

{ New Strategies }

Customer Prioritization



/// Positive effect on profits compared to equal treatment

All customers are equal, but some are more equal SHOULD FIRMS PRIORITIZE THEIR CUSTOMERS?

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Focusing marketing efforts on the most valuable customers so as to increase company profits is not as straightforward as it seems. There is a downside to customer prioritization such as negative reaction from low priority customers. Taking this into account we still show that prioritizing customers does lead to higher profitability and more return on sales. There are two reasons for this. Firstly, it has a positive effect on the key characteristics of a firm's relationship with its elite customers while not affecting the lower level. Secondly, it reduces sales and marketing costs. Customer prioritization is more effective and efficient than equal treatment. We also show that firms can rely on six key levers relating to a company's organizational structure and processes, enabling proper implementation of customer prioritization.

Should Some Customers be "More Equal" than Others?

The relevant question for almost all businesses is: should firms clearly set priorities among their customers and treat their best customers preferentially or should they treat all customers fairly equally?

At first sight, managers should try to treat all customers as well as possible. This should lead to the maximum return a firm can expect from its customer base. The major problem here is that firms do not usually have the resources for this. In highly competitive industries many firms compete for the same customers and as a result customers substantially increase their bargaining power, particularly in business-to-business markets. Therefore many firms actually suffer from a decreasing return on investment in customer acquisition and retention activities.

Thus, in practice, firms cannot treat all customers as well as they would like to do because they simply cannot afford it.

Against this background, firms have to concentrate their marketing efforts on particular customers, thus creating prioritization. Logically speaking, firms should focus their efforts on their best customers. Customer prioritization implies that selected customers receive clearly different and preferential treatment to others in terms of marketing instruments. Firms should do so as their marketing efforts should become more effective and efficient when concentrating on their best customers. *Marketing effectiveness* should increase as the needs of the most important customers are better served consequently leading to more business with them. *Marketing efficiency* should also increase as marketing resources are concentrated on key customers.

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{ Box 1 }

THE RESEARCH APPROACH



We conducted a large-scale survey study. We sent out questionnaires to about 2,000 companies of different sizes and from industries in both business-to-consumer and business-to-business markets. The questionnaires included measures of the variables highlighted in Figure 1 and Figure 3, assessed on commonly used rating-scales (for example, the customer prioritization checklist as shown in Table 1).

We made follow-up telephone calls four weeks after sending out the questionnaires. As a result, we finally obtained responses from 310 business units or firms (if no specialization in different business units existed). The industries represented the most in our final sample are: financial services (16%), utilities (13%), pharmaceuticals (11%), machinery (11%), transport (10%), IT/telecommunications (10%) and chemicals (8%). The vast majority of our respondents are senior level managers, i.e., managing directors/CEOs (31%) or the heads of corresponding marketing or sales departments (52%).

We also conducted more than 250 telephone interviews with customers of a subset of the participating firms in order to validate the managers' responses with regard to customer reactions to customer prioritization. Depending on availability, we also drew on secondary financial data provided by commercial databases to validate managers' assessments of their firm's financial performance. We found that both customer responses and financial performance data were very similar to the managers' assessments, underlining that our findings are valid.

In order to test the supposed effect of customer prioritization on a firm's top-tier and bottom-tier customers, and ultimately on the performance outcome as depicted in Figure 1, we used structural equation modeling (the LISREL software package). This allows for simultaneous investigation of all effects as depicted in Figure 1, notably the effects of customer prioritization on a firm's top-tier and bottom-tier customers' satisfaction, loyalty, and share of wallet.

In order to identify the key levers for implementation, we relied on multi-group structural equation modeling using LISREL. More specifically, we compared how a firm's intent to prioritize customers relates to actual customer prioritization. This depends on whether the firm has a relatively low or relatively high score with respect to the corresponding pre-requisites (see Figure 3). We discovered that the intention to prioritize customers had a significantly greater effect on actual customer prioritization when firms' scores were high on the corresponding levers for implementation than when firms had low scores concerning the six key levers.

The Dark Side of Focusing on Your Top Customers

Arguing for prioritizing customers is obviously appealing, however this also implies that firms should stop doing business with less profitable customers. At rock-bottom, firms have to provide their lower level customers with much less quality. What about ticket vending machines, services for "economy customers," and how do you feel when you are put on hold by telephone hotlines while the charges mount up?

Firstly, the problem of focusing on top customers is that the number of "economy customers" is usually much higher than this. In many firms, the bottom tier makes up 80% of the customer base so much of the lower priority customer base is unhappy when services are cut. As a result, such "pariah" customers may tell other customers or potentially new ones that they have been poorly treated. In the end, many of these customers leave and company sales and profits are affected considerably.

