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Know thy customer

A DISCIPLINED APPROACH TO DATA ANALYSIS

There is powerful evidence linking commercial success to the depth of a company's understanding of its customers. So it is hardly surprising that the mantra of "customer focus" should trip from every businessman's tongue. But how many understand how to achieve this? This Bulletin offers some insights into best practice, drawn from Frontier's experience with a wide range of clients.

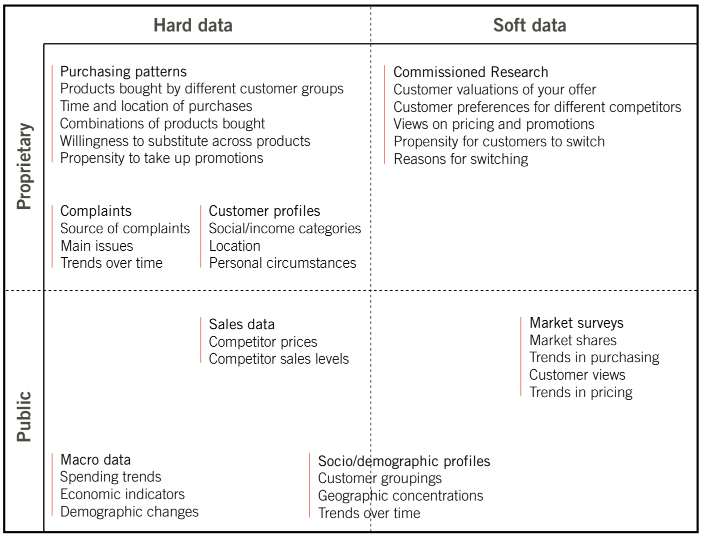
At the start of most engagements to advise companies on competition issues or strategy, we find ourselves told by the CEO or the marketing director that "everything we do in this business is based around customers". This statement will be followed by an assurance that all the information we will need for our assignment can be gained from the company's information systems.

Sometimes, that's true. Sadly, however, this promise of rich and well-understood sources of information may boil down to little more than a few outdated surveys, a bit of macro data and some ad hoc attempts to explain customer spending patterns. There may be some patchy collections of customer complaints and the products of a loose feedback channel from the sales front line to head office. Managers in the marketing department may have strong views on what's happening in the stores. But hard evidence is in short supply.

Such a lack of rigour makes a company doubly vulnerable. Firstly, fooling yourself that you know more than you do is rarely sustainable. The audience (and the rest of the orchestra) will soon discover you aren't really a concert pianist. Credibility, once lost, is hard to rebuild. Secondly, unless your company has a significant degree of market power, a lack of knowledge of customer behaviour exposes you to rapid loss of sales. Knowledge of what customers want (both now and in the future) is key to meeting and sustaining demand.

HARDEN YOUR DATA

For most companies in most markets, there is, in fact, a mass of information available. The chart below indicates some of the main sources available to everyone (public data) or only to the company itself (proprietary data). This information can also be divided into "hard" data – quantitative information, collected regularly and rigorously – and "soft" data – qualitative information, often based on surveys. Unfortunately, it is frequently the "soft" data that attracts the most attention, because its apparent relevance distracts decision-makers from such weaknesses as limited samples, lack of timeliness or questionable hypotheses.



Sources of customer information

The best customer information consists of hard data on actual purchases analysed by customer characteristics. Companies already in the market can collect a wealth of such proprietary information from their own operations, and "wealth" is how it should be seen – a valuable asset, rather than something for the data archive.

Of course, companies have become increasingly aware of the potential in their operational data. Most know that advances in electronic communication and computing power enable them to tap into these hard data sources if they try, and to gain real-time information about their performance. Fewer firms, however, are sure how to construct a framework that extracts strategic information from operational data and use it to inform timely decision-making. The best will not only collect a portfolio of data, but also:

- combine this information within a single model, so that its consistency can be checked and full strategic value extracted; and
- establish a specialised customer information unit, to co-ordinate and analyse all the different sources of information, on which marketing or strategy departments can draw but with direct reporting lines to the board.

It is this co-ordinated use of information that characterises a truly "customer focused" organisation.

KNOWLEDGE IS POWER

Good customer information can be used to improve market positioning in several ways. It should inform decision-making on.

