VIRTUAL STRATEGIST

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Why Didn't I Think Of That?
Seven Symptoms of Incremental Thinking and How to Treat Them

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Organizations think. They think about earnings. They think about market share. They think about growth. Why then, if organizations have the capacity to think, do so many of them not think of *"that"*? *That* is the next big idea. *That* is the headline that grabs analysts' attention. *That* is the $500 million growth opportunity. *That* is the future. *That* is the object of the statement, *"Why didn't I think of that?"* Unfortunately, these words are painstakingly more common than *"I thought of that!"* Why? And how can organizations think of *that* more often?

In order to promote innovation as an organization capability, organizations must first understand why they lack the capacity to think of *that*. The reason is profoundly simple. Most organizations are thinking of *this*. *This* is the cash cow. *This* is today's product. *This* is the organization's existing market share. *This* is often the reason why organizations do not think of *that*. Unfortunately, the religious practice of worshipping at the altar of the cash cow is oftentimes the greatest obstacle to innovation. The inability to understand what the organization does well versus what it sells is a stumbling block to growth.

That is the result of innovative thinking. *This* is the result of incremental thinking. Both methods of thinking contribute to the successful maintenance of the current business and growth of the enterprise; however, it is common for incrementalism to blind the organization to new methods, new products, and new markets.

Businesses think when they analyze challenges, opportunities, markets, products, and competitive threats. While incremental thinking may help at managing earnings in the near term; innovative thinking is required to identify non-linear routes to growth.

Innovative thinking is defined by a unique set of characteristics required when analyzing the business landscape and its subsequent opportunities and challenges. These include: identifying and defining core skills, creating disruptive change, challenging convention, and identifying unarticulated customer needs. Conversely, incremental thinking typically involves a much more myopic analysis of the landscape and the organization's role in it.

The good news is organizations have the option to think of *this* and *that* simultaneously. The challenge is to identify and successfully treat the symptoms of incremental thinking and to create a process whereby the organization can successfully pay homage to the existing business while seeking new routes to growth. Metaphorically speaking, the greatest challenge an organization has is to learn how to build and manage a birthing ward in a nursing home. How can organizations give birth to new ideas while milking the cash cow?

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Organizations that think incrementally typically suffer from early warning signs – precursors to market irrelevance. These symptoms, seven in all, are observational themes discovered from consulting to large and small companies, innovators and laggards, and privately-held and publicly-traded firms on issues of growth, strategy, and innovation. Incremental thinking exhibits specific symptoms. Treating these symptoms, if done effectively, will assist the organization in its search for new wealth. Here's how.

SEVEN METHODS TO TREAT INCREMENTAL THINKING

1. OBSERVE WHAT CUSTOMERS CAN'T DO TODAY VERSUS WHAT THEY CAN

The first symptom of incremental thinking is the inability to attract and retain customers. High customer turnover is often symptomatic of the inability to identify, define, and meet unarticulated customer needs. Differentiating between an articulated need and an unarticulated need can have a profound impact on the organization's sales performance. Articulated customer needs are explicitly stated. They often take on the form of "I want it cheaper, faster, better." Articulated customer needs are often the result of surveys, focus groups, and conjoint studies. For example, if asked how a fast food retailer may increase visits among its core customers, it may receive responses as elusive as "more food, lower price", "cleaner bathrooms", or "bigger burgers." The challenge with delivering on articulated customer needs is that customers are typically unable to understand what is possible. Customers are not good innovators. Think of your customers. Do they truly know what is possible? Consider a pharmaceutical manufacturer who employees hundreds of scientists, experts, and physicians in the process of drug discovery. Think of the discrepancy in knowledge between this group and a patient suffering from heart disease. While the patient may "feel the pain" associated with the disease, she may not necessarily know what is possible in order to treat it. Pick your innovation: the Sony Walkman, sugar substitutes, compact discs, power-by-the-hour aircraft maintenance contracts, and the clockwork spring radio were never articulated by customers. They were created. They were responses to unarticulated needs.

Unarticulated needs are often observed, experienced, or discovered. For example, the same fast food retailer may discover a relationship between its stores and its customers that is profoundly more valuable than the relationship its customers have with its products. For example, in Japan it is common for young people to visit McDonald's in order to learn English. Why? Because most employees of the restaurant speak English as a second language. The store attracts English-speaking foreign visitors, and for the cost of a burger, fries, and Coke, the visit is substantially more cost-effective than enrolling in a Berlitz English Course at a local college.

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EXHIBIT 1

Why you didn't think of that?

The 7 Symptoms of Incremental Thinking and How to Treat Them

	Symptoms	Diagnosis	Cure
1	Customer retention rates declining	No ability to identify unarticulated customer needs	Observe what customers can't do today, spend a day in the life of customers and non-customers
2	Market size derived by number of potential customers	Missed opportunities due to narrowly-defined markets & competencies	Define addressable market by customer behavior vs. number of customers
3	Chasing the headlines product development process	No capacity for continuous innovation	Develop a mechanism for creating a proprietary opinion from public knowledge
4	Overextended brand (ie. too many product variations)	No clear understanding of core competencies	Identify and define what the organization does well vs. what it sells
5	Bucket brigade innovation process	No integrity of concept development	Create a process where the same people manage concepts from ideation to action
6	Shallow employee incentive programs	Employees treated as vendors vs. employees treated as customers	Give employees ownership in new ideas
7	High ratio of income to revenue growth	No significant returns on new ideas	Measure returns on experiments vs. returns on businesses (in order to prove hypotheses)

This is an unarticulated experience that customers have with the retailer. It would not typically be made evident on a survey, rather it must be observed, experienced, and discovered

There are many ways to attract new customers and treat high customer turnover. Whether you implement customer loyalty programs, drop prices, increase promotional efforts, or improve product features, all of these tactics are just that – tactics. In order to treat turnover effectively, the organization must identify those unarticulated (i.e. unspoken) needs of its customers. This requires strategy. This requires unconventional thinking. This involves creativity. For example, in its efforts to identify ways to attract Generation Y to buy appliances, Whirlpool did not ask people what price they would pay for a refrigerator, nor did they offer buy-one-get-on-free promotions. Rather, they gave disposable cameras to people in this segment and asked them to take photos of moments in a given day when they have a problem. The results provide insights much more powerful than surveying. For example, photos were returned questioning what to do with a half-eaten pizza that won't fit in a dorm room refrigerator. Other photos gave insights into the "troubadour" culture of Generation Y. They move around – a lot. How can an appliance manufacturer attract this segment with big white boxes? They can't. At least not with their current strategies, products, and marketing efforts. Rather, they must create new products (or perhaps services) for this segment that deliver on such unarticulated needs. Perhaps a surrogate "maid" might be a more appropriate solution for Generation Y versus a fancy new appliance? After all, many of them never had the responsibility of doing their laundry or cooking their own meals at home anyway. Or if one were to follow their existing behavior, versus creating a new behavior, a laundry delivery service may be more relevant than a dorm room dryer.

In order to begin to develop methods for identifying and defining unarticulated customer needs, organizations need to adopt new behaviors including:

- Spend a day in the life of customers and non-customers
- Have customers keep journals on why they buy, when they buy, and what they buy
- Give customers and non-customers disposable cameras and ask them to chronicle obstacles in their relationship with everyday activities (e.g. if you're in the transportation business, have them document issues with cabs, buses, trains, cars, airplanes, etc. For example, why are airplane overhead bins - overhead? Wouldn't they be much more accessible as "under seat bins"?)
- Ask customers to shop your competitors and compare the experience.
- Ask your customers what they would do if your organization didn't exist (i.e. how would customers needs be met? Force customers to innovate.)

2. DEFINE THE ADDRESSABLE MARKET BY CUSTOMER BEHAVIOR VS. NUMBER OF CUSTOMERS

The second symptom of incremental thinking is evident in how the organization defines the addressable market for its products. This symptom has its foundation in the way organizations measure performance and growth. For example, many retailers suffer from focusing too stringently on Same Store Sales rather than on the behavior of their customers. Although Same Store Sales is a good indicator of year-to-year store performance and an easy mechanism for communicating operating results to regional store managers and Wall Street, it is a weak indicator of relevance.

As a measure of performance, Same Store Sales doesn't reveal lost sales due to new entrants, substitute products, or alternatives. It doesn't give any indication of opportunity cost. Where did customers go? Why did they leave? Who is fulfilling their needs today? Same Store Sales is merely directional – sales were up or sales were down. The larger questions that retailers may wish to focus on would include share of disposable income, product-experience behavior, and willingness to buy in the presence of substitutes. In other words, why and when are they really choosing the store as their provider of choice? In order to promote creativity and innovative thinking among its employees, organizations may wish to look to new metrics. For example, it may behoove Home Depot, in its fight with Lowe's, to re-define its competitive set by including new targets beyond the Do-It-Yourself (DIY) contingent. Emerging trends would suggest there is a significant opportunity for a Do-It-For-Me (DIFM) offering (e.g. aging baby boomers, Generation Y, busy executives) as well as a Do-Nothing (DN) offering as witnessed by emerging trends in modular design and construction.

In order to begin to understand the opportunity costs associated with narrowly defined competencies, organizations must begin to ask themselves new questions including:

- When do customers and non-customers *not* shop us?
- Why do customers and non-customers shop our competitors?
- What products and services offer the same benefits? How are they delivered?
- What do our customers do "in between" transactions?
- How can we participate in the moments between transactions?

3. CREATE PROPRIETARY OPINIONS VERSUS PROPRIETARY INFORMATION

The third symptom of incremental thinking is a "chasing the headlines" culture. Chasing the headlines is often evident when organizations counter strategic moves by would be competitors. For example, Pepsi's recent introduction of Pepsi Twist was an explicit response to Coca-Cola's Vanilla Coke. While piggybacking Coca-Cola's product introduction may be a wise tactical maneuver, creating a proprietary opinion about the changing consumer palette may offer greater rewards. While Coca-Cola may have been responding to an emerging trend, its non-proprietary application of that information in the form of a new product rendered that information irrelevant. In other words, the cat is now out of the bag that consumers may have a palette for more exotic flavors. The proprietary nature of the information while once valuable is now? yesterday's headlines. Therefore, the organization must return to the creation of proprietary opinions versus protecting information.

