Lecture Text

W. Earl Sasser Jr.: Why Customers Matter*

Introduction

What I want to talk to you today about is why customers matter. I remember when this started. It was somewhere back in the early 1980s, and I was watching a video—a Tom Peters video, "In Search of Excellence."

Stew Leonard's Dairy

The one clip that had the most profound impact on me was about a grocery store. There was a grocery store in Norwalk, Connecticut called Stew Leonard's Dairy. This place just kept expanding and expanding and expanding. In terms of listening to customers, they were listening in every possible way. They had suggestion boxes that were full every day. Why would the suggestion boxes be full?

They might have been expecting a good response. They might have thought some of this will happen, right? People would come in. Customers would come in on Saturdays, on their own time, for focus groups to talk about how to improve things. Why? Because when they made a suggestion by Monday or Tuesday they could see the results of the suggestion.

And they were interviewing Stew and his son, little Stew Jr., and one of the questions that was asked was, "How do you know when you have a satisfied customer?" And what did Stew say? "When they come back." And I said, "Wow. That's really simple." All these companies and all these organizations that are trying to focus on customers had a way of calculating the economics associated with customer loyalty.

Because most people at this particular point were lead by someone like Stew, who'd started the business or like a Herb Kelleher at Southwest. It was part of the way they did things. Well, what about those organizations that needed to change? How would they know how to change? And if they sold the economics of it, would it be easier to change? So, that's what I'm on a mission of saying: Let's show people why customers really matter.

Sample CEO Comments

One of the advantages of Harvard Business School is the fact that we get doors open. We get the chance to talk with CEOs. So, I started, like we normally do, by going out with some CEOs and found out what they were saying. You could find it in all the magazines: Our #1 priority is customer satisfaction. Boy, we are really worried about customer satisfaction. They are also telling me, "The customer reigns. He or she is king or queen. They are paying the bills. It all starts with the customers. We ought to be customer-focused." And then, "We are committed to changing ourselves from a product to a solutions company. We've got to become much more focused on solutions than just out there selling products."

I could pick up any newspaper, any business magazine, and you'd find the CEOs in the mid-80s talking about this. But as you know in our cases, we don't stop with the CEO.

*Edited for clarity

It’s often nice to go into the organization and find out what the managers think. And what the managers were telling us was, “All I hear about is customer focus. But when it gets down to rewards, promotion, and the like, you better make budget.” What was the message here? What’s the message these managers were giving us? They wanted to do better with the customers, but there was not budget for it. What else might they be telling us?

A Customer Service Story

And as this research started getting published and so forth, I would get invited to go out and work for some companies. And one of the companies I got a chance to work with was a large global air carrier. And when you worked for an air carrier, it was really great. I got to fly first class and all the stuff like that.

But at some point, I had to go back and give a presentation to the top management group. So, I flew into an airport. I was going to give the presentation right at the airport. First class, flight from Boston to that location. It was really good—great meal, great service. Everything was perfect. As we pull into the gate, the plane as always is met by someone from the ground.

The person comes and said, “Would Professor Sasser meet the special service agent?” It’s around the corner, and I’m saying “Wow, this is great.” I was feeling a little uncomfortable because I was going to talk about customer service and customer focus and these folks were really sort of showing me stuff I’d never seen before. And they were really doing a really outstanding job, so it was like what am I going to tell these folks?

They were really out there, doing great stuff. And this person met me as I got off the plane. She did her job of herding me over to a golf cart. We got into the golf cart. We were through customs. There’s a far right-hand lane. We took my passport and just sort of waved it. We were down in baggage claim in about ten, twelve minutes. And I said, wow, this is unbelievable. I never had it happen like this before. This is great. So I asked the woman “This service that you’re giving to me, do you give to other folks?” She said, “Sure. We have a frequent flyer program, and this frequent flyer program identifies our very best customers. And our very best customers often fly one or two times a week. Now, you’re not in that category of a frequent flyer, but because you’re talking with the top management group, you’re in that category for the day.”

Now, first thing, is it okay to discriminate in favoring your best customers? Can you use the information? You’re not bothered by that? So, they provided service, and she was trained to handle this service. She was pumped because she had degrees of freedom. She could have rented a limo, written a ticket for another airline if that was necessary. Anything it took to satisfy this customer at the very top end, because they’ve identified these folks.