Secondly, focusing on a limited number of customers who receive preferential treatment does neglect economies of scale when offering the same product or service to all customers. Customer prioritization implies that firms create differentiated offers for different tiers of their customer base. This leads to a high level of complexity along the value chain and inevitably, results in higher costs.

Thirdly, a balanced portfolio of top-tier and bottom-tier customers may well be important in order to reduce dependence on a very small number of top customers. When a minimal number of customers accounts for a huge portion of sales, firms then risk losing one of them which may be very unhealthy. For example, the two leading aircraft constructors, EADS and Boeing are indeed competing fiercely for a single deal worth up to 40 billion US\$ for the new USAF refueling tanker. On the other hand, bottom-tier customers may provide small, yet very steady cash flow leading to predictable sales and profits. Thus, by having a balanced portfolio of top-tier and bottom-tier customers, firms can hedge the risk of certain top-tier customer relationships against a solid basis of small, ongoing returns.

These arguments show that customer prioritization does not automatically lead to higher company profits when taking into account its drawbacks. Thus, answering our initial question is not as simple as it seems and therefore needs explaining. Managers have to know how customers of different importance react to customer prioritization in order to assess its effects on a firm’s customer portfolio. Furthermore, knowing if and how this affects firm profits will help managers to make a healthy decision whether to prioritize customers or to treat them all equally.

Does Customer Prioritization Ultimately Pay Off?

In order to address the fundamental question of whether firms should prioritize customers, we had to consider the effects of customer prioritization on a firm’s relationship with *both* important and less important customers. We also took a close look at the effect of customer prioritization on marketing efficiency. To provide comprehensive answers, we drew on a large-scale

company sample consisting of more than 300 business units of different sizes and from various industries. The study was supported by the Institute for Market-Oriented Management at the University of Mannheim (Germany). Details on our sample and methodological procedure are provided in the box highlighting our research approach (Box 1).

Before addressing the performance outcome of customer prioritization, we started to assess customer prioritization itself. More specifically, we asked the firms participating in our study about how far they engaged in customer prioritization. In particular, we assessed the degree to which customers were treated differently with respect to key marketing instruments relating to their importance to the firm. As a result, a high level of customer prioritization became apparent when top-tier customers received a clearly different and preferential treatment. We considered customer prioritization in terms of five key marketing instruments: product, price,

To what extent do you differentiate between your customers / customer segments concerning the following aspects?	To a large extent (100)	(75)	Somewhat (50)	(25)	Not at all (0)
Customer Prioritization in Product					
• Offer of particular goods/ services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Offer of individualized goods/ services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Offer of additional services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Customer Prioritization in Price					
• Price level	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Price conditions (e.g., rebates, discounts)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Flexibility of payment targets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Customer Prioritization in Sales					
• Distribution model (e.g., direct vs. indirect, cross-functional teams for serving customers)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Quality of the sales personnel	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Frequency of contacts initiated by the sales force	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Customer Prioritization in Communication					
• Quality of information given to the customers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Timing of information transfer	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Costs of communication efforts	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Customer Prioritization in Processes					
• Rapidity of processes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Flexibility of processes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
• Transparency of processes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

TABLE 1: Customer Prioritization Checklist

sales, communication, and processes. The lowest possible level of prioritization was given when all customers were treated equally regarding all these instruments. We developed a checklist for customer prioritization consisting of 15 items (see Table 1). Readers can use this checklist in order to assess the extent to which customer prioritization is present in their company.

We then registered how customer prioritization affects the characteristics of a firm's relationship with both its current top-tier and bottom-tier customers. The top tier contains the most important (i.e. valuable) customers to the firm, whereas the bottom tier obviously contains the least important customers. For both customer tiers, we evaluated the effect of customer prioritization on three important characteristics of a customer relationship: customer satisfaction, loyalty, and share of wallet, which is the share of category purchases a customer conducts with the firm. Firms indicated the average satisfaction, loyalty and share of wallet for customers belonging to each respective tier.

We recorded the performance outcome of customer prioritization on the overall level of the customer portfolio by the average sales per customer and the average customer profitability. To capture the effect of customer prioritization on marketing efficiency, we set the firm's marketing and sales costs off against sales. To record financial performance, we assessed the firm's return on sales (see Figure 1).