No other industries are suffering more from the entropy associated with "information wanting to be free" than the music, television, and film industries. With good reason, the organizations that compete in these industries have become paranoid in their protection of ideas and the proliferation of copyright. For example, in the past 25 years, the Motion Picture Association of America has spent a billion dollars fighting video piracy around the world, enrolling over 80 countries in anti-piracy programs. Add to this the millions of man-hours and countless sleepless nights of the industry's executives and one must ask what would have been possible if the industry had only invested that same billion dollars in innovative ways to design and introduce a new economic model. Meanwhile, nearly 1 million movies are downloaded illegally every day (Viant, 2001). At risk is a decades old economic model should these industries fail to reduce the bleeding associated with Internet piracy.

Rather than protecting information, perhaps it would behoove industries such as music, television, and film to focus at on innovative economic models, new products and services, and new markets along with their efforts to protect intellectual property and copyright. Again, while information becomes less proprietary and more accessible, industries dealing in it must seek to embrace innovative ways to capitalize on its creation and dissemination.

Unfortunately, The Motion Picture Association is not alone. In a world where information is a commodity, knowledge can be acquired from any consulting firm, and wisdom – quite frankly – has retired, the only source of competitive advantage that an organization has left is its own creativity and opinions about the future. Creating the headlines requires a new approach to creating competitive strategy. Namely, in order to be proactive in the development of strategy, organizations must begin to ask new questions:

- What are associated counter-trends to current trends? (e.g. digitally distributed content as a counter-trend to embedded content; outdoor adventure travel as counter-trend to "the Internet Age", and super-indulgent fast food as counter-trend to the health boom)
- What stories can the organization tell from seemingly unrelated trends?
- What industries does the organization lag? And, how will their trends impact us? (e.g. semiconductors lagging PCs)
- What disruptive technologies could "put us out of business?"
- What markets are currently underserved by mainstream offerings and our competitors? (e.g. minority groups, micro-markets, 3rd world, etc.)
- What new product ideas can we create by separating form from function?

4. IDENTIFY WHAT THE ORGANIZATION DOES WELL VERSUS WHAT IT SELLS

The fourth symptom of incremental thinking is an over-extension of the organization and/or product brand. In the organizational Garden of Eden, product extension is the sweetest fruit. Why? Simply put, an installed base of customers makes for easy economic modeling. For example, if millions of people use portable personal organizers, wouldn't it be wise to introduce one with a color screen, audio capability, or swappable faceplates? Why not take advantage of an installed customer base? Why not sell new products to an existing market? The answer is – go ahead. In fact, the organization would be foolish not take advantage of this opportunity. However, how long can these methods (i.e. product variations, improved features, and planned obsolescence) contribute to new wealth creation before they begin to cannibalize sales?

For example, nowhere have products been over-extended greater than at the corner grocery store where the cereal, soft drink, and alcoholic beverage aisles burst with product variations.

Whether it's "Light", "Lemon", "Low Fat", "No Fat", or "GMO-free", consumer products manufacturers have learned to stick with a good thing. Is it any wonder that Reality Television is such a wunderkind of prime time? Rather than focusing on identifying its core and unique skills, assets, methods, and competencies, most organizations think of innovation in terms of new products for existing markets vs. new products for new markets. Furthermore, few organizations think beyond products to competencies.

In order to manage the risk associated with overextending a brand and in order to identify the organization's latent and core skills, managers must begin to ask new questions about capabilities.

For example, Kinko's sell copies (or does it?). As the back office to aspiring entrepreneurs, Kinko's clearly has the ability to deliver on a much larger brand promise than hassle-free document reproduction. Kinko's has the ability to give entrepreneurs scale, speed, and operational support to grow. When defined in this manner, a world of possibility is afforded the Kinko's brand. Could Kinko's become the single-source provider to entrepreneurs? It isn't unimaginable that Kinko's could package and market "entrepreneur kits" to the "going solo" world of independent consultants. Where can independent consultants turn today for group health insurance, discounted legal services, or tax preparation services. Certainly options are available, but distribution is fragmented and fees are often sky high. Who will win this opportunity? It could be H&R Block? It could be Charles Schwab? It could be an insurance company? But who owns the customer's time more than any single one of these providers – Kinko's. The difference between defining and designing new products and identifying and exploiting core competencies begins with a new set of questions. In order to surface core and latent competencies, organizations must begin to ask:

- What do we have the ability to do?
- What were unexpected successes over the past 3 years? Why did we succeed?
- What were unexpected failures over the past 3 years? Why did we fail?
- What were customer segments that bought our products unexpectedly? Why? Did we exploit this opportunity or miss it? Why?
- What have we chosen not to do? Why? (This will help surface why and how the organization chose its current business which will help surface competencies)

5. CREATE INNOVATON TEAMS VS. BUCKET BRIGADE INNOVATION PROCESSES

The fifth symptom of incremental thinking is the pervasive *bucket brigade* innovation process, otherwise known as the pass the baton (and responsibility) method, or more popularly known as the "it's not my job" process.

Most organizations are not organized to innovate. They are organized to operate. In other words, the matrix structure that has become so pervasive in large organizations (i.e. functional activities vs. product lines) acts as a barrier to innovation. Why? Simply put, bucket brigade innovation is a fancy method for outsourcing responsibility, which in turn compromises the integrity of the original idea. Like seasoned politicians, managers lobby for modifications to new ideas to nauseating extremes. The resulting product, service, or business is a far cry from what was originally intended. For example, the five extra inches of legroom afforded to airline frequent fliers, while a welcomed improvement, may perhaps be one such filibustered idea. Was this truly the organization's original intent? This phenomenon is evident amongst many consumer products companies such as food, fashion, retail, and music. They all tend to organize themselves in a classic matrix structure (i.e. functions and product lines). Consider the food industry for example. Food manufacturers are typically organized around functional areas such as product development, manufacturing, marketing, and sales & distribution. The challenge when applying this structure to new product development is in getting new ideas to market quickly, effectively, and with integrity. The more "involved" the organization design, the greater risk of an ill-defined product introduction. Witness the McLean, Crystal Pepsi, or Olestra-infused potato chips – all of which are examples of products which have suffered from the complexity of their organization's product development processes. The latter of which was clearly "technology" in search of a business model vs. a business model in search of a customer.

Although a great metaphor for creating new ideas, factory-like processes do not yield innovative concepts. Innovation is a non-linear process that requires a non-linear structure.

In order to begin to develop methods for creating innovation teams, organizations need to adopt new behaviors including:

- Create cross-experiential teams (vs. cross-functional teams) not just for the life of the "research", but through market testing, experimentation, and product launch. (i.e. from basic research to product launch
- Offer incentives to business units and divisional vice presidents who "donate" their best employees to special growth projects
- Create an internal supplier network of experts who act as adjuncts to growth projects versus passing off responsibility
- Encourage teams to syndicate funding from internal and external sources of capital
- Allow customers and non-customers to be the judge and jury along with the internal venture board

Create a skunkworks responsible for generating new ideas, sourcing existing ideas amongst internal staff, and managing new venture development. In fact, many of the unspoken heroes of Edison's Lab – affectionately referred to by Edison as muckworkers – were proud of their skunkworks culture.

6. SHOW THEM THE MONEY AND THEN GIVE IT TO THEM

The sixth symptom of idea rigor mortis is evident from shallow employee incentive programs. In the wake of Enron and Arthur Andersen, gone are the days of corporate loyalty. While there will continue to be a modicum of pride amongst employees, for employers, patents and passion will continue to hang more proudly in garages than in R&D labs. The greatest challenge in the wake of recent business failures, where employees were personally rewarded for new ideas, is to recognize that the desire to "own" ideas will not subside although incentive stock option programs may. While ill-structured incentive programs can derail innovation, so too can shallow employee incentive programs where employees are treated as vendors instead of customers. Overcoming this barrier to innovation requires a behavioral and attitudinal shift about the role of employees.

There are a wide array of options available to organizations for rewarding innovation, these include:

- Offer year-end cash bonuses for successful experiments
- Create phantom stock options that track firm performance
- Package and subsidize employee learning sabbaticals
- Encourage "resisters" to critically improve versus critically reject by offering monetary and non-monetary incentives to those that contribute as adjunct experts
- Evaluate and "sponsor" ideas of organization alumni (if strategic fit with core business, yet the organization does not want to invest human capital and internal resources)

7. MEASURE RETURNS ON LEARNING AS OFTEN AS RETURNS ON EQUITY

While much has been written about the importance of experimentation and "controlled failure" in innovation processes, little has been developed for the measurement of returns on experiments.

In other words, without the proper metrics for measuring learning, organizations often kill new ideas due to their inability to deliver on the requisite ROI common to most budgeting processes. This is often revealed by organizations that maintain a high income to revenue growth ratio. Organizations that have sustained income to revenue growth over a multi-year period are more likely to experience earnings collapse than those with lower ratios (Hamel). The logic is quite simple. At some point, the earnings engine becomes anemic due to issues such as staff layoffs, budget cuts, and plant closures. While all necessary tactics of operating and maintaining the enterprise, there are considerable risks associated with denominator management over a longer period of time. In fact, Professor Gary Hamel of The London Business School discovered that firms who displayed income to revenue growth of greater than 3:1 consecutively over a five year period have over 80% chance of earnings collapse in the fifth year. Professor Hamel's insight surfaced from studying the performance of the companies that comprise the S&P 500 Index and their respective income growth to revenue growth performance over a 5-year period. The point is, organizations must vigorously pursue innovation as a component of their overall corporate strategy and invest in new product and service development in search of new wealth creation.

