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The Trillion-Dollar Opportunity You're Missing

What It Means—and What It's Worth—to Be Truly Customer Centered

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True Story

A customer of a major money-center bank wanted a mortgage recently. He looked like every bank's dream customer. He's a highly active trader through the bank's stock brokerage services, paying huge commissions, which are extremely profitable for the bank. He also keeps lots of money in the bank, and those large balances are very profitable as well. One thing he didn't do was borrow much from the bank—his current mortgage was with another institution. Note: Mortgages can be *highly* profitable for banks. So when the day came that this customer wanted to refinance his old mortgage, he called the bank's mortgage department. He was sure they'd be delighted to hear from such a terrific customer as him.

It was as if he had called the Bank of Outer Mongolia.

The mortgage department had no idea whether he was a good customer or a bad one—highly profitable or break-even or unprofitable.

They gave him the same treatment and made him the same offer as if he were a stranger who had walked in off the street. He would have to fill out endless paperwork, even though the bank already had much of it. He would have to pay the same fees and interest rates as anyone else. When would the bank make a firm offer of the terms of the mortgage? They couldn't really say. In fact, the mortgage department—being ignorant of the customer's history with the bank—couldn't even offer him assurances that he'd get the mortgage at all.

Instead of just being miffed, this customer called the manager of the branch where he has his account—a manager who knew just how valuable this guy was. Then he patched in a manager from the bank's mortgage department. These two managers had never spoken to each other before. Didn't it make sense, asked the customer, for him to get his mortgage and get it at advantageous rates in light of his long history and high profitability with the bank? If he didn't, he'd certainly see if some other bank could be more accommodating.

"Sorry," said the mortgage manager, who explained that his hands were tied. This bank, like most major banks today, is the product of several mergers, and after the last big one all mortgage managers were put on a very short leash until the integration got worked through. He was strictly forbidden to do anything special for this or any other customer.

"Wait!," said the branch manager, now pleading with the mortgage manager in an effort to keep this customer. "I'll pay you the first-year costs of giving this customer a better mortgage deal—just give it to him! Make him happy! We make loads of money with this guy!" "Sorry," said the mortgage manager. "I'm not allowed."

The customer got his mortgage someplace else, at an institution that could see what he was worth and was hungry for the business. He gradually began shifting his trading from the Bank of Outer Mongolia to the new institution as well. So the bank not only blew a great opportunity to deepen its relationship with this highly profitable customer, it let a direct competitor take a significant piece of the customer's business. And it made the customer angry—a lose-lose deal. Bottom line: a complete disaster for the bank. It's no surprise to find that this bank's financial performance is lousy. Its ROE (return on equity)[1] is a dismal 10 percent and falling; profits and its stock price have been plunging, and its P/E (price-earnings) multiple is much worse than mediocre, about half the average P/E for the S&P 500. As we write this, the newspapers are full of rumors that the CEO's days are numbered.

Sound like any bank you've done business with?

Now suppose that instead of this ludicrous, frustrating experience, the customer had encountered something different. Suppose the manager he spoke to wasn't in charge of mortgages or a branch but was in charge of him and customers like him. The manager knew everything about the customer's relationship with every part of the bank and exactly how profitable he was because this information was available on a computer screen at any time. More important, this manager was *accountable* for the profitability of this customer and others like him. A few layers up in the organization was an executive whose entire job was to manage the customer segment to which this customer belonged (the bank might call the segment something like "wealth builders"). Other parts of the bank—mortgages, deposit accounts, brokerage services, branches—functioned as internal suppliers of products, services, and distribution to this executive and the handful of other executives who were in charge of other customer segments.

Does this sound crazy? Let's get really radical: Suppose these segment executives had profit-and-loss responsibility. Suppose the bank could calculate the profitability of each individual customer or customer segment, and these executives were on the hook to deliver specific, budgeted improvements in their segment's profit each quarter.

In this kind of organization, what kind of experience would our bank customer have had? Most likely one that was markedly better—for him and for the bank.

This fantasy bank is no fantasy. It's Toronto–based Royal Bank, which has reorganized its huge Personal and Commercial division in exactly this way. The results have been astonishing. The division has reduced expenses by $1 billion, in part because those product areas—mortgages, deposit accounts, etc.—are no longer fiefdoms with their own separate administrative infrastructures and their own marketing efforts, which were often aimed in an uncoordinated way at the same customers; everyone in the bank realized that loads of money was being wasted as a result, yet it was virtually impossible to do anything about it. At the same time, the division is ahead of schedule in increasing revenues by $1 billion, a natural result of trying to meet customers' total needs rather than trying to sell individual products and services. That's a *$2 billion swing*, which the bank is sure resulted from its new approach to business. Because of the bank's high fixed-cost structure, most of that money fell to the bottom line. By contrast with the financial performance of the Bank of Outer Mongolia, Royal Bank's Personal and Commercial division earns a return on equity of about 25 percent. If the division was a freestanding business, we calculate that its excellent profitability and growth prospects would win it a P/E greater than the S&P 500 average—even though most banks' P/E multiples are way below the average. And the stock of the corporation has outperformed that of most North American financial institutions over the period.

Other than these radically different financial results, what's the difference between Royal Bank and the bank that failed so dismally in dealing with our unhappy customer? Not much, by most criteria. They're both giant, long-established banks offering a full line of financial services to millions of customers. Both have computers loaded with stunning amounts of potentially useful data about those customers. The most important difference between them is much deeper than matters of size, products, or even the business they're in. It is that these banks conceive of the way they do business in profoundly different ways. Specifically, one of them, Royal Bank, has put *customers at the center*.

Do You Have Any Unprofitable Customers?