So, I kept quizzing her about this and it was obvious that they’d done a lot of homework. They were doing a lot of things. They understood the value of this customer to them. And after about twenty minutes, I ran out of things to talk about, and the bags still hadn’t arrived. And the first class folks had just come down. And I expected the bags to be there when the first class folks arrived. The standard would probably be that when first class arrives, have the bags there.

First class folks came. No bags. Coach people came, no bags. Now we're all waiting, and it takes an hour before the bags arrive. I'm a little upset because I need to get on with my presentation of doing audio/visual stuff, getting checked out and so forth. But, I'm a little happy too because I got something to talk about. And so I'm holding this little story in my back pocket waiting for the appropriate time in my presentation.

At some point, during the presentation—because the bags took an hour to arrive—I was late, rushing and so forth. As I did my presentation, I started talking about the service bookends. The first encounter and the last encounter are where the people really remember the service bookends. And as I started describing what had happened to me, I was very accurate. I told about everything and up until this point, the faces were looking up, all the executives were looking me right in the eye. And I started telling this story.

And once I got past that it was a great flight, great meal, great service, great, and I started waiting in baggage handling—the eyes— no more eye contact. It's all gone. And so, I told a story, and after the presentation people came up to talk to me. And there was a person just standing over to the side. When the last person finished, this person walks over and said, "I'm responsible for baggage handling at the airport."

And I said, "I'm sorry that I told exactly how it happened. I didn't make anything up. I thought you should know that, because of just trying to prove a point, it's very complicated when you're in the airline business, because there's so many interactions on the trip. Some of them the airlines control, some of them not, but that last interaction can have a big impact. I just wanted to drive home that point. Sorry, if I caused you any problem.

He said, "I'm not surprised it happened." I said, "What do you mean, you're not surprised?" He said, "This is the last week of the month. This is the last month of the quarter. I have deliberately understaffed baggage handling to make budget." Now, what about that? "I had deliberately understaffed baggage handling to make budget." First question is, did this person make budget? Probably did. Probably it is a cost center. It was a cost center and I suspect this person was rather close to either meeting or not meeting budget.

And it also told me a lot about the pressures of an organization, and the discontinuity between making budget and not making it. Not making it is bad. Not making it even by a little bit is bad. Making it is absolutely great. And therefore, this person did something because they were close. If this person had gone and missed it by a wide amount, what would have happened? They would have thrown him in the kitchen sink to make sure it was easier to do it the next time. Because it was close and he had a shot so he did this. What's the implication of this behavior? Does it have any consequences? Economic consequences? What are they?

So, someone who was on that airline this time would consider flying another airline the next time he or she had a chance to fly?

> Most likely.

Baggage handling. That's not going to affect my revenue, right? Whose revenue is that revenue that I've lost?

> It's my best customer.

It’s your best customer, but who gets credit for that revenue? Sales. Little sales arms all around the world would be affected with me, baggage handling: no impact. In fact, it’s going to make my job easier probably next period because fewer people will be flying. And those who are flying will do what? Carry their bags, right? Making it probably—where everybody carries their bags—a much less positive experience for all of us.

Why do you get this behavior? Why do we see this behavior? As we laugh, it could be any organization. But, it’s not talking about a global airline. Just people do stupid things. The budget out there. People are trying to talk about the budget. Why does it happen? Do you think this person calculates the revenue loss? Had he any idea of the negative consequences of his action? The extent it might have, the impact on—probably not. He’s probably a good person. Trained in an organization to meet budget.

So, what happened is we would go through this scenario and people would say, “That customer you talked about—that customer reigns as long as it doesn’t cost anything.” And then they would tell us “Becoming a customer-focused solutions company. Let me guess who you heard that from.” And what’s the message here? Who do they think we heard it from? The CEO. First from the top, then we’d say, “Well what do you mean about this?”

Kidney Stone Management

They say, “Well you know this stuff about becoming customer-focused, moving toward solutions— that’s just another form of kidney stone management.” You know kidney stone management? This is called, “It’s going to hurt for a little while, but it too shall pass.” And I said, “Well what do you mean specifically?” They said, “Well top management—they don’t have very much to do.”

But they work with consulting firms and academics to create kidney stones, and they roll the kidney stones down the organization and we have to deal with a kidney stone at the same time we’re getting our work done. They even create organizations with kidney stones.” So, I started keeping track of the kidney stones. I mean, we can call *Harvard Business Review*. We find each of these featured. And, I’ve even helped create some.