To put it in a nutshell: our analyses show that customer prioritization indeed pays off. Our findings show that customer prioritization has a positive effect on company

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» Managers have to know how customers of different importance react to customer prioritization in order to assess its effects on a firm's customer portfolio. «

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profits compared to equal treatment using two mechanisms: first of all customer prioritization has a different effect on important customer relationship characteristics (customer satisfaction, customer loyalty, and share of wallet) when comparing top- to bottom-tier customers. While prioritizing customers leads to a higher satisfaction, loyalty, and share of wallet for top-tier customers, there is no negative effect on a firm's relationship with its bottom-tier customers. This mechanism causes customer prioritization to lead to higher sales per customer thus increasing marketing effectiveness.

Furthermore, customer prioritization increases average customer profitability as the former reduces marketing and sales costs in relation to sales. This enhances the efficiency of the marketing and sales effort and leads to higher average customer profitability.

Finally, our results show that firms which prioritize their customers ultimately have a higher return on sales than firms who treat all their customers equally. This allows for a simultaneous increase in financial returns through operational efficiency as well as through revenue enhancement. Figure 1 highlights how customer prioritization affects a firm's relationship with top-tier and bottom-tier customers and ultimately how a company performs.

To summarize, our analyses indicate that customer prioritization implies a higher return on sales as average customer profitability is increased: firstly, by indirectly increasing average sales per customer through increasing top-tier customers' satisfaction, loyalty and share of wallet and: secondly, by decreasing marketing and sales costs. Thus firms that prioritize customers are able to leverage key performance indicators compared to their major competitors. Customer prioritization affects sales, profitability, and return on sales quite considerably. Our company sample in Figure 2 highlights that firms which prioritize customers to a high extent are market leaders in their industries with respect to these performance indicators.

How Should Customer Prioritization be Implemented?

Our rationale is that firms should prioritize their customers on a broad empirical basis. However, our analyses also reveal another very intriguing result: about 80% of the firms participating in our study indicated that they intended to prioritize their customers to a high extent.

FIGURE 1:
How customer prioritization affects a firm's relationships with top-tier and bottom-tier customers and firm performance