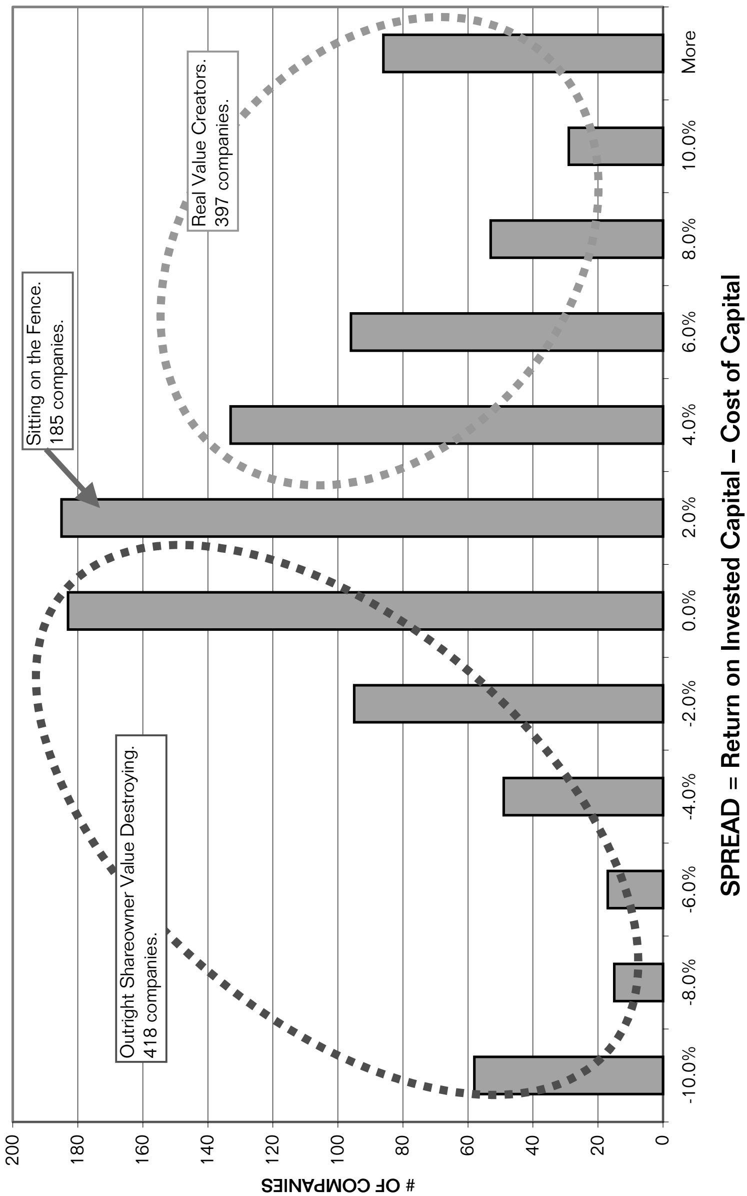
Maybe you're thinking, "That's fine for a bank, but my business is very different." That's just not the case. No matter what business you're in, the principles we're talking about apply to you. We believe that virtually *every* company in every industry will soon have to reconceive its way of doing business along these lines, with customers at the center. Why? Because the evidence is overwhelming that this is every company's number-one opportunity to create new shareowner wealth, which is something all companies desperately need to do. Consider: Even when the U.S. economy was booming from 1995 to 2000, most of the biggest companies either failed the most basic test of business—they didn't earn their cost of capital—or they passed by the slimmest of margins.

We know for sure that companies did much worse through the slowdown that followed the stock market bust in 2000, despite heavy layoffs, divestitures, and other heroic cost cutting. To put this in the starkest terms: Most companies are failing to achieve what they must achieve to make their share prices rise.

That's a big problem. In trying to solve it, the typical executive looks for troubles in the company's products or business units or territories, which sounds sensible. But that kind of conventional analysis is no longer good enough because it's typically applied to all customers, profitable or not, high potential or low, in the same way. Ever more brutal competition, combined with demanding capital markets and suspicious investors, is challenging managers to rethink their businesses in a fundamentally new way. A number of companies are beginning to do so, using a crucial new insight: If a company's return

SHAREOWNER VALUE CREATION

SPREADS: 1000 COMPANIES 1995–2000



on capital[2] isn't much better than its cost of capital, then its trouble is even deeper than bad products or business units or territories. By definition the company must have a boatload of *unprofitable customers*.

This is a huge idea: A company consists of both profitable and unprofitable customers—angels and potential demons. Some customers are making your company more valuable while some are draining value from it. Not that the demons are bad individuals; frequently they're unprofitable simply because the company doesn't know who they are and is failing to offer them the right value proposition. Similarly, managers may be blissfully unaware of which customers are the all-important angels. Combined, your angels and demons determine your company's value. This doesn't fit the way most managers run and measure—and thus think about—their businesses. Yet it's obvious that all the profits and value of a company come from its profitable, high-potential customers. If your company has a market capitalization of $20 billion, that value depends entirely on the future profitability of your existing customers and your ability to attract and retain profitable new customers in the future. Thus the first of the three most important principles that emerge from our work and that we will come back to again and again:

Principle No. 1: Think of your company not as a group of products or services or functions or territories, but as a *portfolio of customers.*

We will see in almost endless ways why this perspective is so extraordinarily valuable, but to get a basic sense of it, just answer this question: Does your company have any unprofitable customers?

We recently asked that question of the top executives at one of America's major retailers. (By unprofitable, we meant failing to earn the cost of capital.) Your answer may well be the same as theirs: No. Amazingly, these executives were quite confident they had no unprofitable customers, even though their business overall was failing to earn its cost of capital. If you're baffled by the apparent illogic of this position, well, so were we. Yet this company's leaders insisted that through some dark financial voodoo, millions of profitable customers somehow added up to an unprofitable company.

Our analysis of customer profitability—an exercise they had never conducted and weren't even sure quite how to conduct—showed them they were wrong. The truth, which shocked them, was that some of their customers were deeply unprofitable. Understand the importance of what this meant: Doing business with these customers on current terms was reducing the firm's market capitalization by hundreds or thousands of dollars per customer. Since the company didn't understand these facts, it was aiming marketing efforts at these customers and others like them. So here's how absurd the situation was: This company was actually spending money to bring in customers that were reducing the value of the firm.