In order to alleviate this symptom, organizations must create new metrics to measure learning. By measuring Returns on Learning, innovative new ideas will be given the requisite time to incubate and materialize as they were originally intended. For example, in many large organizations, new products must contribute to a minimum percentage of sales within a given time frame (e.g. 2% of sales within 18 months) in order to be considered a successful product introduction or addition. The downside of this type of metric is that the new product may very well appeal to a nascent, yet growing, customer segment that may take 5 years to develop. For example, the organic foods movement is the fastest growing segment in the food industry (eg. Whole Foods is growing at 20% year-over-year); although it contributes to an overall minority of total food sales. In the near-term this market may not seem as attractive as processed food; therefore, it requires new metrics to measure its relevance as the segment grows. These metrics may include:

- Brand elasticity. What are "accepted" levels of product innovation among customers? What will they "believe"? (e.g. Nike car tires? Organic Foods from Quaker Oats?)
- Customer acquisition costs (e.g. SG&A expenses are a great indicator of product relevance as great ideas are bought not sold. Experiments are great methods for extrapolating marketing and selling expenses associated with a new product introduction, e.g. online viral marketing communities as highly-leveraged sales forces for record labels, book publishers, clothiers, and image branding concepts)
- Concept development (i.e. how did the experiment contribute to the approval or disapproval of working hypotheses about the business model?)

In closing, all organizations have the capacity to overcome incrementalism, think innovatively, and adopt continuous innovation as an enterprise-wide capability. In short, by identifying areas within the organization where these 7 symptoms may reside, the organization can begin to apply new methods, new perspectives, and new questions to the process of strategy creation. Most importantly, organizations that identify these common pitfalls in their own thinking will be able to embed innovation as a core competency (as they did with quality, continuous improvement, and knowledge management in years past). The objective is to think of *this* and *that* more often, in a more structured fashion, and for the betterment of all stakeholders. This leaves only one question, what are the growth strategies available to organizations once they've treated the symptoms of incremental thinking? What does the organization do once it has acquired a new method of thinking? Stay tuned in the next edition for "Smart Growth: From the Core to New Markets".

Now, get to work. You've got *that* to think about!

SUGGESTED READING:

Competing for the Future; Hamel, Gary; Prahalad, C.K., Harvard Business School Press, 1996

The Alchemist; Coelho, Pablo; Harper San Francisco; 1993;

The Art of Innovation; Kelley, Tom; Doubleday; 2001

"In Search of Relevance: The Innovation Imperative"; Razeghi, Andrew; www.strategylab.com

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It's About Time

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"Time is money." The phrase has become a cliché, but is still as true as ever. In a society of increasing material wealth, time continues to displace money as the limiting constraint for decision making. Time can buy money, but money can't always buy time. Just ask any frazzled parent or overworked middle manager.

Yet just as we try to make more effective use of what time we do have, we – consumers, employees, managers – face ever greater obstacles just to keep up. Simple phone tasks that used to take a minute or two now consume several times that. We use our limited time to navigate lengthy telephone menu systems and wait on extended hold (all the while being told "your call is important to us.") The wait in line, at what used to be called a "fast" food restaurant, just seems to be getting longer and longer. And we find our commutes becoming longer too, as we spend more and more time sitting in traffic.

> There's no question that highway capacity is a scarce resource, particularly in many urban areas. A 2001 study by the Texas Transportation Institute estimated the annual cost of traffic congestion in the U.S. at nearly $80 billion dollars. Yet we as a society seem helpless when it comes to efficiently allocating our highway capacity.
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> For a number of reasons, highway space is rarely assigned based on what motorists would be willing to pay. Instead, access is barely managed at all. Access to most roads is effectively free until the road reaches capacity; thereafter, usage is effectively rationed to those who are willing to sit in traffic. Unlike a sensibly priced toll, the revenues from which can be used to fund additional construction, maintain existing roads, or even reduce taxes elsewhere, *the time that motorists spend sitting in traffic provides no economic benefit to the system*.
>
> Adam Smith recognized that it's economically inefficient to allocate a useful commodity resource (like gold) for use as coinage. Using a less scarce substitute metal makes the society more efficient because the gold can then be used where it is most economically productive. Likewise, forcing people to pay by consuming time is a non-productive use of a limited resource, and a net drain on the economy. And unlike gold coins, which can at least be used over and over again, the time spent "paying" to drive on an overcrowded freeway can never be reused or reclaimed. That scarce resource is gone forever.

The strategic use of time is a concept that is only partially appreciated. Competitive pricing strategies are widely embraced, but few of those strategies explicitly recognize the role of consumer time requirements as a component of total price. Business process optimization projects are common, but most optimization is from the firm's point of view, not the customer's. Strategic use of time means more than shortening product development times or enhancing internal processes. It involves a wholesale recognition that time is an important (and scarce) economic resource that pervades every interaction a firm has with its customers, employees, and suppliers.

A framework for time-based decision-making

One way to make more effective use of time is to always keep two deceptively simple questions in mind. First, does a specific action or initiative save time, or does it consume additional time? This question applies not just to a specific firm or individual, but to everyone involved in buying, selling, using, or delivering any product or service. It also leads directly into the second question: How are the time savings (or costs) to be shared and compensated amongst the participants? Together, these questions provide a basic framework for exploring time-based initiatives.

The first question provides an obvious place to start. Where are the time-wasters in your organization? These time-wasters include many of life's little unnecessary annoyances – the clumsy and confusing web site that makes it hard to accomplish a simple task like selecting and buying a product, those inscrutable product instructions that make it impossible to correctly assemble your patio bench the first time around, or that stupid billing error that takes hours to track down and correct. Time-wasters consume time but yield little or no benefit in return.

A well-designed web site doesn't necessarily cost more than a clumsy, time-wasting site, but offers significantly better value by making customers more efficient. Likewise, well-written product assembly instructions need not cost more than the confusing variety. Many companies have worked diligently to eliminate problems with order, billing, or product quality. Such efforts often start out as a way to reduce a firm's direct customer service costs, but often generate broader operating efficiencies and improved customer satisfaction. By eliminating the time-wasters, firms help themselves <u>and</u> their customers.

The second question, how to share benefits or compensate participants, introduces economics into the process. A company may find that it can generate considerable cost or time efficiencies, but only by imposing moderately higher time costs on customers. One example is product assembly, where shipping unassembled products can save considerable transportation costs. If the incremental time cost of customer assembly is less than the total assembly and shipping costs saved, this represents a net economic benefit. One task is to devise an appropriate pricing strategy that shares the net economic benefit, compensating the consumer for incremental time costs in a way that provides superior returns and improved market position for the seller. A broader challenge is to adopt a mindset that incorporates time requirements as an added dimension to pricing and strategic positioning.

Some firms, whether intentionally or accidentally, find themselves “stealing time,” which is when a company shifts a significant time burden onto customers (or others) in order to create only modest incremental benefits for itself. Examples of such "time crime" (thanks to Contributing Editor Elaine Baran for coining the term) range from email “spam,” which is easy to send and time-consuming to clean out, to inappropriately long customer queues (whether at airline ticket counters, customer service call centers, or retail check-outs). One critical aspect of "stealing time" is shifting the burden onto unwilling participants, often those who are unable to take their business elsewhere. The perpetrator may be a customer service organization which intentionally understaffs as way of discouraging inquiries or service requests, or an airline that routinely tolerates check-in queues stretching out the door. Although the consumers may already be locked in to this particular purchase, the firm runs the risk of converting these customers into "victims" and generating a strategic opening for competitors willing to offer a better deal for the customers' time.

> Basic mathematical models derived from queuing theory provide insights into the tradeoffs between customer service levels and the cost of providing such services. For example, the length of a queue is often highly sensitive to small changes in the number of customer service personnel. Using plausible estimates observed during a recent business trip, a typical airline ticket counter with six customer service reps would be roughly 98% efficient at keeping the staff busy, but could easily have fifty people in line and an average wait approaching a half hour. Increasing the number of service reps from six to seven cuts the line down to almost nothing, with an average expected waiting time of less than two minutes. Whether through policy decisions or poor management, our sample airline implicitly values the time of one additional service rep as being equivalent to roughly forty-five passengers. If a service representative's time is worth, say, $15 per hour, the implication is that the airline values the traveler's time at less than thirty-five cents per hour. Creating equivalent estimates for a call center is more difficult; waiting on hold doesn't provide visibility into the number of service reps, arrival rates, or the number of people in the queue. Nevertheless, one basic principle still holds -- when a company forces customers to spend

significantly more time waiting than being served, it is likely that a modest increase in capacity would result in dramatically better service. The implication is that customer time has little value for such companies.

Of course, it may not be as simple as adding a few customer service reps. The system must have sufficient capacity to accommodate the incremental volume, the benefits must be apparent to current and potential customers, and enough customers must be willing to pay for improved services so that the firm can justify the investment in terms of better margins or additional volume. Still, any firm with the opportunity to make a significant reduction in total product cost would be seriously evaluating its options. Why should the approach be any different when that cost is measured in minutes, rather than dollars?

By recognizing the economic value of time and expanding their perspective beyond internal boundaries, firms increase their capacity for generating value, and add another dimension for differentiating themselves against their competitors.

Ten Ways To Make The Economics of Time Work For You

(1) Pay attention to time. Be as efficient at controlling time costs as you try to be at controlling cash costs. Seek out and eliminate unnecessary inefficiencies wherever possible. While this objective certainly sounds obvious, many firms find that nothing gets done unless it is made a priority. Consider the fast food industry. Despite the label, fast food is often anything but fast. When the industry started paying attention, it realized that faster service directly increases revenues. One 1999 study showed that sales at a typical Burger King restaurant grow $15,000 a year for every second it shaves off drive-through time. Once the fast food industry recognized the importance of service times, they were able to find numerous ways (including training, incentives, process changes, and technology) of speeding up customer service. These opportunities were all available previously, but nothing was done until service time became an explicit priority.