Look at these. And this was really more about how they’re implemented. These were all great things to think about, but what these folks would say is they do one month and maybe three months later they’d come with another kidney stone. And I started looking to try to figure out whether I was in kidney stone territory. And if I walked into a site to give a talk and there was a big sign over the stage that said: “The Year 2002: The Year of the Customer,” I pretty much knew I was in kidney stone territory because all I had to ask was, “What was 2001? What was 2000?” They all had another kidney stone to tell me about.

Managers Don't "Walk the Way They Talk"

So, what we discovered is these folks really didn’t believe. They didn’t understand economics—and why? Why don’t the managers walk the way they talk? First, because they didn’t have very good customer satisfaction measures, but much more importantly, there was really a lack of research that was linking customer satisfaction to profitability. And that’s what I want to spend time talking to you about this afternoon.

MBNA

And where did I learn the most? Early on, it was at a credit card company called MBNA. It was part of Maryland National Bank. We went down, and we saw Charlie Cawley, CEO. And Charlie was worried about his business because they were growing, but not growing profitably.

So they were attracting more and more customers, but the more customers they attracted, the more money they lost. And in the credit card business, you have a lot of economics that are available to you. You know the mailings you send out. You get some idea of what your acquisition costs are. You can look at how many people say yes. You can look at their record over a year. You can see how many people renew. You can see the usage and so forth. So, most subscription businesses, if you're in the newspaper business or you're in the magazine business or cable TV or even, say, the telephone business, you'd have some of these economics available to you.

Lifetime Value of a Customer

So, the first thing he did was he calculated something I want people to think about—the lifetime value of a customer. And he did this calculation. He did it on a discounted cash flow basis. It's taking us five years to break even. We have such high acquisition costs—up-front costs. When you look at the usage pattern and renewal rates, it's taking us five years to break even. But he also knew one other thing. His average customer only stayed with him for four years. This is not a good business model. If you attract customers that take you five years to break even, and they only stay with you for four, it's not going to work.

Ways for MBNA to Increase Profits

So, what I want to ask you to do is think about this particular—we can go back to here. Think about this problem. What options are available to Charlie Cawley to increase profitability of the business? What are some things that he might do?

As they went in, one of the things they discovered is that the average customer stayed with them for four years. They were losing 20 percent of their customers every year. And how many new ones do I have to find before I even grow? At least 20 percent if they are as good as the ones that stayed. I mean I got a real problem, and he took a look at it and said, whoa. So, let's just think about this. So one of the things I can do is do a better job at retaining them. I can get them to refer. That's going to reduce my acquisition cost. How do I get them to stay? And how do I get them to give me positive word of mouth? What do I have to do?

> Find out why they would leave?

Part of the issue here is why are they leaving. So if I'm able to take the 20 percent of the folks who are leaving, and I'm able to do so some sort of root cause about why they leave, and I fix the problems about why they're leaving, what will happen?

> You'd like for them to stay.

Retention Cycle

We want them to stay. If they stay what else will they do? They'll stay because of what? Why will they stay? Because somehow they're satisfied. And if they're satisfied, the likelihood of them giving us positive word of mouth—what? Goes up. And if they're satisfied what else will they do? What other behavior will they give us?

Spend more money.

Customer Behaviors

They'll spend more. Now, if we can get ourselves into this loop, this virtuous cycle, of sort of finding out why, fixing the problems, and by doing that, they stay with us more, right? They buy more, and they go tell other people. Three behaviors. The three behaviors are retention. That's a customer behavior. They decide to stay. Related sales. They buy more. They come in buying something. They buy even more. That's a second R. And referrals—the third R.

Insightful Executives

Now as we're sort of doing this research, we went out and we got some experience from three people. One of the the three people is Wayland Hicks who works at Xerox, executive vice president. And what he said is their research showed that someone who gave them a five, on a customer satisfaction rating scheme of one to five, with five being the best score, was six times more likely to repurchase than someone who gave them a four. So someone who gave them a five was six times more likely to repurchase than someone who gave them a four.

What does that tell you about the shape of a curve of retention in their business and customer satisfaction? A five is six times more likely—what's the shape of the curve? It's just like that. So, it says we have good economics. But it appears that the economics move is based on the Xerox experience to move people to fives rather than fours because of the intent to repurchase. Scott Cook says people just don't understand it.

"We're working on this Quicken Software. We're doing these things right to get this product right. Because if we get this particular product right, and it works the first time—which is computer software that automates the financial lives of our customers. And we are able to boot that thing up and it works—what happens? What's the behavior that we'll get? Or the behaviors that we'll get? We can't compete with the likes of Microsoft for advertising dollars."