If you believe your company has no unprofitable customers, we hope you're right. But experience has shown us that, like the executives of this retailer, you're probably fooling yourself. We've found that most companies have some very unprofitable customers—as well as hugely profitable customers—but managers rarely believe it or know who they are. In fact, as we'll see in later chapters, the bottom 20 percent of customers by profitability can generate losses equal to more than 100 percent of total company profits. Even if you know you have unprofitable customers, you may be clueless what to do about it. ("We can't fire customers, can we?" some managers ask; the answer is that in some cases you can, as we shall explain, though there's almost always a better alternative. Those demons can often be exorcised.) Yet if a company can't figure out a way to earn at least its cost of capital with individual customers or customer segments, it's just a matter of time until its share price gets crushed. These days that's something no company can afford to risk.

But suppose your company is fabulously profitable already. Are you immune to unprofitable customers? We doubt it. We have examined the customer profitability of two of the most profitable companies in North America and found that 10 percent to 15 percent of their customers are hugely unprofitable. So even in these cases, managers have an opportunity to make their company still more profitable.

It's crazy so many managers refuse to believe they lose money on some customers. Wall Street analysts should be all over this issue, digging deeply into the facts of customer profitability at the companies they cover, especially at companies that are failing to earn their cost of capital. Yet most analysts aren't doing so. In fact, two of Wall Street's top-rated food retailing analysts told us unequivocally there are no unprofitable customers at any of the companies they cover. Little did they know: We had performed analyses at some of these very companies and had found, as we find at every company, that some customers were deeply unprofitable. Yet the news wasn't all bad, for we also discovered highly profitable customers at these companies. But the analysts didn't have a clue.

A Better Way to Boost the Share Price

These analysts, like most managers, are missing what we consider the most powerful way to understand the true economics and influence the share price of a company: analyzing the profitability of its portfolio of customers. Here we begin to see the second of the three vital principles that leap out from this work and that will be elaborated much more fully in Chapters 2, 3, and 4:

Principle No. 2: Every company's portfolio of customers can and must be managed to produce *superior returns for shareowners*—meaning a consistently better than average share price appreciation—not just to produce earnings per share or EBITDA or revenue growth or customer satisfaction or anything else.

This sounds obvious. Why is it so important? Because it truly is a matter of corporate survival, now more than ever. Capital today travels around the globe instantly, continually, relentlessly seeking its best use. Information about your company and everything that affects it is far more widely available than ever in history, and it, too, travels instantly, globally, continually. Every company now gets a daily report card, in the form of its share price, on how it's doing in the worldwide competition to attract capital, and the grading is getting tougher. Even in Japan and Germany, former bastions of what some analysts used to call, admiringly, "patient capital," the party is over. No capital is very patient anymore. Global capital is demanding performance, and companies that don't deliver are finally being forced to do the unthinkable: fire CEOs, reform boards of directors, and face the new music.

This new imperative is truly unavoidable. Even if your company has an eccentric majority owner who just sits at home watching MTV and couldn't care less what his stock is worth, failure to beat the crowd in making it worth more will lead to trouble in the company's day-to-day operations:

- The best employees, who increasingly want to be paid partially in stock so they can participate in the success they help create, won't want to join a company that lacks a reputation for creating superior returns for shareowners. Further, companies that don't offer stock-based compensation may have a tougher time holding excellent employees; if they're paid only in cash, it's easy to leave for a better deal elsewhere. Without the best employees, the company will only go further downhill.
- A history of poor value creation makes new capital more expensive to attract, so the company will have a harder time funding research, development, and expansion that will let it serve customers better. As disaffected customers turn elsewhere, the situation gets worse.

- Companies often need to buy other companies in order to acquire technology, customers, or employees and keep them out of competitors' hands. Valuable shares make an excellent currency for such acquisitions, but if a company's shares haven't grown sufficiently in value, then these acquisitions may be too expensive. The company's competitors win these prizes instead, and yet another downward spiral begins.

We hope it's obvious that creating superior returns for shareowners isn't just in the shareowners' interest. It's in everybody's interest. The company that creates tons of shareowner value will employ more people, pay more taxes, and serve more customers—all while enriching shareowners, who nowadays are most likely ordinary citizens who need their pension funds and mutual funds to perform well in order to pay for retirements and college educations. Failing to create superior shareowner value means none of these good things will happen.

Now a number of leading companies—including Dell Computer, Toronto–based Royal Bank, Fidelity Investments, Best Buy, Britain's Tesco, and others—are getting a grip on their portfolio of customers and managing it to build substantial competitive advantages. What they are doing contributes powerfully and quickly to topline growth, profitability, and a rising share price. The risks of not putting customers at the center therefore become unbearable, and companies that don't do it will face an ugly future. Companies that do it ahead of their competitors will position themselves to dominate.

We must declare up front that this isn't easy to do. That's good news and bad news. The bad news is that it will strain your organization and require a lot of work. The good news is that it will probably be just as hard for your competitors. The even better news is that putting customers at the center offers significant first-mover advantages. So if you can do it first, your company may be able to establish competitive advantages that will last an extraordinarily long time.

Why You're Not Really Customer Centered

What we're asserting here is much more far-reaching than you may be tempted to think. We can hear you (or your boss) objecting: "We already do this!" The fact is most managers will insist they already put customers at the center. "We put our customers first!" and "We're committed to our customers' success!" claim virtually all companies. Indeed, *customer centric* is one of the loudest business buzzwords of the era. One of America's largest retailers, which we'll identify in a moment, claimed in 2001 to have just three "strategic imperatives," one of which was "creating a customer-centric culture to better satisfy and serve our customers." A Wall Street analyst reports that one of this retailer's top executives told him at the time, "We have a heightened sense of urgency and a clear focus on the customer, and we are working as one unified team to make retail history!" Which retailer was this? It was Kmart. We have to admit the firm did make retail history: In 2002 it filed the largest bankruptcy petition of any retailer, ever.