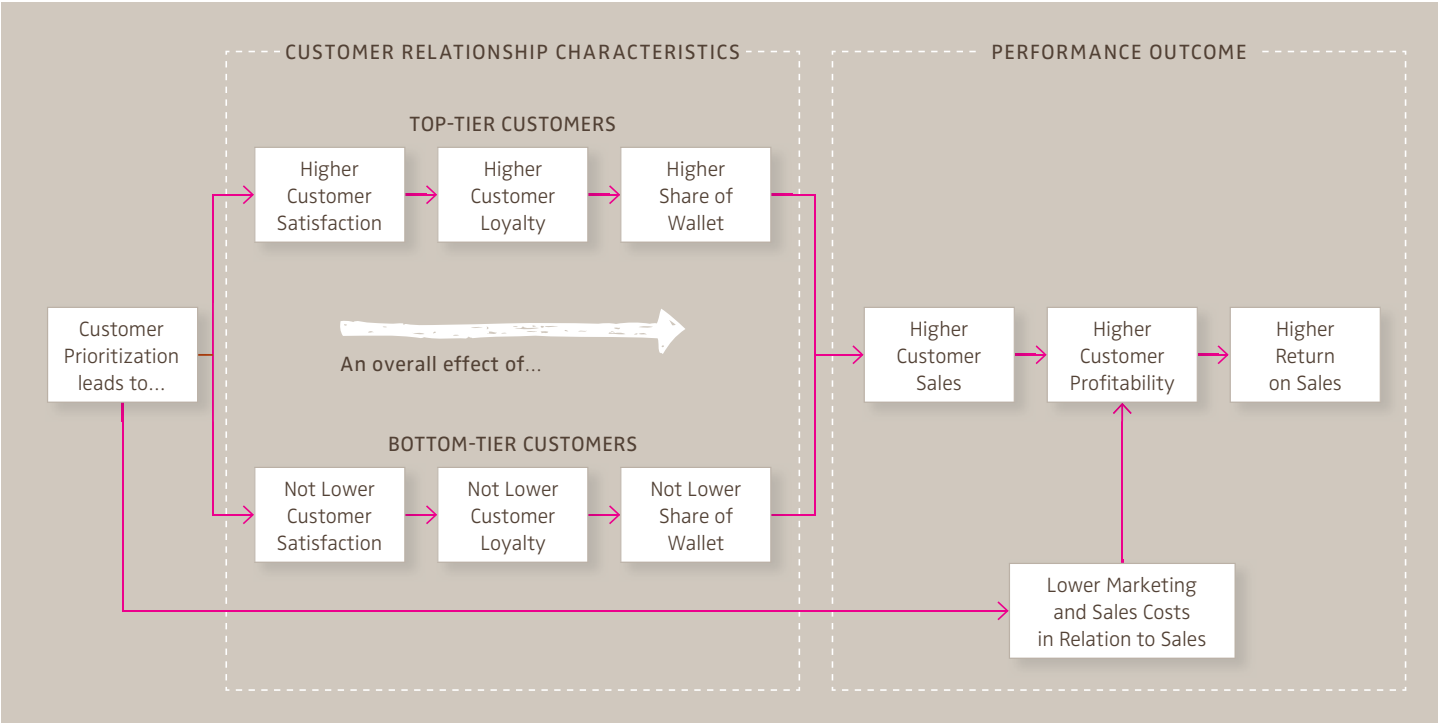
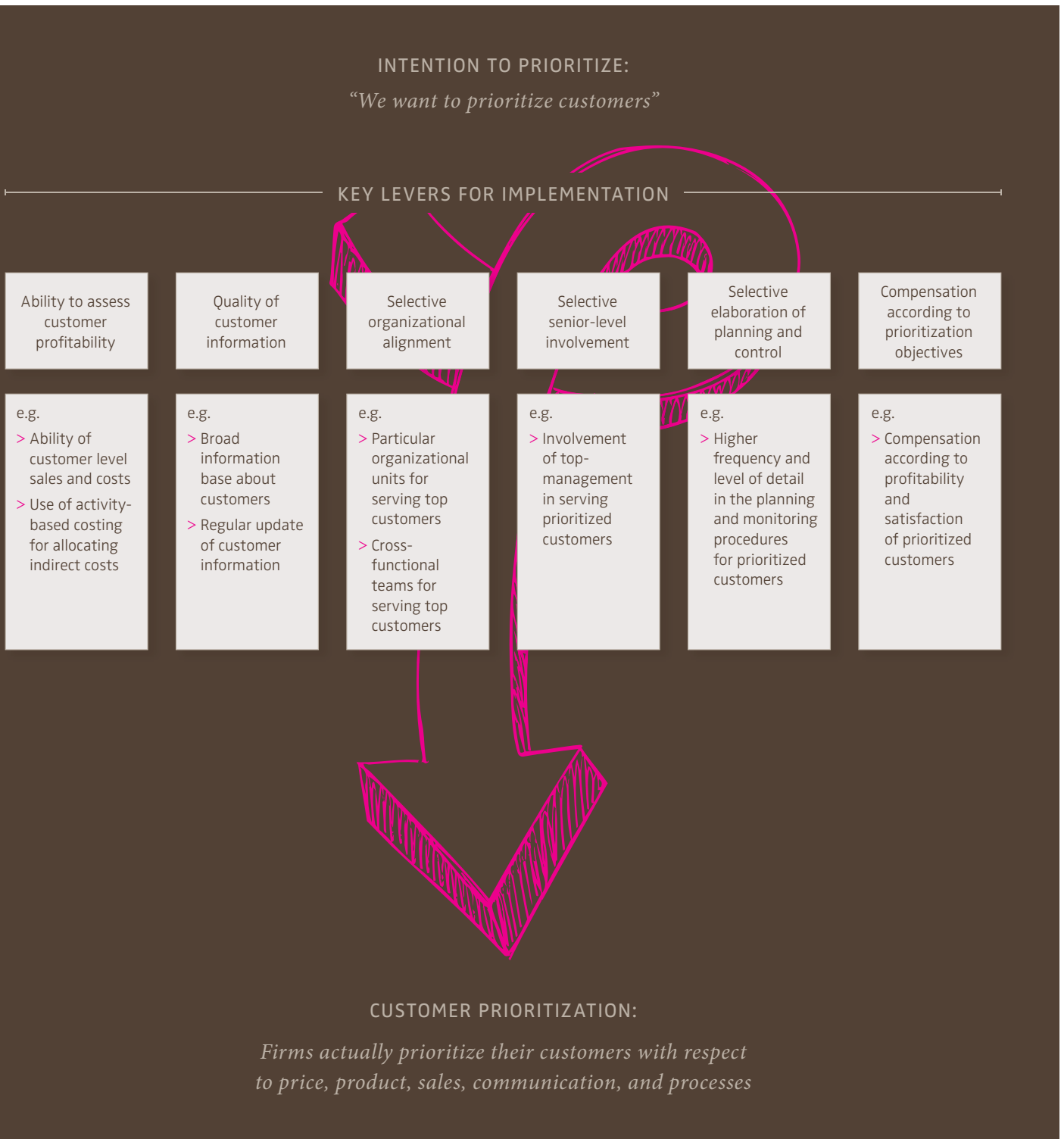


FIGURE 2:
How customer prioritization increases firm performance relative to the competitive landscape



Figure 3:
SIX KEY LEVERS TO ASSURE CUSTOMER PRIORITIZATION
IN YOUR COMPANY



In contrast, when examining the firms' answers to our prioritization checklist (see Table 1), less than 40% indicated that they actually did prioritize to a high degree.