"We have to do it a different way. So, if we get it right they'll go out and tell their family and friends, and what the real key for us in this early stage is we need to create apostles. Do it so well, in terms of what we deliver first, and when they have a problem—when they call in—that they'll go out and tell their family and friends about this. And that's going to bring them in."

And then Carl Sewell of Sewell Motors down in Dallas, Texas said, "I had to get this concept across to our folks that we really weren't just selling a car. We really weren't selling a service interaction. What we were doing is selling a long-term relationship with our clients."

And what he did, how we find him, is he wrote a book called, *Customers for Life*, and he didn't do elaborate net present value calculation.

All he did was he totaled up for the average customers how many cars and how much service they may buy in their lifetime. And he came up with a number of $332,000. And he said, "If everyone in my organization from sales to service knows that when someone walks in to buy a new car that that's worth $332,000 long term, they'll behave a lot differently than they had in the past."

We were sort of getting people saying, there really are economics involved with this. What we're trying to do is we're trying to worry about customer satisfaction levels and the probability as we move these levels that we will get the behaviors that lead to profitability. So, it's not about just customer satisfaction scores. The real payoff is when you get the scores and when you get behavior changes. If people stay. If they buy more or if they tell other people.

Retention Exercise

As an example, think about this, it shows just part of the problem that Charlie Cawley would have had. I start with a hypothetical example. I've got a 100,000 customers and I put up some satisfaction rating, a percentage in each of these categories. Five percent of them are very dissatisfied, ten percent are neutral, thirty percent satisfied, fifty percent very satisfied.

And this is hypothetical. I assume that the probability retention is pretty low if you're very dissatisfied, right? So, I call that .1. Those who are dissatisfied are .2, neutral .3, satisfied .6. If I'm very satisfied the probability of them staying is pretty high. If you carry that through, what you see is when I start out with a 100,000 customers and I have that behavior, I've only got 73,000 customers for the next period.

Now I could play around with this depending on your business and you put your own business up there and so forth but when you see that. Actually I started with a 100. Now I've got 73. What do I need to do? Where do I need to put the attention? One of the things that becomes pretty obvious is it's not enough to drive some of those fours up to fives, right?

Because that would be a great behavior change just to get the fours up to fives. Why? Because if I did that, I've driven up to fives. I've changed the percentage. Now, I've got 5, 5, 10, 10, 70. Where before I had 5, 5, 10, 30, 70. What's happened? So, what have I got to do? What's the implication?

This is a volume thing so far. This is about the number of customers. So, how do I really look at it? What's the way to look at it? Simply to show you that the number of customers I don't make up very much by moving them. Just by the number of customers. So what do I have to do? How would you want to adjust the analysis?

Yeah, so another way of thinking about this is remember as I move from there to there, you're saying. I'll get some other benefits. Our research has shown us that we thought that moving fours to fives was the big deal. But it turns out that the big deal is fives staying fives. They'll buy a lot more. So, one of the things that this allows is just to start showing you the numbers of people who stay. But what we really have to find out is what are the buying habits of those people?

The fours we move to fives, the fives are staying and that has to do with related sales. How much more are they going to buy? And so, as we would take our analysis and we'd have to do this for each of our own businesses and we'd have them tailored. One of the things is we might just want to get their retention numbers. For that mass, a major thing here is what's the actual revenue or the profitability.

We could have profitability in terms of the customer in each of those categories. Another thing we'd like to do is we want to ask ourselves about the behavior of referral. How do we think that's going to behave as we move from very dissatisfied to very satisfied?

Much higher for the top end and the probability that someone…If I refer a progress service to you and I'm at the high end what's the probability if you're trying it. Is it higher than if I were at the low end and said something about it. Probably is, right? We could test that. So, there's another thing here that we could get at is the power of referrals.

We could assign economics to new people coming in based on referrals. And what will we know about the cost of bringing someone in by referral versus conquest advertising? It's going to be a lot cheaper to bring them in that way.

So, we need to get good data in terms of what happens to retention. Whether they stay or not. We need to get good data about how much more they buy in each of the different categories. And we need to get some good data about their probability of referring, and if someone got referred to would they buy?

MBNA Example

If I go back to this chart when Charlie Cawley started this movement—one of the first things he did, he said, "Let's make sure I define what customers we really want. Because we may have a few customers that aren't good for us. And we could never serve them well."