(2) Focus on the big picture. Many companies have undertaken re-engineering projects or similar efforts in order to save their own time. Fewer have recognized the opportunity to save time for their customers. Every minute you save for the customer is equivalent to reducing the customer's cost of buying your product or service. A technique may make *you* more efficient, but if it causes the customer to wait then you've effectively increased the total cost of your product. And don't forget employees, suppliers, and other business partners. Wasting their

time can be just as damaging as wasting customer time.

(3) Use queuing theory and agent-based modeling to measure and manage the trade-offs between cost and customer service times. Queuing theory provides a set of proven models for analysis of customer service processes. Agent-based modeling, not as simple to use but potentially offering even richer insights, draws upon complexity theory to describe emergent patterns in customer service systems.

(4) Make queuing time more productive. If you can't (or won't) change your system to reduce customer waiting time, help your customers make more efficient use of that time. Consider the example of Disney theme parks. Waiting in line is one pervasive downside of the theme park experience. (Any park with sufficient capacity to eliminate lines would likely be prohibitively expensive to operate.) Disney's strategy has been to make queuing time more enjoyable, by offering entertainments, games, and other diversions to waiting guests. It's hard to imagine a park that customers would visit just to stand in line, but a park that makes lines more enjoyable can generate significantly higher revenues by accommodating larger crowds of happy customers.

(5) Define metrics to monitor how you and your competitors use customer time. Most companies today rigorously measure the cost of providing products and services, and continuously monitor their costs against competitor costs. The time it takes a customer to use your service is another type of cost, and is just as important to monitor. Just as a more expensive product creates openings for competition, a company that extracts a higher time cost for its products also makes itself vulnerable to competition. Boeing's new Sonic Cruiser jet is designed to save more time for travelers. Not only does the plane's faster speed make for shorter flight times, but the plane is tailored for point-to-point itineraries (rather than funneling huge number of passengers through congested central hubs), thereby shortening total travel times even further.

(6) Offer alternatives to segment the market. While it's economically inefficient to use queues solely to regulate demand, they can be a useful tool to segment the market. IBM pioneered the time-based segmentation concept by artificially slowing down computer chips so that it could maintain high prices for customers able to pay for top performance. They were then able to capture additional revenue (while protecting their big-ticket accounts) by providing the slower machines to customers who would have otherwise gone elsewhere. Priceline follows an analogous segmentation strategy -- liquidating excess capacity at low prices to customers who assign relatively low values to their time, thereby protecting the higher-margin

time-sensitive customer base. Some amusement parks have started using time-based market segmentation in the opposite direction, holding prices relatively steady for the majority of their price-sensitive customers, but capturing incremental revenues by providing special services to VIP customers willing to pay extra to bypass queues.

(7) Use technology to speed up customer service, but be wary of potential downsides for customers. Many forms of technology offer the potential to improve customer service, response time, and overall efficiency. Just remember that if these involve a significant customer learning curve, if they don't work as promised, or if they slow down your customers, then your great leap forward will be perceived as a big step backward. Automated telephone menus and voice mail are generally thought to represent progress, but how many customers yearn for a simple human voice? ("Good morning. Acme Corporation. How may I direct your call?")

(8) Provide information. Most consumers would avoid buying a product with no posted price, yet many companies expect customers to make a time commitment with little or no information of the time involved. Providing information (how long a wait to expect, how long it takes to assemble the product) allows consumers to make economic decisions regarding their time. Some decisions may well result in lost sales but many will result in a more economic use of available resources, such as consumers calling back when they have more time or when demand for service is lower.

(9) Provide accurate information. Customers don't know whether you've quoted them the wrong "time price" until they've paid it, so low-balling the wait may allow you to salvage some sales. Doing so also undermines your credibility for all future interactions.

(10) Know when to speed up, and when not to. The overall theme of this article is that queues are bad and saving time is good, yet speed isn't always appropriate. Nobel-Prize-winning economist Gary Becker has suggested that fine restaurants will sometimes want to encourage queues. An orderly reservation process that efficiently deposits arriving diners right to their tables may be efficient from an economic perspective, but a long line at the front door and a crowd waiting at the bar convey to the world that this establishment is a hot destination and an experience worth waiting for. On a more mundane level, fast service may not always be worth the cost of providing it. Assign appropriate costs to customer waiting time, factor in your own costs, and optimize appropriately.

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Performance Management and Growth Metrics

Amy Wong

Amy Wong is currently a Managing Director of the MetricMaps Group, a performance management and strategy consulting company, which applies Complexity Theory and the Balanced Scorecard framework to focus, clarify and improve corporate performance. She has consulted with major corporations and start-up companies in industries such as retail and healthcare.

In today's competitive environment, it's not enough to have strong profitability. Wall Street constantly expects continued and predictable growth, whether from start-ups, mid-sized corporations or huge, established companies like Wal-Mart and across all industries, regardless of business cycles or macro-economic effects. To continually grow, it is not enough to rely on a naturally expanding base of customers, whether domestically or globally. For decades, McDonalds has relied on domestic saturation and then global expansion to fuel its growth. Today, faced with stagnating growth, McDonalds has experienced turmoil in the executive ranks as they attempt to develop sources to recapture their growth rate. Occasionally there have been forays into product innovation (which are most notable for their failures) such as the McDLT, the McLean, and the Arch Deluxe. But by defining itself as the quintessential provider of particular hamburgers in a fast food environment for so many years, McDonalds has locked itself into an image that then becomes difficult to change, even as they now seek growth by expanding the concept of who they are. After 50 years of Big Macs and Quarter Pounders, how open can the public be to the idea of them serving spaghetti or becoming a quasi-retail location?

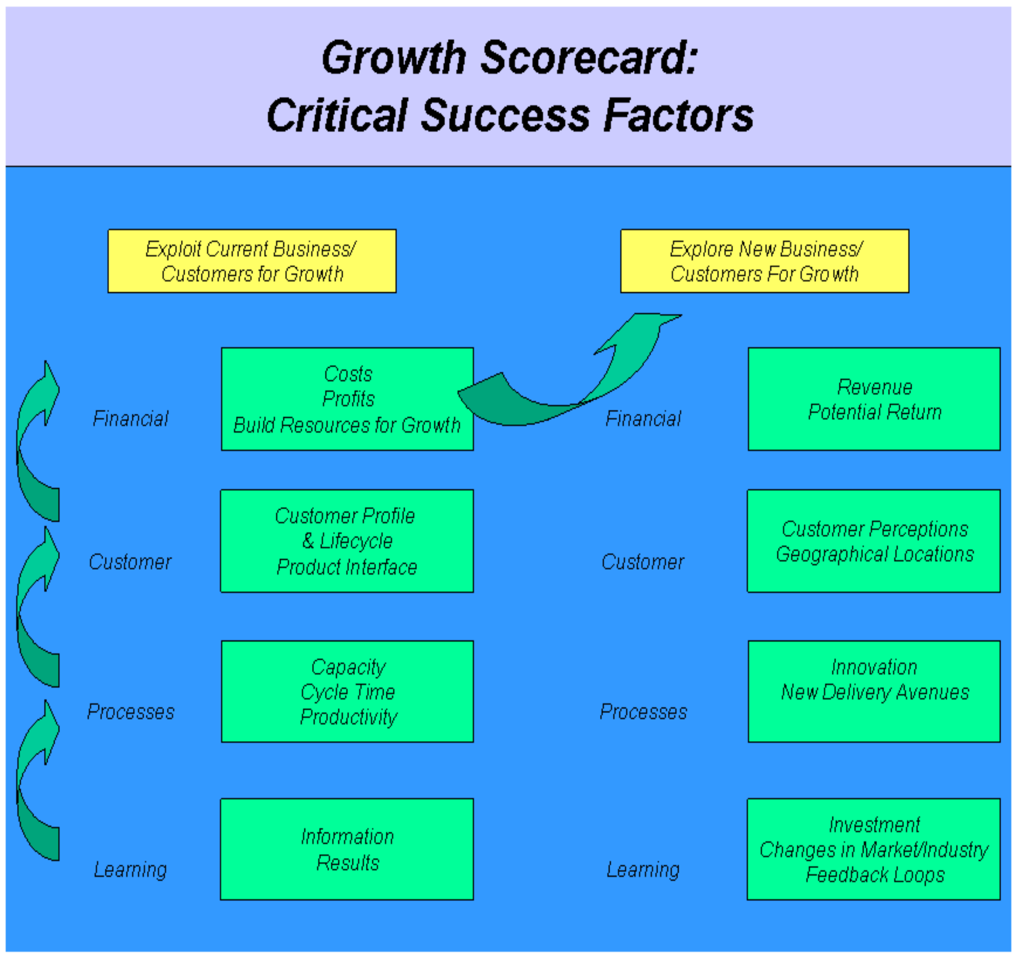
From a performance management perspective, this means strategically measuring growth is more than creating a list that tracks increases in numbers of customers, products sold, or even "share of wallet" as compared to competitors. These are the *results* of growth. Instead, strategic growth metrics must be designed to focus efforts on initiatives that will *drive* growth.

Performance Management Frameworks

The metrics framework provided by balanced performance measurement systems, such as the Balanced Scorecard, is highly useful for driving strategy into action. The Balanced Scorecard looks beyond the traditional financial metrics, adding three additional inter-related perspectives. It (1) reflects how financial results are affected by customer satisfaction, which (2) is determined by the execution of processes, and which (3) relies on the organization's learning capabilities. It is this cause and effect link between the four perspectives that make the metrics coherent, instead of just a list. The Balanced Scorecard relates strategic initiatives (cause) to how the firm does business (effect).