The claims of customer centricity at most companies are an outright fraud. These companies don't put customers at the center—not really, not as if they truly mean it, not like we're talking about. If you doubt that, ask three questions:

1. Who in the company "owns" the customer? That is, which one, specific, identifiable person is responsible for understanding a designated customer or customer segment thoroughly, for figuring out those customers' total needs and desires, and for figuring out and executing a value proposition that meets them better than the competition, driving the share price as a result? At most companies the answer is: no one. Or rather, more insidiously, the proudly declared answer is, "Lots of people own the customer!" But when a number of people have responsibility for any given customer, the truth is that nobody owns him. Probably not one of those people is responsible for the customer on behalf of the whole company. Instead, each probably represents only a part of it, most likely a product or a function or a territory. Employees in any of those organizational areas may say they own a given customer, but they can't *all* own him. In fact, they are responsible only for those needs and desires of the customer that happen to intersect with the employee's area of the organization. Does this arrangement seem logical? It does to the vast majority of companies everywhere, which are organized in exactly this way. Just remember that it is precisely what got the Bank of Outer Mongolia into so much trouble.

2. Who is accountable for the profitability of any given customer or customer segment? Again, the answer is usually: no one. In fact, as we will see in shocking detail very soon, most companies don't even know how profitable any customer is. It's ludicrous to claim you've put customers at the center if you don't know which ones are making you money and which ones are costing you money, and no one is in charge of managing profitability through creating, communicating, and executing value propositions.

3. How significantly does the company differentiate its interaction with different customers? Companies that put customers at the center don't treat them all the same. On the contrary: These companies understand the importance of a mutually beneficial value exchange, treating different customers very differently because they know that customers have widely varying needs and desires. Meeting these needs better than competitors offers the company the opportunity for earning superb profits, thus turbo-charging its stock. To treat all customers the same makes no sense—yet many companies try hard to do just that and even try to claim that it's a virtue.[3]

For most companies, answering these questions in a customer-centered way amounts to a deep reconception of how they do business. It's a real mind bender for many business people, but the companies doing it are hardly the ones you'd think of as radical.

Royal Bank is 138 years old and has 10 million customers. Dell Computer is the world's largest maker of personal computers. Fidelity Investments is one of the world's largest sellers of mutual funds. The surprising fact is that many of the companies at the leading edge of a clear trend toward putting customers at the center are big, established—and producing spectacular results.

Remember Where the Money Comes From

Putting customers at the center has always made sense for a simple reason that seems so obvious it wouldn't be worth saying except that managers continually forget it: *Customers are where the money comes from*. We will return to this simple but profound truth a number of times because it is, after all, the ultimate reason for putting customers at the center. Ignoring it will almost always get a manager into trouble, if only because it will render him unable to maximize profitability.

Consider: If your company is organized around products, then top management makes decisions based on measures of product revenue or product profitability. But that is not really what management most needs to know. Why? A major retailer with which we worked was earning a handsome profit selling certain dresses to Customer A and losing money selling those very same dresses to Customer B. The reason was that Customer B demanded an enormous amount of the salesperson's time, made lots of returns, was always unhappy with alterations, causing rework, and always paid her house charge account promptly—a potential demon. If the retailer had known this, it might have found ways to turn that demon into a profitable angel, perhaps by discouraging returns ("Let's make *sure* this is the right size, shall we?"), by offering a broader selection of sizes to replace problems with alterations, or by offering the customer highly profitable products (shoes, handbags, belts) that would logically go with the dresses but that she hasn't been buying.

Most companies, however, amalgamate all their financial data into a measure of product revenue or profitability. As a result, the clueless product manager in charge of those dresses just keeps trying to sell more of them, and her efforts—repositioning the garments on the sales floor, motivating sales and alteration people, running advertising, and sending out mass direct mailings—may very well cause Customer B to continue behaving in an unprofitable way, dragging profits further downward. Because product managers typically have no idea which customers are profitable and which ones aren't, they waste lots of resources on the wrong products and customers and leave vast amounts of money on the table by not fully meeting customers' needs.

The benefits of putting customers at the center go far beyond fixing unprofitable customers. When accountable operating executives focus on customer segments rather than on products, functions, or territories, their behavior changes. Rather than just trying to sell more of the product or service for which they're responsible, they try to fulfill more of the customer's total needs. In the previous retail example, the accountable executive focuses on customer segments. She may discover that some of the highest profit potential customers may be petite Asian women who require extensive, expensive alterations due to lack of appropriate sizes. Fixing this problem could easily spark huge increases in profitability through lower costs and increased revenue.

Rather than trying only to take product market share away from direct competitors, managers try also to capture more of specific customers' total spending. Their perspective—and the company's opportunities for profit—expand enormously. This observation leads us to the third of our three vital principles:

Principle No. 3: Companies enhance customer profitability and drive their stock by creating, communicating, and executing competitively dominant customer value propositions.

Consider our bank customer. For the Bank of Outer Mongolia, this story is even more tragic than it first appears. Not only does this customer trade lots of securities through the bank's brokerage operation, he also does loads of trading through other institutions as well. He maintains big cash balances at the bank but also elsewhere. He buys insurance, but not through the bank. Someday soon he will need trust services. He'd like technical help getting his whole financial life on-line and would be happy to pay for it, but he doesn't even know where to start. In short: *huge* opportunities for the bank.

