependence in which its strategy is aligned with that of its core suppliers, and not every supplier is capable of providing sufficient value to the customer to be included in a joint business model. A joint business model and mutual strategic dependence produce high customer relationship value only when the customer achieves economic success. If the customer does not turn out to be successful then, "the customer's problems will be your problems." On the other hand, aligning with future marketplace winners, and developing shared business models with them, greatly enhances the relationship capital of these customers. The challenge for most companies today is to manage the tension between short-term revenue and profit-generating pressures, and investing for enhanced long-term customer relationship capital.

3. Invest in Customer Relationships

Without investments the value of customer relationship capital rarely grows. In general, companies have well-accepted disciplines for investing in products, in fixed assets such as plant and equipment and, to a lesser extent, in R&D. However, systems for measuring potential return on investments in customers are rudimentary at best. The inability to measure these returns frequently leads to under-funding of the customer relationship.

"Getting our bank to invest in client relationships is actually quite difficult. We have quite correctly developed strong product organizations; these organizations control resources and people and provide specialist coverage for the clients. However, many of our strategic relationships require multi-product, multi-geographic solutions. It can take 12 or 18 months for the bank to develop a solution and prepare the documentation before the client is ready to buy. We have had a very difficult time getting the product groups to invest. We finally decided that for strategic clients we should have a different approach. If we, in Client Management, do not invest in the extra cost of coverage and product development,

we will never get a relationship premium. Today's investment in client relationship building is tomorrow's share of wallet. A big part of the strategic account manager's job is to help shape the thinking of our product partners on what the clients are looking for. The product partners are busy running their businesses; they don't have the luxury of developing a comprehensive view of how our mutual clients are evolving. And, if each product area invested in its client separately, the bank would not secure economies of scale, and we would not achieve the degree of client insight we have today."

Senior Executive Vice President, Global Wholesale Bank

Investing in customers is a lot more than building good personal relationships and chemistry. In today's performance-driven economic environment, companies are under severe pressure to manage costs and capital out of their financial statements onto other members of their "extended enterprise" as much as possible. For many suppliers this is a difficult financial decision—it is quite literally investing in the customers' future.

4. Expand the Long-Term Customer Wallet

In order to grow customer relationship capital effectively, the SAM's role should be redefined from increasing the firm's share of the customer's wallet to creating new customer wallets and systematically capturing them. Rising shares of growing customer wallets is nirvana for the SAM, and is the net result of effectively managing customer relationship assets.

The customer wallet is a reflection of the customer's business strategy. If your customer's strategy for markets, target customers, products and returns should change, it will likely be reflected in its wallet for products / services to be secured from suppliers. Therefore, responding to your customer's fluctuations in strategy will shape your strategy. In fact, the successful strategic account program aligns the company's strategy with the strategic priorities of its core customers. Strategic alignment involves achieving congruence between the strategies of both the supplier and the customer and jointly expanding the wallet for both companies.

"Over the past five years, our company has made the transition from a sales-driven to a customer-driven company. I'm not sure that the difficulty of making this journey is fully recognized by our customers. As a customer-driven company selling technology products, we quickly figured out that the biggest part of the wallet was in the services associated with the use and maintenance of our products,

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rather than with the purchase of our products per se. We also recognized that our customers were increasingly troubled – some would say frustrated – by the rising levels of costs and complexity that we building into the technology we sold.

Our approach to strategic customers today is simple—we change their cost structure from fixed costs to variable costs by offering them outsourcing We focus their technology organizations on value-added, revenue-generating projects that provide their firms with market-place advantage. For example, we have taken a $50 / 100 million p.a. relationship focused on hardware, to a billion-dollar multi-year strategic relationship where we are embedded in the customer's business and operating system.

Being customer-focused has altered our approach to the customer wallet; indeed, we have completely changed the concept of the wallet. Today, the potential wallet of a typical strategic customer is almost its entire total cost base. Instead of selling products, we focus on changing the customer wallet and then controlling it. Clearly, the skill set required to develop the new customer wallet is quite different from selling to the old wallet. We have managed a major transformation of our sales and customer executives by investing significantly in training and upgrading the skills of all our SAMs."

Vice President, Northern Europe, Major Technology Company

A focus on expanding the long-term customer wallet is very different from expending effort on increasing share of the current wallet. It requires a very different approach and very different skills, yet it is fundamental to enhancing customer relationship capital.