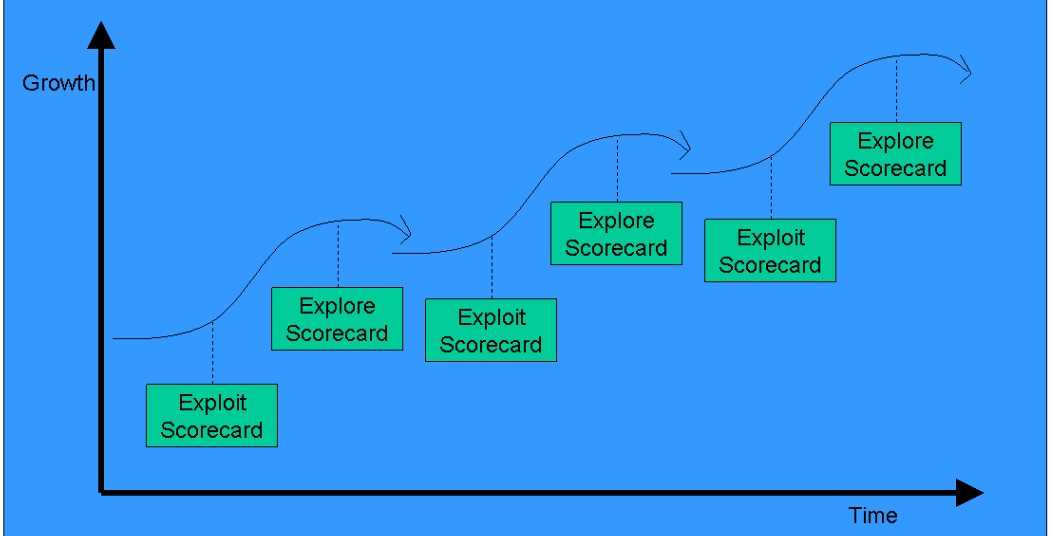
However, like many strategic implementation tools, the traditional Balanced Scorecard and measurement reporting looks at strategy as an iterative loop: create strategy, implement, gather feedback, and adjust strategy. With this linear view, when organizations suddenly find their growth stagnating, they react by revising, improving or changing their strategy by casting around for acquisition targets to create new customer bases, justified by operational synergies.

What's needed is a model that shows where your current business is, and continually evaluating potential growth initiatives and how they organically fit, rather than ending up with a hodgepodge of efforts episodically tacked on as solutions to growth problems. Growth strategy and metrics should be continually developed and aligned parallel to the current business. To provide for the parallel strategy of growth, a second dimension can be added to the Balanced Scorecard.



This second dimension acknowledges that the demands (and measurements) of running a current business are quite different and separate than those of developing new products/ services, customers, and evaluating new businesses to enter, whether as a green field, a merger, or an acquisition. In addition, it eliminates the arguments over which strategy and businesses an organization should focus on- the current versus new dilemma. The answer is both. As new initiatives become established products and businesses, their strategic focus shifts from the second dimension to the first.

Growth Scorecard: Aligning the Two Dimensions



As each growth opportunity is discovered and implemented, the opportunity will transition from *Explore* to *Exploit*. These two dimensions within the organization moves in alignment. Without the resource foundation from *Exploit*, *Explore* is not possible. If *Explore* is neglected, the organization will either plateau or decline.

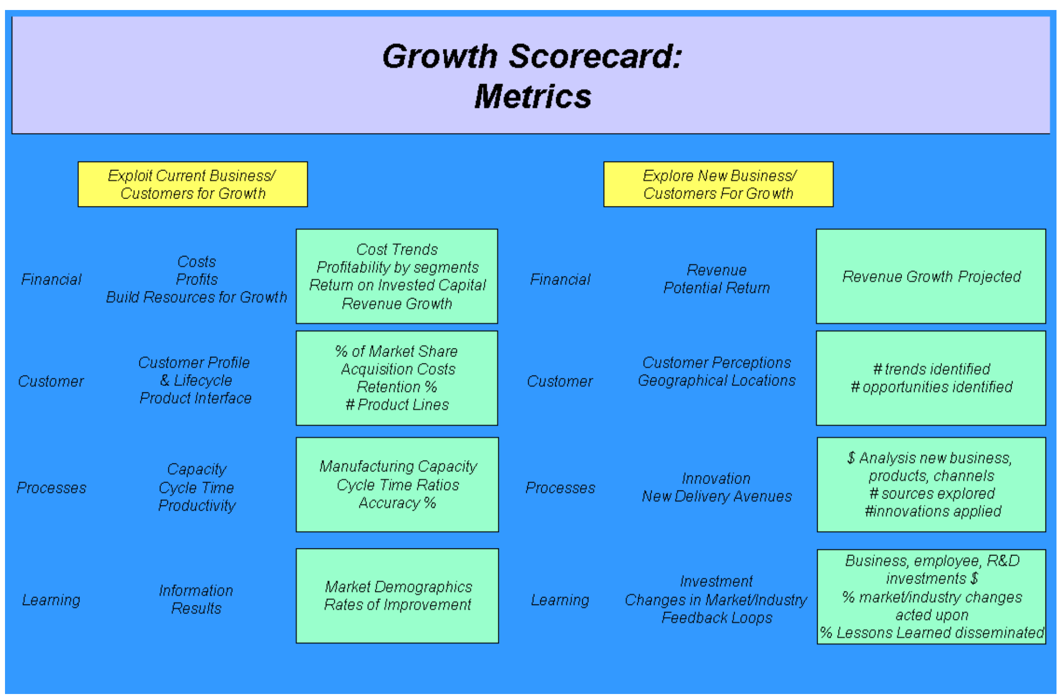
Planting the Seeds for Growth

To prepare for sustainable growth, organizations must first develop the foundation. Inefficient internal processes, inaccurate understanding of their customers, and lack of resources creates an organization that has difficulty meeting current market demands, let alone able to grow and leverage areas of opportunity. At this stage the organization needs to focus on the fundamentals of their current business in order to understand their current environment, and consequently build the resources that will fund future growth. This exercise can be made more effective by the use of the traditional Balanced Scorecard, Performance Excellence Management or other operational improvement plans.

The Two Dimensions of Growth

There are two dimensions to growth. The first dimension, *Exploit*, is to increase business based on the existing parameters. That could be either from increasing your customers for current products, or increasing the products purchased (whether by unit quantity or frequency) by each customer. Business process re-engineering and customer relationship management are some of the techniques that have been leveraged to maximize gains on the first dimension. But advancements in technology, changes in consumer interests, and other factors, have shortened product lifecycles from years down to months. Consequently, growth along this dimension can becomes a series of sprints, particularly in industries like fashion or high tech consumer products, where the two market forces combine to dizzying effect.

The second dimension, *Explore*, is to add or develop new bases, whether at the product/service level on up to complete businesses, upon which increases in customers and/or product purchase frequency and quantity can then be built. *Explore* opportunities come from two sources: internally and externally. Internal opportunities arise from innovation, whereas external opportunities also arise from innovation or mergers and acquisitions. 3M built their whole business, literally and figuratively, around developing and leveraging product and process innovations internally. On the other hand, Wal-Mart has leveraged external technology innovations in customer database mining capabilities and supply chain information to drive business growth through stocking the right products and ensuring availability. On the mergers and acquisition



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front, automotive companies have been jockeying for position in various countries through the purchases of car brands (Ford with Volvo and Jaguar, Nissan with Fiat) to gain access to new bases of customers.

The performance metrics on the *Exploit* dimension tend to be fairly standard measurements, familiar to executives and managers. They measure results, and are lagging indicators. The performance metrics on the *Explore* dimension are leading indicators. They track the process of growth initiatives, how much action is being taken on the opportunities and changes identified, rather than waiting to see if those actions were successful.

For example, Cisco has experienced tremendous growth for several years by working both dimensions. On the *Exploit* side, they sold network routers to everyone and everywhere. But on the *Explore* side, they were constantly evaluating and then acquiring new technology. So some of the *Explore* metrics might have been: How many different technologies are we looking at? How many analysts (technical and business) are assessing those potentials? What percentage of our resources (man-hours and funding) are we devoting to the effort? How long would it take before we start seeing returns if we select these initiatives for acquisition or implementation? Once an initiative is approved for implementation, then the *Exploit* dimension metrics start to apply. Care must be taken that the *targets* for those metrics are not at the same level as for an established product or business.

Growth and Innovation

The dimensions of *Exploit* and *Explore* in developing growth metrics are very similar to the dimensions of innovation metrics; in fact they can be regarded as the same, just at different levels of granularity. (See The Metrics of Innovation, Virtual Strategist, Issue 1/Fall 2001). Innovation is a source of growth because it changes or creates new value for the customer. While innovation initiatives focus on identifying change and opportunity to leverage, growth initiatives focus on selecting which change/opportunity aligns with the current business or aligns new businesses with the organization.

Summary

The metrics of growth strategies measure the effectiveness of ongoing growth initiatives, not merely whether growth has occurred. When designing growth metrics, the organization needs to take into account that these metrics are separate and different from those metrics used to evaluate the current business performance. And as growth initiatives become established products and businesses, their metrics will evolve. Aligning and coordinating the *Exploit* and *Explore* metrics insures that organizations have a cohesive approach to growth.

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Driving Growth through Strategic Account Management - *Using the Tools of Business Strategy to Sell and Maintain Complex Accounts*

James W. Wilson

James W. Wilson, Founder and Managing Director of Claremont Strategy Center, helps businesses grow profitably by assisting them in the design and implementation of innovative business strategies and plans.

Here's a question that keeps many corporate Executive Vice Presidents (EVP) of Sales up at night: How can we improve our effectiveness with large, complex accounts?

The targets are huge, i.e., the Fortune 200 and Global 500 companies that account for a substantial share of total market potential. Most product and service vendors of any size count these very large accounts as customers or prospects and address the market segment as national, major, or enterprise accounts. Unfortunately for most vendors, the difficulties of doing business with these accounts largely offset the rewards. Complex accounts present a litany of headaches as they:

- tend to be geographically dispersed
- have multiple-decision makers
- have complicated decision processes
- require pricing concessions owing to volume
- demand high levels of operational and customer service

Sales organizations face severe challenges in attempting to sell and manage complex accounts. Many firms have established a separate sales force to manage selected large accounts and have left the general field sales force in place to cover smaller accounts on a geographic basis. While this approach helps to focus sales representatives on the appropriate activities for their assigned accounts, it adds a layer of cost and still leaves open the question of how the major account representatives can be most effective. For example, in the typical situation, geographically-based representatives who call on local facilities and business units of major accounts have compensation heavily weighted to near-term revenue generation and have little visibility into account activities and relationships outside of their home territories. This can be very frustrating for the major account representative who is trying to orchestrate a team approach to a complex account. But despite these difficulties, which may drive account profitability into negative territory, many product and service vendors continue to play the game. The prestige, experience and volume to be gained by serving the world's leading companies are just too tempting to pass up.