Needless to say, no one at the bank knew any of this. Yet someone there *could* have known all of it and more, either through third-party data sources or simply by paying attention to the customer. (For example, just knowing how much money he made by trading should have tipped off managers that he wasn't keeping all his cash balances with the bank.) Armed with this knowledge about the customer's specific needs, the relative importance of these needs, and the degree to which competitors were meeting them, the bank could have put together a knockout customer-value proposition to attract all of this customer's financial services business: lower commissions and faster execution on his trades, lower interest rates charged on his margin debt, higher interest rates paid on his cash deposits, a better deal on his mortgage, lower premiums on his insurance, technical help getting his finances on-line, and trust planning—the customer would have been better off in every way. We're well aware that if it isn't careful, the bank could discount itself to a loss. But in this case the bank could have been much better off because it could have more total business and more total profit from this customer even after allowing for discounts. Indeed, if the customer's primary need was saving time—one-stop shopping with a single, high-quality point of contact—discounts might not have been needed. His relationship with the bank would be so deep that competing banks would find it almost impossible to pry him loose. Because the bank would know him so well, it could offer him products and services tailored to his needs, on which the margins would likely be substantial. The customer would be such a fan of the bank that he'd help generate new business through friends, family, and business associates. The bank would be more profitable immediately and for years in the future.

But of course none of this happened.

This customer went to the head of the bank's retail operations. He called him and told him this story. Yes, said the executive, it sounded all too familiar. He'd love to do something about the situation. Trouble was, every idea for addressing the problem seemed to take power away from the managers who ran the product fiefdoms—mortgages, brokerage, etc.—so they found ways to kill every proposal. Because this bank puts *products* at the center, not customers, it never came within a million miles of realizing its huge opportunity with this customer or the thousands like him. Nor does it even realize how awful its performance is, since it measures itself against other similarly awful institutions and therefore thinks it's doing fine. Heaven help it if Royal Bank ever comes to its turf.

Why This Is a Mind Bender

The advantages of being truly customer centered are so large and so clear that one has to ask: Why didn't most companies do this long ago?

Part of the answer is precedent and habit. In an earlier economy, most businesses were based on physical assets—mines, factories, ships, rail lines. Creating all these things required enormous amounts of financial capital, and the capital providers—lenders and equity holders—understandably wanted a careful accounting of how their investments were performing. For financial reporting purposes, it seemed most convenient and logical to match up a mine or factory with the product it produced, a ship or rail line with the territory it served. So the managers of a nineteenth-century industrial conglomerate might report to the owners that bricks (i.e., the brick factory) had a profit of $400,000 and Latin America (i.e., the Honduran railroad) had a loss of $200,000. Then as now, what gets measured gets managed. Thus grew up a system of managing companies on the basis of products made, functions carried out, and territories served.

So ubiquitous did this practice become that it pervaded, and still pervades, companies that did not have to use it. A small retailer, such as a convenience store, corner deli, or dry cleaner, may be financed entirely by its proprietor and may have only a small number of customers. For this business, putting customers at the center would not be too tough. The dry cleaner should find it easy to offer pickup, delivery, and expedited service to its most profitable or highest-potential customers. Yet it rarely happens, simply because the mind-set is missing; our business history and culture don't lead us in that direction. A boutique investment bank, though far larger, is similar: It may be financed entirely by its partners and have relatively few customers. But most investment banks are organized around products—equities and fixed income, for example—rather than customers. An industrial firm that serves major automakers has only a handful of customers, so putting customers at the center would not be technically difficult. It's just a matter of the all-important mind-set.

For many modern businesses of any size, putting customers at the center has also been a huge practical problem, which is another reason it hasn't happened. For any company with lots of customers, the data demands could be overwhelming. If your company has ten products and a million customers, which would you organize around? The products, obviously. Even if you could classify the customers into a manageable handful of segments, the challenges of collecting and handling data about each customer so that each could be assigned to the proper segment—and repeating the exercise for every customer every month or even more often—have in the past been almost insurmountable. The problems of simply tracking the behavior of large numbers of customers who may interact with the firm through various channels—by phone, by mail, on-line, in person—can be huge.

Aggregating that data so it could be sliced and diced usefully was another monster challenge. Extracting the data you wanted and then analyzing it were separate, complicated tasks.

But now, in just the past few years, the practical challenges have been met. At long last, computer technology now enables companies to do everything they must do in order to be truly customer centered. For business this is a wonderful, historic development. The trouble is it leads managers to believe that the challenge they face is adopting the technology. It isn't. What many companies are discovering, to their grave disappointment, is that this remarkable technology by itself does not lead them to create significant new value. Many companies have spent millions on the needed software—including ERP (enterprise resource planning), CRM (customer relationship management), and many other applications—with little or nothing to show. What they are finding is that this new technology, like many important new technologies of the past, requires them to do something even harder than spit out numbers or make software work: It demands that they rethink the way they run their businesses. Specifically, it requires them to shift corporate power and redesign business processes as they face the inevitability of putting customers at the center.

An analogy: When electricity came to industry, it was used first to power traditional craft-based forms of work. Efficiency increased somewhat—but then visionaries (such as Henry Ford and Frederick Taylor) saw how this new technology enabled work to be reorganized fundamentally, and wealth creation exploded.

Similarly, when computer technology came to business, first in back-office applications, companies applied it to existing processes and achieved modest gains in efficiency. But then some saw how processes could now be reorganized—for example, by combining ordering, billing, and shipping into a single process—and they achieved breakthroughs in productivity.

Now we have technology that enables companies to manage customer data, and all the associated financial information, in ways that weren't possible even a few years ago. Once again we see most companies applying this new technology to existing conventional processes, generally in sales and marketing, within a conventional structure centered on products, functions, or territories. If these companies are very lucky, they get incrementally better results. But the pioneers are realizing how this technology enables a profound reconception of the business—with customers at the center—leading to breakthrough advances in competitiveness and value creation. It's this reconception, built around the shift in mind-set of putting customers at the center, not the technology, that's most important.

