



The Value Profit Chain

Treat customers like employees and employees like customers

Résumé

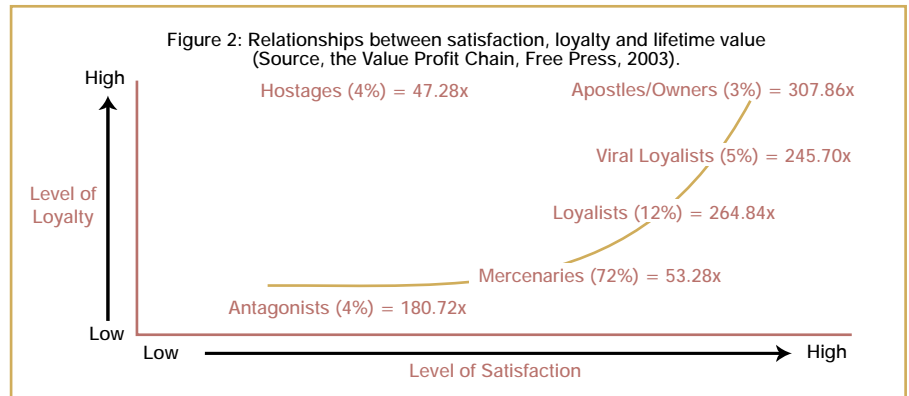
The Value Profit Chain is a set of principles for building successful organisations through delivering value to employees, customers, shareholders and any other key stakeholder groups. Published in 2003 by Free Press, the 'Value Profit Chain' is written by James Heskett, Earl Sasser and Leonard Schlessinger. It develops the ideas in their earlier book, 'The Service Profit Chain' and draws on three decades of Harvard Business School research into what makes organisations (private and public sector) successful.

Part 5: Customer Lifetime Value

In many ways, the concept of customer lifetime value underpins the entire Value Profit Chain philosophy. Simply, customer lifetime value (CLV) tells us that customers' financial value to an organisation increases exponentially the longer you keep them. As long ago as 1990 Frederick Reicheld and Earl Sasser observed across a range of industries, that as customers stay with a supplier they tend to engage in an increasing range of desirable and profitable behaviours, summarised in Figure 1.

To reap the full benefits of CLV you have to do more than just keep customers. Before a supplier sees the financial benefit of CLV customers have to move through several levels of loyalty, with Harvard's typology labels shown in the panel on page 9.

Moving customers from Mercenaries to Apostles doesn't happen by itself. It's based on the extent to which the supplier delivers results to customers. Where



customers believe a supplier is delivering the right results for them, they engage in a whole range of desirable behaviours. Desirable because they deliver big financial results to the supplier's shareholders! As shown in Figure 2, high levels of customer satisfaction generate a huge pay back in terms of loyalty and CLV, but the difference across loyalty segments is vast. Harvard estimates the average length of customer relationship as one year for mercenaries and over ten years for Apostles.

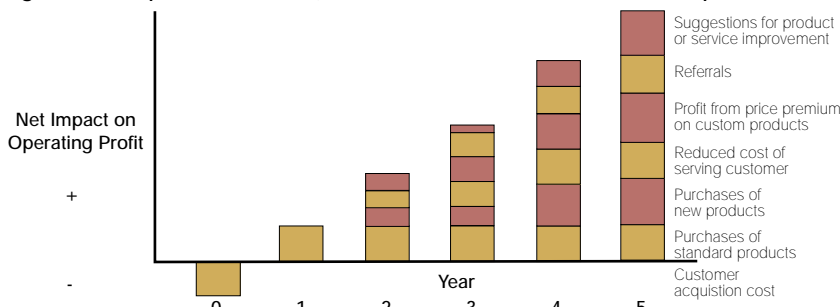
Based on Harvard research across

sectors, the values at the right of each entry show the relative units of operating profit generated over the lifetime of each group. Based on each 1% of the customer base, Mercenaries generate only 0.74 units of operating profit compared with 102.62 units generated by Apostles. As shown in Figure 1, this added value comes from the fact that highly satisfied customers stay longer, buy more products, are less price sensitive and cost less to service. They recommend the supplier to their associates (very important since referred customers are the most profitable), and, in the case of Apostles, they assume responsibility for the supplier's continued success, communicating a stream of constructive feedback and suggestions for product/service improvements. Carl Sewell famously estimated the lifetime value of a customer of his Cadillac dealership as \$332,000 (Carl Sewell and Paul B Brown, "Customers for Life").