So how can companies be more effective in selling and maintaining complex accounts? This article offers an approach to deriving more value from relationships with a firm's largest and most complex accounts that leverages the tools and thought-processes of business strategists.

Much has been written on the subject of complex accounts with Robert Miller and Stephen Heiman's Strategic Selling probably the most widely-recognized approach. Despite its success and popularity, the approach known as "strategic selling" is necessary but not sufficient for exceptional performance in complex accounts. The opportunity is to infuse strategy into the *content* of the account relationship as well as the *process* of the sale. And while making no claim to have found the magic bullet sales process for complex accounts, it is suggested here that many of the approaches and tools of the business strategist can be successfully repurposed to make strategic selling truly strategic.

The Role of Strategy in Sales

In the business literature, the terms “strategy” and “sales” often appear as part of the same concept. In Miller & Heiman’s strategic selling approach, which has been used successfully to train thousands of sales reps and sales managers, strategy is about a long-term, customer-centered view of success as opposed to an over-emphasis on near-term tactics which can set up a win-lose situation for seller and buyer. “Strategic selling” provides a disciplined approach to defining account objectives, understanding current positioning in the account, then undertaking a series of analytical steps to create an action plan for improving the account position. Much of the content focuses on battle-tested methods to identify and properly address the various influencers and decision makers in large, complex accounts. The primary analogy is a military campaign that requires elaborate planning and implementation to achieve success. To summarize, strategic selling as defined by Miller-Heiman is primarily a strategic approach to the sales process.

Others who have addressed sales for complex accounts take a more advanced view of strategy. In their book Rethinking the Sales Force, Neil Rackham and John Devincentis offer a redefinition of selling aimed at creating and capturing customer value. The authors present a segmentation model for complex accounts which differentiates “strategic value customers” as a target of opportunity. As the authors define it:

> *“Strategic value customers demand an extraordinary level of value creation. They want more than the supplier’s products or its advice. They also want to deeply leverage the supplier’s core competencies. They are prepared to make radical changes in their own organization and its strategies to get the best from their relationship with their chosen strategic supplier. It’s a relationship between business equals who are working together to create an extraordinary level of new value that neither could create alone.”*

This begins to sound a lot more interesting from the standpoint of strategy. What could be more “strategic” in a sales process than collaborating with a customer to combine capabilities to create new kinds of values for their customers? And what does one call a sales process that is designed to create these kinds of relationships and deliver these kinds of values? It certainly does not sound like “strategic selling”. We’re no longer talking about being strategic in the way you sell. Rather, this is about being strategic in the way you envision and create a customer relationship.

Defining Strategic Account Management

Strategic Account Management is defined here as the process of creating and implementing relationships with selected customers based on a shared understanding of each customer's business strategy. Complex accounts can be "strategic" from two points of view. First, they are strategically important to the vendor if they define leading-edge values to be delivered. And second, the values delivered may be "strategic" to the customer in the sense described by Rackham and Devincentis, that is, they enable the customer to redefine the values delivered to their *own* customers.

Strategic Account Management begins with understanding the customer's *business* goals -- from the CEO's perspective -- then follows the translation of these goals into specific strategic initiatives and processes which then become the vendor's targets of opportunity. The more closely the vendor can tie its solution to an element of the customer's strategic architecture, the more important the potential bond between seller and customer. Consider the following example:

> Infrastructure Software, Inc. had developed a portfolio of software solutions that enabled businesses to rapidly and cost-effectively develop and deploy Internet-based businesses and web-enabled business processes. The value added from these solutions was based largely on the volume of transactions or the number of users that would eventually use the applications – in other words, the name of the sales and marketing game was to penetrate massive applications in very large accounts. The targets of opportunity of course were truly complex accounts: geographically dispersed, multiple decision makers, complex decision processes.
>
> From their early experience with the product line, executives at Infrastructure had learned that their products had strategic value to customers. Many of their large customers had made strategic commitments, either publicly or privately, to utilize new technologies to streamline business processes and to support new access channels for *their* customers. Accordingly, time was of the essence in designing and deploying these new applications, and Infrastructure Software was one of the vendors who could help accelerate the process. In designing the sales process, Infrastructure's sales executives focused on the key strategic interests of their customers, e.g., the business results customers were trying to achieve, the strategic initiatives that were most critical to their success, and the competency gaps they were trying to fill. Once Infrastructure's sales team understood the prospect's strategic interests and priorities, they went to work to identify the opportunities for which their products and their support services had the most dramatic impact on one or more of the customer's strategic initiatives.

> When Infrastructure's sales team presented these opportunities back to customers, they did so in a way that clearly demonstrated the connection between Infrastructure's solutions and capabilities and the customer's probability of success in mission-critical applications. In many cases, Infrastructure's competency in the design, integration and implementation of large-scale applications changed the way that Infrastructure's customers conceptualized their approach and the values they were offering to *their* customers.

As the example suggests, Infrastructure was able to implement this approach with numerous clients over a period of time. In fact, the company developed a repeatable process for connecting their products, services and competencies with a set of complex target accounts. In the following sections we identify some of the key principles and practices that enable companies to use the tools of business strategy in their sales and account management processes as well as some implications for firms who desire to use this approach.

Making Sales Truly Strategic: Elements of the Approach

Getting started with strategic account management involves a blending of methods and tools from the world of major account sales with tools of business strategy. This can be a challenge since people skilled in strategy don't always have a well-defined location in the organization. Also, strategists often fail to survive downsizing efforts in hard times. Even when they're on-board, the strategy staff is unlikely to have sufficient critical mass to support an operational process like sales. So for most organizations, finding strategy talent and melding it into a sales process is a key challenge. However, as we will see, the payoff for bringing a strategic perspective to bear on sales opportunities is huge. Following are some elements of the approach to strategic accounts that will challenge most sales organizations.

Gaining an Understanding of the Customer's Business Strategy: An important step in developing a strategic approach to complex accounts is to understand each account's business strategy. Only by breaking down the elements of the customer's strategic architecture can the vendor identify opportunities where its solutions and competencies can help the customer advance most rapidly toward strategic objectives. In the best case, this will include an identification of specific capability gaps recognized by the customer or strategic initiatives and milestones that the customer has targeted.

This is a difficult task because companies rarely publish their business strategies and because putting together the pieces from the outside is just plain hard analytical work. The good news is that business analysts and strategists who are experienced in preparing competitor profiles should be aware of where to find source materials that will help. In addition, the only real requirement is a good framework and a good start. Once the customer understands the vendor's interest in having access to this information and non-disclosure agreements are in place, the vendor most likely will be able to see documents and conduct interviews as needed to complete the picture.

Developing Points of View about the Customer's Industry and Business Issues: Vendors need to provide customers with good reasons to consider using their solutions and technologies and to jointly pursue initiatives that will add strategic value. Customer executives want to understand the vendor's vision of the future and how it matches up to their own vision. Companies who can provide a compelling discussion about how their solutions fit into an evolving future scenario stand a good chance of being asked to partner with customers to co-create that vision of the future. Returning to our earlier example, Infrastructure Software, Inc. was able to engage customers with well-reasoned points of view about the business values that are created when their Internet infrastructure solutions are fully implemented.

Developing and leading discussions that can sufficiently engage customer executives to re-think the future requires a combination of industry knowledge, product expertise, strategic thinking and creativity. Internal sources for this kind of help would typically be managers involved in business development or in business or marketing planning. External strategy consultants with proper expertise can help develop and articulate breakthrough ideas that are outside the box of current thinking. Again, the framework for the discussion is the first critical step, as the content will evolve through discussion internally and with customers.

Facilitating Executive-to-Executive Relationships and Commitments: A customer organization's choice to enter a relationship that will bring strategic value is an executive-level decision almost by definition. This means that customer executives will be decision-makers and that the vendor executives who match up will need to be closely involved in the selling process. Obviously, vendor executives need to be on board with the points of view as described above; ideally they will co-create these perspectives and help lead the discussion.

Major account reps have experience in the processes and tactics required to bring key executives to the table. What's different is that the conversation is not just about products and services to be delivered. It's about developing a relationship that involves a new kind of promise to the customer. Only an executive with a broad understanding of not only the organization's capabilities but also the existing commitments of resources supporting those capabilities can responsibly offer this kind of help.

Exploring the Potential for Sharing Various Aspects of Organizational Competency: For vendors to gain insight into how their strategic capabilities could complement the capabilities of their customers, they must spend time walking in their customers' shoes. The starting point for this discussion is a sharing of business strategies on both sides of the table and then continuing with an exploration of how the customer is approaching key objectives and initiatives. This requires a level of communication that goes far beyond the typical sales conversation.

Proven methods involve "day in the life" working sessions that explore the customer's experience in trying to deliver more value to their own customers in product development, customer service, logistics, and other touch points. Francis Gouillart and Frederick Sturdevant bring this approach to life in their best-selling HBR article "Spend a Day in the Life of Your Customer". The magic happens when individuals from the vendor organization hear first-hand the situation and aspirations of the customer as well as the frustrations inherent in the current approach. A free exchange of ideas based on these kinds of deep insights will frequently lead to fruitful themes for collaboration. Again, many of these methods are familiar to business and market strategists with experience in qualitative techniques for developing breakthrough customer insights.