Many firms intend to prioritize among their customers, but give way at the implementation stage. In other words, although customer prioritization is strongly present in a firm's marketing strategy, this may not correspond to the actual allocation of resources and the use of marketing instruments in daily business. We therefore identified crucial leverages managers need to consider in order make a prioritization strategy really work.

We found that a firm's intention to prioritize customers does in fact lead to real customer prioritization when important internal prerequisites are met. These leverages are the firm's ability to assess customer profitability, the quality of customer-related information, selective organizational alignment, selective senior-level involvement, selective elaboration of planning and control and employees' compensation in customer care according to prioritization goals. Figure 3 highlights the six key levers for customer prioritization as well as explanatory details.

Firstly, a firm's ability to assess profitability at customer level and the quality of customer-related information is crucial to prioritize customers properly in daily business. This is important as employees concerned with prioritizing in customer care have to be provided with the necessary information. Notably, sales and cost information for each customer account are crucial for understanding which customers should receive preferential treatment. Besides, firms need this customer-level information to be able to assess the profit impact of particular marketing initiatives. Our results also show that this information has to be up-to-date and that firms should not solely focus on "hard data" but should also consider qualitative customer information (e.g., information on referrals or complaints).

In addition, organization alignment is important in order to achieve properly implemented customer prioritization. In particular, our results imply that firms should install customer-responsive structures and internal processes depending on the customer's importance. Specifically, firms should create particular units that are solely responsible for looking after key accounts. By the same

token, these units should include personnel from different backgrounds (e.g., marketing and R&D) as cross-functional teams are better equipped to deal with the complex needs of key customers.

Senior-level management has to engage in customer prioritization as well. Senior-level involvement is an important signal for all employees in customer care and for the customers that they receive special treatment. In particular, senior-level management should actively participate in dealing with these key accounts.

Firms also have to install adequate planning and monitoring procedures. These should address key prioritization goals as well as the corresponding resource allocations for specific customer tiers. Our analyses show that, in line with selective organizational alignment, planning and monitoring, procedures should also be differentiated according to the customer's importance. Planning and monitoring procedures should be more specific, followed more rigorously and updated more regularly for top-tier than for bottom-tier customers. In particular, more frequent, detailed planning and monitoring for high-priority customers leads to more specific and

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accurate plans for these customers. Furthermore, monitoring procedures should be more rigorous for top customers. Relatively small deviations from expected sales or customer satisfaction scores should instigate an investigation of the circumstances that lead to this deviation.

Finally, firms can support customer prioritization by setting the right incentives. They should compensate their employees in customer care based on key performance metrics evaluating relationships with high-priority customers. In particular, compensation based on criteria such as customer satisfaction or sales volumes of high-priority customers will encourage sales people to provide higher value for top-tier customers.

» Firms can support customer prioritization by setting the right incentives. «

Key Implications for Customer Relationship Management

Our initial question was whether firms should prioritize customers. Our analyses lead to one major implication: firms should strive for customer prioritization simply because it pays off. Customer prioritization increases a firm's average sales per customer account. Managers can rely on this sales-enhancing effect as customer prioritization improves relationships with top-tier customers whereas bottom-tier customers do not suffer. Therefore, customer prioritization allows the development of important relationships that ultimately drive sales and profitability. In addition, customer prioritization drives customer profitability by reducing marketing and sales costs. In this way managers can simultaneously enhance the efficiency of their customer relationship management efforts and increase sales by prioritizing customers.

However, the will to prioritize customers itself does not necessarily mean that this will be properly implemented. Firms are facing a considerable implementation gap today. Customer prioritization first requires proper information systems which provide profitability information on a customer-account level. These have to be up-to-date and should provide key customer-related information. Managers should also align their organization selectively as well as monitoring their customer tiers. Firms should support prioritization efforts by aligning their organizational structure, for example, by creating customer-responsive units for the most valuable customer accounts. Furthermore, preferential treatment of key customers is a task for top management. Upper management should be largely involved in customer relationship management for key customers. Finally, firms have to set the right incentives for their employees in customer care in order to facilitate customer prioritization. Thus, firms have to support customer prioritization by substantially aligning their organization to this end. •

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