5. Align with the Customer's Organization

In order to mange the "wallet of the future" effectively, the SAM must embed his company in the customer's decision-making process as it relates to jointly creating a new wallet for both companies. The SAM and members of the strategic account team must be actively involved at multiple levels in both the customer and supplier organizations and in the decisions that are being made to grow a new and expanded wallet. Many factors impinge on the SAM's ability to bring about this alignment.

"We have recognized the difficult challenge involved in aligning with the customer at the operating level. We have been doing this for years with increasing effectiveness. We have made major investments in understanding our customers' decision-making and influence systems and in understanding their strategic objectives. The process for putting effective SAMs in place is excruciating as we have been required to broaden our search for the right sort of people and invest in training them and members of their account teams. It is difficult for our SAMs to be so actively involved in the customer decision-making process and recognize that they have to represent both organizations—customer and supplier. They

have to be advocates without coming across as just salespeople. The challenge is to get the customer to think our way—if that happens the customer will buy what we sell. Some of our best SAMs seem to be able to manage the customer interface despite these difficulties, but it's a real challenge for our less experienced people."
Vice President, Strategic Accounts, U.S. Manufacturing Company

Aligning supplier and customer organizations entails lining many things up appropriately. At its root, it is about the supplier's ability to function as a virtual client-service team across the boundary between the two organizations.

RISING SHARES OF GROWING CUSTOMER WALLETS IS NIRVANA FOR THE SAM, AND IS THE NET RESULT OF EFFECTIVELY MANAGING CUSTOMER RELATIONSHIP ASSETS.

6. Manage the Product Mix to Match the Customer's Strategies

In building customer relationship capital, the firm often faces considerable pressure to be a "full service provider." Customers want a bundled price and unprofitable products are often included in the total package. The company's challenge is to maintain the full-service relationship without incurring the low (or negative) margins associated with the least attractive products. Customer relationships must drive product strategies rather than customer coverage being driven by product priorities—the normal practice in a product-defined strategic context.

"In any large customer relationship, we have considerable cross-subsidization of products and geographies. We are very careful to maintain the primary client relationship, but our high cost base does not allow us to make a reasonable return on several products that are important to the customer. Extensive discussions with our product divisions have led us to the conclusion that no matter what actions we take, we cannot make a return on these products. Hence, we have reluctantly given up this 'volume business' to competitors with lower cost bases that are more suited to these products.

However, we have moved further up the value chain. We have invested in the relationship by working with the customer on several new areas that have high potential both for us and the customer. Although we are ceding ground to low-cost competitors and can expect that some of them will eventually move up the value chain, our investment in the customer relationship will be even more critical to future returns."
Vice President, Consumer Electronics Division

SAMs must ensure that the "voice of the customer" is transmitted accurately to the product groups. The firm must develop processes that allow the SAM to profitably manage multi-product sales. Unfortunately, in many companies, product plans are developed in separate silos and do not come together seamlessly at the customer. Successful creation of customer relationship capital requires a systematic discipline for integrating the individual plans from different product divisions with plans for strategic customers

Customer Relationship Capital as an Alternative Management Paradigm

During the past decade, there has been considerable discussion about the relative merits of stakeholder concepts of management versus the shareholder view. In general, the shareholder view value concept has gained ground, placing primary importance on financial assets and returns. Capital allocation efficiency questions across product groups and fixed investment comprise the central decision nexus for many companies. However, focusing exclusively on the capital assets without recognizing the impact and long-term sustainability of strategic customer relationships presents an incomplete view of a company's economic value.

Increasing transparency and accountability across product and geographic divisions has led firms to develop well-recognized management processes to allocate capital and other resources among products and geographies. However, these are not sufficient when customer relationship capital emerges as a key element of shareholder value. Companies need to develop processes that drive increased customer relationship capital—especially when the customer buys multiple products in multiple geographies.

We believe that the six core decision areas we have just discussed can help companies transform their mindsets into becoming more customer-relationship focused. Senior management must articulate a commitment to enhancing customer relationship capital, then implement the customer management processes that drive value. Sales and customer executive professionals must address the challenge of revising their sights and changing their mindsets as well as help transform their organizations to meet the expectations of increasingly demanding, but ever more valuable, strategic customer assets.

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