Implications for the Organization

The idea of targeting a segment of complex customers for delivery of strategic value broadens the context of "sales" from the sales organization to include executives responsible for strategy and business development. Designing and implementing a truly strategic account management process requires changes in selling resources, processes, territories, and performance measures and expectations. Some specific implications include:

Access to Business Strategy Capability: Sales organizations involved in complex sales require the skills of business strategists to be successful. Many organizations are thin in experienced business strategy development talent and will have to make qualified strategists available either from internal or external sources.

Structuring the Strategic Account Sales Process for Success: For many companies, the structure of sales territories, compensation plans, knowledge sharing, and sales process stage-gate definitions are not suited for selling strategic value in complex accounts. For example, the significant up-front investment and longer sales-cycles for these kinds of accounts require that compensation be biased toward base pay rather than toward commissions based on short-term performance.

Integrating Executives into the Sales Process: There's really no way around it. And since the time of executives is severely limited, the key to success is careful qualification and orchestration of executive-to-executive interactions so that the time is used in a productive way. Again, this has implications for the sales process for complex accounts.

Clearly Defining and Articulating Business Strategy: Sales reps and executives will need to have a clear understanding of their own company's business strategy in order to envision realistic assistance to customers. Some companies have good strategies that are not widely shared in the organization. Others lack strategies that are universally understood and supported by the management team running the business.

Joint Solution Development and Risk Sharing: When vendors make commitments to support their customers' strategic initiatives, the risk changes from the threat of a lost sale to the possibility that the customer's strategic initiative will not achieve the intended business results. In evaluating these risks the vendor must apply a new level of business analysis and judgment to the traditional sales funnel.

Involving a Broader Set of Resources in the Sales Process: The stepped-up investment in strategic accounts is in part driven by the diverse set of resources required to understand the potential fit of vendor capabilities into the customer's strategic vision. Organizations must be willing to commit internal resources from functions like engineering, research, IT, and HR that are not traditionally involved in sales. It sounds expensive and risky but it's a fact of life in the world of complex products.

Getting Started: Requirements for Sales Representatives

To support a robust, strategic approach to complex accounts, organizations need to evolve in the ways described above. But in the near term there are clear drivers of success that are largely within the control of the sales organization. Some of the requirements for success based on the experience of other companies in strategic account management are:

An Outside-In Perspective within the Sales Organization: Understanding the world from a customer point of view can be difficult for individuals who are highly skilled at finding ways to position pre-existing solutions by screening customers for certain kinds of needs. In most cases, sales organizations need to adopt tools from business or market strategy development in order to develop the deep customer insights that lead to totally new kinds of solutions.

Sales Reps Who Understand Business Strategy: Sales representatives need to understand the strategic competencies of their own organizations, not just the products and services. In order for this to happen, there must be a deliberate process to gain consensus on what those competencies are and to develop communications around them to support development of account relationships based on sharing those competencies.

Sales Reps Conversant in Customer Business Issues: Sales representatives need to be able to speak to the business issues of their customers, not just to product/service features and benefits and applications. This will take some effort as well, since individuals skilled in business strategy and management tend to gravitate to management and executive positions where these skills are more highly valued.

Sales Reps Conversant in Diverse Functional Topics: Sales reps need to be able to communicate with the diverse array of managers and individuals who could logically be involved in designing and delivering solutions based on organizational competencies. This means having credibility and comfort in conversing with professionals from the vendor as well as the customer organization in engineering, research and development, IT, HR, supply chain, customer service, etc.

Adopting approaches and methods from business strategy to sell and manage complex, strategic accounts isn't a simple task and will undoubtedly create a few headaches along the way. But it does have the potential to connect businesses to customers and growth opportunities in exciting new ways. If executives lose sleep over this prospect rather than fretting over the status quo, so be it.

Additional Resources - Articles

"Spend a Day in the Life of Your Customers"
Francis J. Gouillart; Frederick D. Sturdivant, Harvard Business Review, January 01, 1994

"Strategic Sales Management: A Boardroom Issue"
Adrian J. Slywotzky; Benson P. Shapiro; Stephen X. Doyle, Harvard Business Review, November 29, 1994

"Value Innovation: The Strategic Logic of High Growth", Renee A. Mauborgne; W. Chan Kim, Harvard Business Review, January 01, 1997

Books

Rethinking the Sales Force: Redefining Selling to Create and Capture Customer Value
by Neil Rackham, John R. Devincentis , 1999

Solution Selling: Creating Buyers in Difficult Selling Markets
by Michael T. Bosworth, 1994

The New Strategic Selling : The Unique Sales System Proven Successful by the World's Best Companies
by Stephen E. Heiman, Diane Sanchez, Tad Tuleja, Robert B. Miller, 1998

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Earning a Positive ROI on Your CRM Initiative

Les Stern

Les Stern is President of L. Stern & Associates, Inc., a marketing consultancy that offers a full range of strategic and tactical marketing services.

Eric Stern was the first expert at Customer Relationship Management (CRM) I ever knew. Here are some interesting things about Eric Stern (my father) you may not associate with a CRM expert.

- He never went to college
- He never used or owned a computer
- He never used the Internet; in fact, he passed away in 1984, years before the Internet made its way into society.

So why was my dad an expert at CRM? Here's why. My dad owned a men's clothing store. Following is a typical customer encounter.

- He would politely greet the customer, either by first name or last name, depending on the relationship.
- He would briefly excuse himself, go to his office, and open a small metallic box (his CRM "hardware").
- He would sort through the index cards (the CRM "datamart") and pull the index card he had filled out - in pen - for that particular customer (the "customer record").
- He would then analyze the information ("content") in that record. That data would include purchase history, "customer demographics" (i.e., birthday, spouse's name, etc.) and any other information.
- With this intelligence, he would return to the customer. He would engage the customer, drawing out his needs. He would remind the customer of his recent purchases (which would impress the customer). Then, based on the customer's needs and his knowledge of past purchases, he would put together the "solution" the customer needed.
- He would back this with excellent service, including free alterations, delivery, etc.

Although he never even heard the term CRM, what Eric Stern did captured the essence of what you need to do to achieve a positive return on your CRM investment: combine the intelligent use of information with a true caring for the customer. Twenty years later, CRM is a buzzword. Everybody says they are in the CRM business:

- Companies that sell sales automation and other types of technology (part of CRM, certainly, but certainly not the total package)
- Companies that sell demographic and behavioral data (again, an important piece of a total CRM solution, but not CRM itself)
- Even companies that sell gift baskets and premiums such as pens and T-shirts have claimed to be in the CRM business.

Small wonder, then, that when organizations are being barraged by an ever-increasing number of CRM solutions, peoples' eyes glaze over. The purpose of this article is to provide some simple facts about what CRM is (and isn't), to explain why many CRM initiatives don't work, and to provide some tips so that you can achieve a positive return on investment on your CRM initiative.

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What is CRM?

The term “CRM” is trendy. Everybody says they are in the CRM business. Therefore, an important starting point is to explain what CRM is. Not surprisingly, there are several definitions. Peppers and Rogers accurately defines it at its most basic level:

“CRM is a way of thinking about your business that puts the customer at the center – it’s about focusing resources and retaining valuable customers and acquiring more like them.”

Gartner Group provides a detailed, more process-oriented definition of CRM:

“CRM involves capturing customer data from across the enterprise, consolidating all internally and externally acquired customer-related data into a central database, analyzing the data, distributing results to various customer touchpoints and using the information when dealing with customers through any touchpoint.”

The key elements of both these definitions are worth discussing.

The Peppers and Rogers definition drives home a critical point – CRM will fail in an organization that is not customer-centric. You need both customer-centric people and processes (having nothing to do with technology) before you can even begin thinking about CRM.

Once those are in place, it is possible to investigate the Gartner definition.

First, it is essential to capture customer data from across the enterprise, and the more the better in terms of points of contact and information. In fact, great data is the fuel that powers a successful CRM program. How can you manage customer relationships if you don’t have the information to know your customers?

For a hospital, for example, that means capturing information from clinical points of contact (inpatient, outpatient, physician office), as well as from the call center and even the gift shop and cafeteria. It also means capturing information when people attend health fairs, wellness classes and screenings. This enables the hospital to provide even more personalized service, resulting in a customer that is more satisfied, likely to come back, and likely to refer others.

The depth of information also is important. For clinical encounters, this means not only the type of encounter, but also the financial information associated with it. Because of vastly different reimbursement rates, a particular procedure may be highly profitable for customers covered by Preferred Provider Organizations, but unprofitable for customers covered by Medicaid. While the hospital would not and should not turn away Medicaid customers, they don't have to spend precious marketing dollars on programs directed to attracting them.

Second, it is important to supplement internal data with "externally acquired customer related data." This includes information such as demographics (age, income, marital status, etc.), behavioral information (often taken from warranty cards) and even psychographic information. Automobile dealers, for example, want to understand this knowledge about their current customers so they can find other people who look like those customers.

Third, it is important to compile all this information into a single database. A distributor of industrial products, for example, will have revenues from several sources. They have a sales force that goes out and sells. They may sell some products through direct mail, and may also sell products over their Website. If these systems sit separately, there is no way to understand the most efficient way to sell to each customer. It is also impossible to determine overall customer profitability

Fourth, it involves analyzing the data. Analyzing the data will answer a variety of questions. Who is a profitable customer? Who isn't? What are the most effective strategies to deepen customer relationships? What new products and services can we offer? Many supermarkets are sophisticated users of this type of analysis. Those cards that you swipe at the store are used for a lot more than discounts. They help determine what coupons you receive in the mail, what products to order and not to order, and where to place them on the shelf.

Fifth, it means making sure everybody in the organization has access to the information. How frustrated are you when you call the customer service area of a company you do business with, and they don't have the most updated information on your account?
Compare that to the experience you have when you check into your favorite hotel, and they not only know the type of room you want, but also what newspaper you read and your wine preference? That's the difference between good and bad customer relationship management.

Finally, it means using the information. The information from a good CRM system can drive virtually every business decision an organization needs to make. Product strategies, sales strategies, marketing strategies and operations strategies all can be driven off the information to be culled from a CRM program.