He did a lot about saying what are the customers for, and as he listened to the phones, calls were coming, and he read some of the letters. He said, "We got about three, five percent of our customers that are costing us a lot of problems. We should let those customers go because we can't serve them well. Not all customers are good for you. Lots of customers are a lot better than other customers for you. Let's just focus on those that we should focus on."

By doing that, even when he did a mailing—when he decided to invest in recruiting new folks—recruitment could be much more targeted than in the past. Then the offer could be right to that group rather than using a shotgun. He started using a rifle to go after the new people he wanted. That, with getting better and better because they were getting the root cause analysis in.

Their retention rate started moving up a point or two each year. As the retention rate started moving up a point or two each year, the acquisitions cost started getting lower and lower. What happened to word of mouth as they started doing that? Retention rates started getting lower. What happened to share of wallet of this card? It went up.

And it would start to be going up. As he drove retention rates, he started getting behaviors of word of mouth and related sales. What happened to profitability? Does it go up a little bit or a lot?

A lot. In the six, seven year period that he did this, profitability went up sixteen times. It was a big deal. They moved from being way at the back of the pack to being one of the leaders in the field. Results as of today: Net income for the fourth quarter of 2001 rose to $524. That's just a quarterly number. An increase of 25 percent compared with 2000 for the full year—one seven versus one three.

Their earnings have consistently grown on an average of 25 percent in each of forty-four quarters since they became public. I don't know. Is this good? I mean I'm not a finance professor. Is this good or is this bad? It seems quite good if you ask the people at MBNA what's the secret and they will say, "Finding the right customers and keeping them."

Customer Satisfaction vs. Loyalty

Now as we look at this what do we see? What we see is that, the satisfaction, the loyalty, does it vary with the amount of competition in the marketplace? For those of you, who are the monopoly situations—this doesn't matter. Customers don't matter. They have no choice. They got to use you. You can abuse them. If you have a monopoly, or you have a duopoly, it's not quite as important.

However, if you are in a competitive environment or if you are in an environment that's about to become competitive because some people who thought they were in a monopoly situation woke up one day and said uh, oh, I'm electric utility—I have competition. I'm a phone company. I have competition. It switched on them almost overnight from being in the top curve to being in the bottom curve.

And it leads to thinking about that space and these dimensions. You've got the people who are completely dissatisfied but they can't leave. They're hostages. You've got people who are completely dissatisfied and they're out the door. They're defectors.

You've got people who are half highly satisfied but who will leave you for a penny. We call them mercenaries. And then you have people who are highly satisfied, and who are highly loyal, and you can get right up at the top. You've got the people you really want who are the apostles. Whether you are in a consumer business or you have hundreds of thousands, millions of people you put in those categories.

And you try to move them up to the top with your actions or whether you were a business where you have a finite number of customers. You can put them in a category, too. And for those of you in the business of business you can go even one step further and you can even take the people with whom you deal in that business and put them [in categories].

So, you can take the client and you can, down at the bottom right hand corner, you might find a purchasing agent. Up at the top left, if you're selling some sort of product. Let's say I'm an IBM computer salesperson. I go and I sell IBM and I still have some Mac lovers. There are those folks who just love Macs.

But we have a company policy that says you've all got to have IBM. Anybody who's got an IBM computer who loves to have Mac is a hostage. What you want to do is identify by individual clients. Who the players are and how you move more people to the right hand corner to get the behavior you want by client. You can do it by client. You can do it by the group of clients.

Or can you just put them all up here and say, "How do I get more to the top of the right-hand corner?"

Customer Analysis

So, this is a great exercise. You go back in your organization, invest in some Post-it notes. Put the names of the clients or put the names of the people [on the notes].

Half the people debate where they belong and then develop strategies for moving people to the top right-hand corner and we want to move people to the top right-hand corner: Why?

Because when you get to the top right-hand corner we get the behaviors that we want of retention, related sales, and referrals.

What else do we know? We notice that in most cases you're faced with this curve that looks like this and that if we analyze what the problem is, the real problem usually is that in the bottom part you just aren't meeting the basic promise that you're making to the clients.

You're just screwing up on the basic promise. Moving out further, you're resolving those problems with product but you're mainly in problem resolution, or recovery mode. Only when I could walk into your clients' [offices] and they would say, "I am in a relationship with these folks. They really are providing me with a solution. We are a partnership." [Then] do we find ourselves in the point that we want to be?

Conclusion

So, the closing message, pretty simple: You acquire with product or the basic service. You retain with that extended service but you create apostles with solutions for your clients or customers. Very simple message—but when we create the apostles, we do it because we get the right behaviors.

Thank you for your attention.