Waking Up from the Technology Dream

Weren't we all supposed to be getting rich through customer knowledge by now? For business, this was a major part of the great promise of the Info Age: At last we would really be able to know about our customers, no matter how many, really keep track of all their interactions with us, and know much more through information from third-party providers, all of it combining seamlessly, constantly, in real time. The payoff? We'd know exactly what every customer wanted—products, services, whatever—and would amaze and delight them with our uncannily on-target offerings. They'd love us. They'd happily pay prices that translated into fantastic margins for us, they'd never leave, and they'd tell all their friends. We'd make so much money and be so competitively dominant that our stock price would burst through the ceiling. We would be business heroes.

That's no exaggeration of the vision that formed as the capabilities of information technology became apparent. Countless books and articles were written about it, including excellent books like those in the *One to One* series by Don Peppers and Martha Rogers. Plenty of people could see what was becoming possible, and they found it awesome. Terms like *mass customization* and *learning relationship* entered the business vocabulary. Technology was about to revolutionize the way business was conducted and even the way it was conceived.

It's true that many companies have started down the road toward capitalizing on their customer data, often by making breathtakingly large investments in computer hardware and software. But where's the payoff? Think of your own experience. How often—or rather, how seldom—are you amazed and delighted by a company that has offered you a solution to one of your problems before you even asked? How about after you've asked? Overall, has your experience as a consumer or as a business customer improved over the past five years?

We don't know many people who would say yes, but in any case we can take a far more rigorous approach to this important matter. Think of the companies that know the most about you and about millions of other customers—that is, the companies that should be realizing the greatest benefits from their new technology-powered abilities to know and serve customers better. Which companies would they be?

They'd probably include credit card companies. Think of what your primary card issuers know about you: where you travel, when, in what class of service, where you eat, what kind of food you like, what kind of wine you drink, where and when you buy clothes, books, furniture, and probably groceries, prescription drugs, gasoline—their data about you is staggering, when you think about it.

Who else knows a lot about you? How about your mortgage issuer? Think of what you had to disclose to get your mortgage—all the assets you own, their locations, their value, all your debts, all your sources of income, your income tax returns, even the terms of your divorce if you've had one. Other financial services providers similarly know a ton about you.

Now that you've got the hang of it, think of what certain other companies know. Your phone company. The airlines, if you travel a lot. Insurance companies, which serve virtually every business in

America. The biggest companies in these industries are sitting on troves of customer data almost beyond imagining. This is supposed to be their moment. Now that the technology future has arrived, they hold the keys to the kingdom.

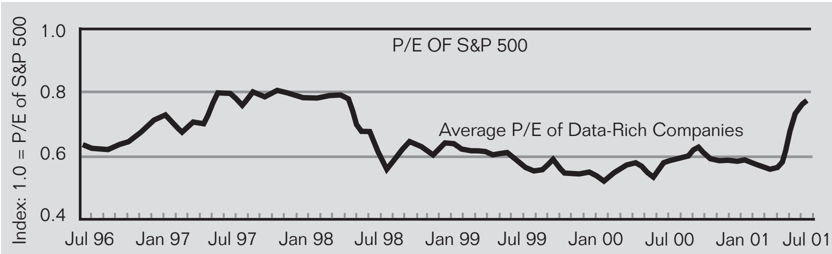
That's why the reality of their situation is so stunning. We chose a sample of a dozen leading companies[4] from these info-rich industries (see chart on page 23) and analyzed their performance over the past five years, looking for the payoff where it ultimately counts: in the share price. The stock markets have been up and down over that five-year period, so we looked at a more constant gauge: how the companies' P/E multiples compared with the average multiple of the S&P 500.

Our remarkable finding is that every one of these companies failed to match the S&P 500 average multiple throughout the past five years, usually trailing by a substantial margin.

What's the problem? The managers of these Dismal Dozen companies do not dispute that they are missing a huge bet. In every case we found that they understand quite urgently the need to capitalize on their customer knowledge opportunity as quickly as possible. They have invested heavily in the new technology tools; most of them spend over $1 billion a year on computer technology and services, and some spend over $3 billion. They employ lots of intelligent people.

None of that is what's wrong. Their problem is that *they haven't put customers at the center*. Every one of these companies is still organized around products, functions, and territories. On all three of our tests of customer centricity, they fail:

1. No single individual owns the customer.
2. No one is accountable for customer profitability (and unprofitability).
3. These companies make little effort to differentiate customers and to treat them differently.



Rather than rethinking their businesses, they're tweaking old processes and customer value propositions, and significant value creation isn't happening.

This cost to shareowners is astonishing. If the Dismal Dozen could simply raise their P/E multiples to the S&P 500 average—that is, if they could really get it together and become mediocre—they would create *a half-trillion dollars* of market capitalization. If they could begin to realize the value in their extraordinary depth of potential customer knowledge, say by achieving P/E multiples as far above the average as they are currently below it—a modest goal, we believe, as the next chapter will make clear—then they would create a trillion dollars of new shareowner value. We will return often to this notion of moving from a discount P/E to a premium P/E.

That is the potential for just these dozen large companies. Think of the potential for the companies with which they compete, virtually none of which are performing much better. Then consider the possibilities for other companies worldwide, all of which possess customer data, have access to more data than they now possess, and are probably realizing little of the opportunity it holds. When we call this a trillion-dollar opportunity, it's clear we are being conservative in the extreme. The true opportunity is much, much larger. And it is *your* opportunity, whether your business is manufacturing, services, or information, whether you sell to businesses or individuals—no company is exempt.