Notice some words which were not included: words like technology, software, data warehouse.

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Remember the example above. Before the days of computers, relationship managers were able to take advantage of the technology of their day: index cards, binders, etc., to collect information about their customers, track results and establish long-term relationships. They understood the essence of CRM. It's not about the technology.

Of course, technology can add power to the CRM program. If information is the fuel, technology certainly is the accelerant. Imagine your favorite airline frequent flier program trying to figure out what offers to send you and its millions of other members without computers and powerful models to analyze segmentation and profitability. But, again, this accelerant is nothing without the wise use of relevant information and a true caring for the customer.

Why Do CRM Programs Fail?

According to Gartner Group, 55% of CRM initiatives are doomed to fail in the next five years. This is consistent with other findings.

There are many reasons for this.

There is no plan. First, too many organizations do not clearly think through why they are undertaking a CRM initiative. The CRM initiative must be based on solving one or several business challenges…increasing customer retention, increasing market share, etc. It should not be technology-driven. Yet too many organizations say: "We have to have a CRM initiative because everybody else is doing it." Then they go out and buy the latest and greatest technology, with no idea of what they want to do with it. Then, after they figure out what they want to do, they realize the technology they have invested in won't support that application.

The wrong people own it. This is a related problem. If the process is a technology-driven process, then frequently the Information Systems department owns it. While these are undoubtedly people with a keen understanding of technology, they do not have the business perspective required to lead a CRM initiative. The Marketing Department is the logical place for the CRM initiative to reside..

There is no corporate buy-in. While the marketing department should own the CRM initiative, this ownership is useless without strong executive-level endorsement. Successfully implementing it is an enterprise-wide undertaking that requires a strong endorsement at the highest level of the organization. After all, the initiative will touch every corner of the organization on several levels. First, and most critically, a successful CRM initiative "puts the customer at the center," in the words of Peppers and Rogers. So the executive team must endorse the customer-centric philosophy, and the processes and cultural shifts needed to create it.

On a more technical level, the successful CRM program will link databases from around the organization – operations, sales, marketing, customer service, finance. So representatives from all these units must be included in the process. And since legacy systems will be involved, the IT area also needs to be included. The CRM system will only be as strong as its weakest link, and one weak link can render the system useless.

In order to make sure there is enterprise-wide support, executive backing for the initiative is imperative. To make sure that happens, the Marketing Department should work with other departments to put together pro forma Return on Investment models that can be used to sell the investment. This is no trivial task, and will require an understanding of costs and revenues throughout the organization.

Before You Start

Before you even start implementing a CRM solution, as mentioned, you need to be sure you have a customer-centric organization, with customer-centric people and processes. There are several companies that will guide an organization through their CRM customer-focused strategy and business goals, redesigning the core business processes to be customer focused..

A CRM Framework

A proper CRM program entails a closed-loop process. This closed loop process allows organizations to do the following:

- Identify the best targets for acquisition, upsell and retention
- Segment these targets
- Quantify the value of these segments
- Profile these segments
- Execute strategies
- Track responses
- Track return on investment
- Refine strategies

Each of these is discussed in greater detail below.

Identify the Best Targets

Once the CRM database has been created, the first thing to do is identify who your customers are, and which ones present the greatest opportunity. Several methods can be used for this. For example, lifetime value can be calculated to identify which customers are most profitable over time. This is done by discounting the monthly profitability of a customer over the expected life of the relationship, and subtracting the acquisition cost. This is an ideal, pure way of finding out who your most profitable customers are. Knowing this, you can then try to find prospects who look like them.

Note that this analysis does not have to be restricted to best customers. For example, a health plan may want to identify unprofitable customers for the purpose of identifying ways to make them profitable (i.e., health education programs to keep them out of the emergency room).

Segment The Targets

A group of "best customers" is not homogeneous. For example, a mutual fund company's best customers could include both households aged 55-64 saving for retirement, as well as younger households with children saving for college education. One needs to segment these "best customers," because you obviously cannot attract both with the same services, products and communications methods.

There are several types of segmentation systems. These include the following:

- Geographic: a division of the market according to discreet geographic units
- Demographic: a division of the market based upon consumer characteristics such as age, income, etc.
- Geodemographic: a division of the market based upon geography and demographics
- Psychographic: a division of the market based upon consumer lifestyle or personality
- Behavioral: a division of the market based upon consumer knowledge, attitude or product use

Any of these are acceptable methods of segmentation. The critical thing, though, is that the system has to be "tied to the ground," i.e., you have to be able to use those attributes and find them on a marketing list.

Quantify the Value

Once you have identified the segments, you prioritize your opportunities by quantifying the value of retaining best customers, upselling current customers who look like best customers, and acquiring prospects who look like best customers. There are several methods:

- For acquisition, which current customer segments provide the greatest lifetime value. You'll want to find noncustomers who look like them.
- For retention, what is the impact on lifetime value of extending the tenure of specific segments? At some point, the cost of maintaining a relationship will exceed the expected revenue from the relationship. For example, an insurance company might know that the average tenure of an automobile insurance policy is seven years. By projecting the remaining revenues expected from that particular customer, the insurance company can make investment decisions as to how much it wants to spend to retain that customer at different points in the relationship.

Profile the Segments

Upon identifying and prioritizing the segments, one next needs to find out all they can about those segments, and even individuals within those segments, to design the best products and communications strategies. For travel agents, for example, pieces of information that are helpful include, but are not limited to:

- Recent trips taken
- Preference of airline, hotel and rental car companies
- Customer demographics
- Leisure activities enjoyed (to plan side trips)
- Media preferences (for advertising purposes)
- Preferred communications method (direct mail, telemarketing, e-mail, etc.)

Execute

The above encompasses the strategic component of CRM: the use of information to identify the best product, sales and communications strategies targeted to the most appropriate segments.

With this information, one can then develop the most effective products, and create and execute the most appropriate sales and marketing programs. This should entail development of a multi-channel strategy to optimize the value of all sales and marketing channels. For example, a company may discover that its customers prefer buying over the phone, but may want to be communicated with via e-mail.

In executing marketing programs, it is always important to include a control cell of people you do not market to. This way, you cannot only analyze which segments perform best, but also the overall impact of the marketing program.

Track Responses

Once a marketing campaign has been executed, the first step is to track the immediate effectiveness of the campaign. This simply entails finding out how many people, by segment, creative cell, etc., responded to your call to action (how many people signed up for your pre-approved credit card offer, etc.). While this is only an interim step and not a substitute for ROI, it is important. A key requirement here is the ability of the organization to actually capture those responses. This must be thought through up front, which is why early buy-in from all operational areas is required.

Track Return on Investment and Other Key Metrics

Tracking return on investment allows you to identify the true effectiveness of a campaign and of the total CRM initiative. For example, for companies that sell technology business to business, this entails capturing the downstream revenues generated from a particular sales or marketing effort, as well as acquisition costs and costs for maintaining the account. Here is what return on investment analysis will do.

- Identify the best performing segments in terms of return on investment, lifetime value, etc.
- Identify the impact of the marketing campaign, by analyzing the results from people marketed to vs. results from people not marketed to (the control cell).

Additionally, other metrics can be examined, such as productivity metrics, cost reduction metrics, etc.

Refine Strategies

This is the piece that closes the loop. After analyzing return on investment, organizations can refine their strategies to make their following activities even more effective.

Build vs. Buy

Now that you understand how to generate a positive return on your CRM investment, the final question is the technology question. What is the best CRM technology solution?

The first decision is the build or buy decision. The natural inclination is to build the system internally. Your IT department will tell you they can do it cheaper. And since this is a major initiative, they will want to do it.

A few words of caution, though. First, you can probably get it done more quickly using an outside supplier. Your IT department is constantly facing shifting priorities and responding to crises. Chances are, despite the best of intentions, conflicts will arise and the project will take significantly longer than expected.

Second, putting together a CRM system is hard. No single vendor has developed a technology suite that satisfied the enterprise CRM technology needs, despite multiple years and billions of dollars of engineering investment. How can an IT department even think they can come close, in addition to providing a flexible, scalable, upgradable solution.

Selecting the CRM technology partner can be an arduous process. It should involve the following steps.

- Begin by putting down in writing what your vision of your CRM program is. Write down exactly what business issues you are trying to address, and your expectations as to how the CRM solution will address them.
- Research the various alternatives. Use the Internet, read trade journals, attend conferences, talk to colleagues. Begin to put down a list of the possible companies you might want to talk with.
- Perform an initial telephone screen with a common, written list of questions. To the extent you have already identified what capabilities you are looking for, you can quickly eliminate companies that don't provide those capabilities.
- Based on those telephone screens, invite several companies to meet with you and to present their capabilities. Provide a written agenda of topics you expect to cover. Expect to see a product demo, but do not settle for a feature-fundtion product demo. You need to be sure your business process can be enabled through the technology, so demand to see a business-process oriented demonstration. For example, ask to see how to initiate a marketing campaign all the way from targeting to execution to measurement. At this point, initial pricing discussions also are appropriate.
- Plan onsite visits to those companies still in the running so you can get a better handle on their people and processes. You will definitely want to meet with the people who will be handling your account. Make sure that, in addition to the technology, you have confidence in their project management expertise. That will be a big part of making the initiative suc-

cessful.

- Check references. Have a detailed list of questions for the references. Ask about product performance, service, expertise, etc. Make sure to ask the question: If you had to do it all over again, would you select them? If possible, actually visiting clients at their sites so you can see in person how they use the solution is strongly recommended.
- Negotiate the contract.

Conclusion

Establishing a CRM initiative requires a long-term commitment over several years. You cannot expect dramatic results from a CRM program overnight. The program itself takes months, if not years, to set up. More importantly, profitable customer relationships are usually built over several years. But if you build the program right from the start, and carefully maintain it, it should quickly generate a positive return on investment, and be a positive force in your organization for years to come.

Additional Resources

<u>Articles</u>

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