- Product design – enabling you to make evidence-based comparisons, develop improvements and identify gaps in the market.
- Service design – helping you to assess whether you are adding value to your product, and how your service might be improved.
- Marketing and customer acquisition – helping you determine whether you are communicating effectively and if you could acquire customers more cheaply.
- Pricing and promotions – aiding you to assess whether your prices are truly competitive and pitched right for different customers.
- New markets – assisting you to analyse the costs and benefits of market entry.

QUESTIONS, QUESTIONS

Of course, the kinds of data described above will not be easily available to all companies in all markets. In some, customer purchasing data may be extremely expensive to acquire. Businesses that do not have operational sources that are easy to tap into (such as electronic point-of-sale data) may need to invest in large-scale IT systems specifically for analytical purposes. There has been a trend in recent years from firms to develop systems capable of providing very detailed customer-level information.

However, before making such investments, or even bothering to collect operational data, firms should be clear what they want to do with it. Applying statistical tests to gigabytes of data in an unfocused way can be a very expensive mistake. It is important to define and refine the set of questions you wish to try to answer. These will, of course, vary between companies and market sectors. But the following generic list may act as a prompt.

- What proportion of your customers' (relevant) spending are you capturing?
- What is the most important reason why you are losing customers to (or winning customers from) your competitors?
- Which of your customers are most profitable to you?
- Is your current pricing structure appropriate for each of your customer segments?

The first two questions spring from the understanding that it is usually cheaper to win more spend from existing customers than to attract new ones or enter new markets. The second two are designed to help you use your data to enhance profitability. It should be relatively simply to work out which data sources you need to mine to arrive at answers to these questions. Some, however, are trickier than others.

To work out which of your customers are the most profitable, you must be able to segment the customer base and then map this against a good management accounting system. Assuming you have been able to do this, then the further steps required to test whether your current pricing structure is appropriate for each of these customer segments involve the estimation of each segment's willingness to pay (see Frontier's Bulletin of August 2001 on establishing a framework for price sharpening).

SLICING IT UP

What is clear is that, unless you are selling a basic commodity to a homogenous market, you will want to be able to segment your customer base, analysing it both by its demographic and socio-economic characteristics and by its spending behaviour. Statistical techniques such as cluster analysis, along with econometric modelling, can be used to identify distinct groups of customers. There are many ways in which you may wish to group them, but willingness to pay is likely to be an important influence on your marketing strategy. Understanding how different groups are likely to respond to changes in what you offer them will help you to think more creatively about pricing and product design.

But price is not the whole story. It is important to try to understand what it is that each group values about your offering, and why. Most products and services can be broken down into a set of attributes: an ability to rank these by their importance to different customer groups will provide key insights into, for example, their tendency to switch from one service to another, particularly if this data can be mapped against wider information for the market as a whole.

To carry out these kinds of analyses, three sets of skills are required:

- technical ability, to handle large and disparate data sets;
- statistical and econometric expertise, to "make the data talk"; and
- commercial and marketing skills, to understand the implications and turn them into strategy.

PUTTING YOUR MONEY WHERE YOUR MOUTH IS

It may seem blindingly obvious, but it is all too often forgotten that information is no use unless it is used. Building up complex databases of knowledge on customer behaviour serves no purpose unless the importance of exploiting its commercial value is woven into the fabric of the firm. Genuinely "customer-focused" businesses, therefore:

- aim to create a culture driven by the desire to find out what customers want and identify ways to satisfy them (generating a constant demand for information on their behaviour);
- invest in the high-quality supply of customer information;
- put in place processes that ensure all commercial and strategy decisions are based on rigorous understanding of the customer base.

Standard practice? Well, almost every business will claim to follow such practice. Sometimes, however, it turns out to be more fluff than focus. To test whether your organisation is bluffing, try the following checklist.

→ Six questions to check your customer focus

1. Is your customer feedback best described as pro-active and at the customer interface or as centralised and passive?
2. Are there a set of customer satisfaction indices which somebody is incentivised to improve?
3. Does the CEO get monthly (or more frequent) reports on what customers are doing and their level of satisfaction, or does he/she get an annual summary?
4. Does customer feedback take an equal share of the review criteria for all business heads or is it relegated to a secondary issue?
5. Do internal project or investment appraisal processes explicitly capture the impact on customers?
6. Does everyone in the organisation share the same views about what customers think and do?

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