Managing, Measuring, Strategizing in a New Way

Start imagining all the ways a company with deep customer knowledge could please customers, and the endless possibilities make you almost light-headed. But forget about the blue-sky possibilities. What's really striking are all the simple, obvious things that still aren't being done. Consider:

- The front cabin of an airliner is filled with a variety of customers. Some may be infrequent travelers who bought a low-fare coach ticket and are using an upgrade given to them by a family member. Others may be business fliers who pay full fare and travel across the country and back every week. The airline knows which is which and logically should want to make sure the high-profit customers get their first choice of seat, meal, wine, etc. Yet it almost never happens, meaning the airlines often—and needlessly—tick off their most valuable customers.
- A phone company offers DSL (digital subscriber line) service in the same way to all its customers: by sending them a kit with which to install the service themselves. But the company knows, through a customer's name or monthly bill size, which customers are small businesses or other heavy consumer users who are likely to be especially busy and willing to pay for installation. Since the company has an army of technicians in vans, offering the service to just the right customers

needn't be a problem and could be highly profitable. Yet many major telcos haven't grabbed this opportunity despite the rapid commoditization of their businesses and plummeting P/E ratios.

- When you slide your bank card into an ATM, the machine instantly knows a huge amount about you, yet it acts as if it never heard of you. It knows that on 98 percent of your visits over the past two years, you've withdrawn $200 in cash from your checking account. It could ask immediately if that's what you'd like to do this time, but instead it runs you through the same menu as every other customer. While you're waiting for it to check your account and disburse the cash, the screen tries to sell you the bank's Visa card—even though it knows you already have one. It also knows you have no home equity line of credit with the bank, but it makes no attempt to sell you that.
- Even small retailers possess valuable but unused customer data. A restaurant owner knows—though he may never have dug through his data to figure out—which customers most often order expensive wine, the most profitable item any restaurant sells. Through further analysis of the information, the restaurateur can approach these customers in many ways: by notifying them of special offers of their favorite foods or of seasonal foods, by offering late-notice reservations at the busiest times, by assuring them of their favorite table or server, or by offering particular high-end wines that aren't on the wine list. It isn't complicated, but most restaurants don't do it.

By now you realize what the problem is. Because of history and habits, most managers behave as if profit comes from products ("Yogurt is up 13 percent this year!") or places ("Europe is off this quarter"). But it doesn't. It comes from customers, and facing that reality is a bigger change than most managers realize.

In these examples and in general, note one of the most important attractions of capitalizing on customer data: *It's creating value from what you already have*. As every industry consolidates and becomes more competitive, the pressure to create value only increases, and it isn't going to let up. Every company needs help. In these circumstances it feels like a gift to discover that you have a valuable "new" asset that in fact has been sitting there all along, underused because the company wasn't organized to optimize it.

Corporate managers aren't the only ones thinking more about the value of this asset. Investors are too. In fact, a blue-ribbon task force created at the request of former Securities and Exchange Commission Chairman Arthur Levitt found that investors increasingly want information about companies' customer-knowledge assets as an aid in evaluating companies. The task force urged the government to "take as many actions as it can" to create an environment that encourages companies to disclose such information as the loyalty of its customers, changes in its customer acquisition costs, and changes in its revenue per customer, none of which need be reported under current rules. In our view it's essential that companies get a handle on customer knowledge not just to compete for business in the product and service markets, but also to compete for investors' money in the capital markets. This becomes obvious once you think of a company's share price as the sum of customer segment values.

Putting customers at the center will also help overcome one of the largest business problems of recent years, the high failure rate of mergers and acquisitions. We have just gone through the biggest M&A (mergers and acquisitions) wave in history, with acquiring companies paying huge premiums to get their targets, but most of these deals don't pay off for shareowners. Why not? The most common justification for deals today is cost synergies, but they rarely yield much benefit for the acquirer's shareowners because these savings are easy to estimate ahead of time and in practice end up getting negotiated away as a price concession to the selling company. The buyer typically pays a huge margin above the value of the acquiree's tangible assets, a difference that accountants call goodwill as a catchall term for the company's intangible assets. In practice, the most valuable of those intangible assets is the value of the acquired company's profitable or high-potential customers, which represent significant new profit potential. Yet it's extremely rare for an acquiring company to focus on realizing that value by intensively mining the gold in the acquired customer data, and even rarer for it to develop and combine both companies' customer knowledge assets. Instead, most buyers just whale away at cost cutting and whine about incompatible legacy computer systems. As we'll show in Chapter 10, most companies would serve their shareowners far better if they approached M&A with customers at the center. During the historic M&A wave just concluded, in which deal volume exceeded $12 trillion, we estimate this approach could have saved shareowners at least $1 trillion—another $1-trillion opportunity, on top of the one already described. It could also have avoided some severe customer dissatisfaction and needless, ineffective layoffs of hardworking employees.

If it sounds as if we're saying most companies are just plain clueless, we aren't. Our research at dozens of major companies shows that many managers understand the immensity of the customer knowledge opportunity and want desperately to begin realizing it. Managers know they're leaving enormous amounts of wealth on the table. In every industry we've cited, virtually all companies have launched programs to create more value from their customers. But because most of these companies haven't placed customers at the center by following the three key principles—thinking of their companies as a portfolio of customers, managing the portfolio for share price appreciation, and creating, communicating, and executing dominant customer value propositions—their programs aren't doing very well.

Rate Your Readiness

We have developed a framework for realizing these new opportunities that is unlike any you have seen before. It brings together three key concepts that will appear time and again throughout the book:

1. *A premium P/E multiple as the measure of success*. Never forget that the bottom-line goal of every business is to create superior returns for shareowners. As markets rise and fall over time, a premium P/E is your constant assurance that you're exceeding the average and achieving that goal. Specifically, it shows that investors acknowledge your superior ability to create value now and into the future.

2. *Value Proposition Management (VPM)*. This is a new way of thinking about the process of using customer data to deliver vastly improved customer value propositions and thus create and sustain a premium P/E. Not just data mining, not just decision analytics, not just customer relationship management, VPM is a new, hands-on approach to realizing the enormous opportunity in customer data.

3. *Creating a customer-centered enterprise*, characterized by a mind-set, an organizational form, and a culture based on accountability for increasing the share price through customer knowledge. Everyone in business knows that nothing good happens unless someone is accountable for it. We will see repeatedly the importance of creating an organization and culture in which managers are accountable for realizing the potential of customer knowledge. In most companies the required changes will be substantial, but they are worth it. Halfway measures, such as complex and often confusing matrix organizations, suck huge energy out of the workforce. Clear accountability, by contrast, attracts hard-charging managers who want to show they can deliver.