Top box satisfaction

Based on the huge financial difference

Figure 1: Components of CLV (Source: Harvard Business Review September 1990)

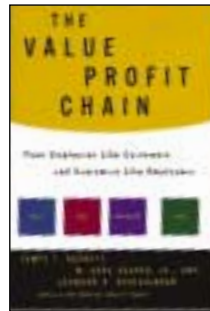




between satisfied and highly satisfied customers, companies are increasingly pursuing 'top box' customer satisfaction. Since top box scores (or, more usefully, 9s and 10s on a 10-point scale) are so difficult to attain, companies pursuing them have to be totally committed to customer satisfaction. Enterprise Rent-A-Car (see page 10 of this magazine), demonstrated its commitment by disqualifying managers from promotion if their customer satisfaction index was below the corporate average. Based on the slope of the curve in Figure 2 and the disproportionate gains from the highest levels of satisfaction and loyalty, it pays to focus efforts on customers just below top box (e.g. 8 out of 10) with the aim of moving them to top box Apostles. This necessitates adequate samples to reliably understand the priorities of the 8s and exactly where to focus priorities for improvement. Customers' loyalty personality is also relevant. Some customers will always be Mercenaries, attracted by low price rather than value. Attracting and retaining the right customers is a key factor in maximising CLV. This emphasises the benefit of referrals from Viral Loyalists and Apostles since they associate with like-minded people, thus generating a stream of new customers who value quality and service rather than low prices.

Communicating customer lifetime value

In view of the immense financial benefits of CLV, but the considerable difficulty of achieving them, the Value Profit Chain recommends that companies invest heavily in communicating the benefits of customer satisfaction and CLV to employees. At Enterprise Rent-A-Car customer satisfaction was promoted to the top of everyone's agenda. The Value Profit Chain refers to the phenomenal growth of credit card supplier MBNA, much of whose success is attributed to its conscious drive to increase its average customer lifetime from five to over ten years. To do it, MBNA developed a culture obsessed about customer satisfaction. Walk around and you'll see the phrase "Think of yourself as a customer"



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everywhere in the building, even woven into the carpets and carved into the door frames. A daily measure of customer satisfaction feeds into a customer satisfaction-related bonus that pays out quarterly for every day on which the satisfaction index was above target. If you work at MBNA, you know that customer satisfaction's important! At USAA, a provider of financial services to US military personnel and their families, and a company with the most loyal customer base ever found by Harvard, the typical customer lifetime is 50 years!!

The role of CLV

Although it is possible to calculate precise CLV based on the net present values of future cash flows from current customers, it's rarely worth the effort. An good estimation (like Phil Bressler's that a loyal Domino Pizza customer was worth \$4,000) is usually enough to demonstrate to staff just how much it is worth going the extra mile to deliver results to customers. And that's what it boils down to. Understanding customers' requirements and making sure you meet or exceed them. It doesn't need a multi-million pound CRM system, a re-branding exercise or a 'year of the customer'. It just needs employees to see delivering results to customers as their top objective. If in doubt, just "think of yourself as a customer". **S**

If you have any views on the Value Profit Chain please write to the Editor or email info@stakeholdermagazine.com

Loyalty levels

As shown in Figure 2, CLV can vary enormously across customer segments based on their level of loyalty. Starting with the least valuable, the segments are:

Antagonists

These are customers that really don't like you - possibly because you have given them an awful customer experience but sometimes because their requirements just don't fit with your strategy. Low cost airlines like Southwest in the USA and Easijet in the UK have to accept that some customers will be offended by certain policies such as the seat allocation system or the early and inflexible check-in closure, but these procedures form a core part of delivering value to good fit customers. Antagonists are very active, or 'viral', in voicing their dissatisfaction, often forming websites for the purpose.

Mercenaries

Mercenaries are not bad customers (or bad soldiers), but they are not committed. They are usually not dissatisfied, but neither are they highly satisfied. In their eyes, the value being delivered by their current supplier could easily be matched by most of its competitors, so if a seemingly better offer (lower price) comes along they might as well switch.

Loyalists

These customers are very satisfied and exhibit many of the desirable behaviours of loyal customers such as a long customer lifetime and buying a range of products / services, but they haven't reached the viral level.

Viral loyalists

Sometimes called 'advocates', viral loyalists are so satisfied with the results delivered to them by the supplier that they actively and frequently sing its praises. From viral loyalists the supplier gets the full benefit of all the 3Rs - retention, related sales and referrals - and of these, it's the referrals that give a huge boost to the CLV of this segment.

Apostles

Apostles have such a strong relationship with the business that they think and behave more like owners or partners. As well as being extremely influential with referrals and not even considering alternative suppliers, Apostles feel involved with the company, making suggestions for product or service improvement and feeling genuinely concerned about the future success of the supplier.

Hostages

Sometimes firms have a group of customers that are superficially loyal (at least in terms of retention), but are not favourably disposed towards the business, usually because they feel that they have no choice. Clearly common in public sector and other monopoly situations, they also occur in free markets with high perceived switching barriers, such as the small town with only one supermarket. Hostages are frequently responsible for negative word of mouth and their discontent can make them costly to service.