What are the requirements and rewards of this opportunity? Here's an analogy about the potential of laser focus and unrelenting discipline. About six years ago General Electric decided to pursue a six-sigma quality program. Many other companies had adopted such programs, with varying success. GE realized that the only point of such a program is to create returns for shareowners, and realized also that it would never succeed without total commitment. So the company, using elements of six-sigma quality analysis that were generally available, created its own program that involved every employee. No manager could be promoted without six-sigma training, and every manager was held accountable for creating value through six sigma. Today, after spending hundreds of millions on training, technology, and operationalizing, GE has produced over $5 billion of new profits beyond the required investments.[5]

The point is that GE didn't invent six sigma. It didn't have to. The pieces were there, waiting to be put together. What GE did was assemble them and apply them with total commitment, making managers accountable for the results.

We believe that the shareowner value potential of putting customers at the center is at least as great as six sigma. It is now, finally, a practical goal: The pieces are there, waiting to be assembled and applied. It's time for visionary leaders to make their move. Doing so will require intense focus and discipline. The good news is that the benefits can begin to be realized quite quickly.

Our analysis of successes and failures in realizing the potential of the data gold mines that many companies are sitting on shows that winning requires effectively addressing the needs of customers, shareholders, and employees. To do so, every company needs a strong foundation made of seven leadership elements. All seven are required; a missing one, like a missing stone in a foundation, will lead to certain trouble. The seven are highly interdependent. A few fortunate companies have possessed some of these elements for decades—a powerful competitive advantage, and all the more reason for other companies to start building right away.

As we describe the elements, ask which ones your company has, needs to build, or needs to strengthen. Ask yourself what's in it for your customers, shareowners, and employees. Give your company a score of zero to ten on each trait. Many managers find it valuable to score their most threatening competitor as well. At the end we'll explain what your total means.

1. Your leadership is committed to delivering and maintaining a premium P/E multiple.
2. Your company organizes strategic planning around customer segments—with a cultural belief that not all customers should be treated identically.
3. Your company has a truly customer-centered mind-set and a corporate organization built around customer segments, each with a leader bearing full profit-and-loss accountability and concomitant authority to wow the customer and realize the company's financial goals.
4. Your company understands the true profitability of its customers and how this determines its stock price and P/E.
5. Your corporate culture has a consistent bias toward creating new winning value propositions by forming hypotheses, then testing, verifying, and executing the results on a major scale.
6. Your company has a record of merging or acquiring business successfully, with zero decline in customer satisfaction and significant increases in customer knowledge among the most valuable customer segments.
7. Your top management regularly spends at least 25 percent of its time teaching these principles to all levels of the organization.

Now add up your score. Here's what the total means:

0–25 Like most companies, you're a long way from raising your stock price by putting customers at the center. Focus first on taking the baby steps that will get your total up.
26–50 You're getting there. With a score in this range, you're probably doing a few things very well. The key now is to improve your lowest scores quickly.
51–70 You're far ahead of most companies. Go for it. The manage-

ment challenges won't be easy, but you're better prepared for them than most. Move now, and you could build a strong competitive advantage with your customers and deliver a consistent premium P/E for your shareowners.

If you don't score well, don't despair. Few companies get high scores, which means the opportunity for you is great. In addition, since fully capturing this opportunity is difficult, the first-mover advantage is unquestionably significant.

The first movers are already putting distance between themselves and their product-, territory-, and function-centered competitors. Turning to them for real-world examples, we'll create a picture of how the many elements of this opportunity can be combined to create a powerful engine of shareowner wealth.

Specifically, we'll show the keys to high scores on each of the questions above:

- Question 1: Chapter 4 shows why a premium P/E multiple is so important.
- Question 2: Chapters 5 and 6 show the value of organizing around customers and differentiating between them.
- Question 3: Chapter 5 plus Chapters 6 and 9 show the critical importance of mind-set and accountability.
- Question 4: Chapters 2, 3, and 4 show the surprising ways your customer relationships add to or detract from your company's share price and thus its P/E.
- Question 5: Chapters 7 and 8 describe how successful companies create, communicate, and execute winning value propositions.
- Question 6: Chapter 10 presents a new and better approach to mergers and acquisitions.
- Question 7: Chapters 9 and 11 describe the methods of spreading these ideas throughout an organization.

Let's now take the next step in making your company a winner by understanding more deeply the benefit of putting customers at the center, focusing where it counts most: in sustained profitable growth and the share price.

Don't Buy These Excuses

Managers in every industry can come up with plenty of reasons for not making better use of their extensive customer data—but many of their excuses aren't valid. Among those we've heard most:

"The privacy issues are too tough."

As long as a company is using its own data or legitimately purchased third-party data, privacy issues are rarely significant. More important is how much the customer expects the company to know: A consumer may be jolted to receive an offer suggesting that his credit card company knows the size of his mortgage, though that information may be easily and legitimately available. An advantage for big financial services firms is that customers expect them to know a lot.

"We're in a regulated industry."

Government regulations may prevent certain moves; phone companies, for example, can't differentiate some services by customer profitability. But even then, opportunities to use customer data for creating shareholder value—through cross-selling, up-selling, and offering new products and services—remain plentiful.

"We've already got a lot of customer-focused initiatives."

An insidious excuse, because it suggests that all is well. But all is not well unless those initiatives are expected to realize customer returns on invested capital significantly above the cost of capital, and someone is being held accountable for those results. It's rarely so.

"We're under too much short-term earnings pressure to do it now."

Then you'll never do it—can you think of any company that *isn't* under short-term earnings pressure? If you don't get the process started now, competitors could seize an advantage. When that happens, you'll really get to feel some earnings pressure. It's all about prioritization by leadership.