Can marketing regain the personal touch?

“Continuous relationships” with customers can, in fact, be achieved

Classical marketing skills, not expensive IT and neural networks, are what’s needed

Pilots, skunkworks, and pragmatism

Avoiding electronic green stamps

Peter Child • Robert J. Dennis • Timothy C. Gokey
Tim I. McGuire • Mike Sherman • Marc Singer

Years ago, retailers, bankers and auto dealers had real customer relationships. They knew their customers personally, understood what they wanted, and, as best they could, satisfied their needs through personalized service. As a result, they earned loyalty and a large share of their customers’ business. But this was a costly and inefficient system, and eventually it gave way to mass marketing. Customers traded relationships for greater variety and lower prices.

Peter Child is a director in McKinsey’s Paris office; Bob Dennis is a principal in the New York office; Tim Gokey, Tim McGuire, Mike Sherman, and Marc Singer are consultants in the Minneapolis, Toronto, New York, and San Francisco offices, respectively. Copyright © 1995 McKinsey & Company. All rights reserved.
Today, falling IT costs enable companies to offer both. American Airlines gate agents whom you have never set eyes on know that you are a valuable customer and upgrade you to first class in preference to a once-a-year holiday traveler. Auto dealers remind you when your car is due for a service. USAA sends your daughter information about learning to drive just after her fifteenth birthday, when she is about to sign up for driver’s education. Nordstrom sales reps call you when your favorite line arrives. And Hertz takes your reservation on a dedicated line, then presents you with a waiting rental car complete with your name in lights.

These companies are practicing elements of a new approach to marketing that uses continuously refined information about current and potential customers to anticipate and respond to their needs (Exhibit 1). Done well, this approach rests on a clear understanding of individual customers’ economic potential. In its most advanced applications—like the custom binding of Parents magazine according to the age of readers’ children, Fingerhut’s production of scores of tailored catalogs, or intelligent agents that sort through mountains of online information to select the items you are interested in—it is nothing short of revolutionary.

Yet there is hidden tension in this trend toward what we call continuous relationship marketing (CRM). Marketers can now obtain all kinds of new information about their customers, and IT makes it easy to slice and dice this data in a thousand different ways to produce a welter of marketing options. Yet none of this is a substitute for the skills of the classic marketer and general business manager—or for simple, sound business insight. Hertz, USAA, and Nordstrom are successful because they understand their customers, competitive position, and profitability, and they have figured out practical ways to gather information and act on it quickly.

Most are not so successful. Many retailers offer discounts, rebates, or goods if customers present loyalty cards at every purchase, yet they fail to use the resulting information to tailor their offerings to individual customers’ tastes, buying patterns, or value to the company. In the United Kingdom, the grocery industry appears to be rushing to introduce loyalty card schemes at a cost that could reduce industry profitability by as much as 20 percent. Their challenge will be to do more than just create the electronic equivalent...
of the green stamps of the 1970s, giving away margin in a way that any competitor can readily match. They will have to generate real benefits.

Banks often pay lip service to the idea of a customer-driven approach, yet they continue to base their marketing on product lines, rather than customer segments. Ninety percent of US banks with assets over $1 billion have some sort of marketing customer information file, and many are using it for direct mail purposes. But few are building competitive advantage by continuously refining differentiated product offerings and targeting them to customers or prospects for whom they will create real value. The avalanche of cut-rate credit cards cascading into mailboxes may make financial sense in terms of expected take rates, but in many cases their undifferentiated approach and mass-market coverage are unlikely to build profitable, sustainable customer relationships.

Auto makers seem unable to wean themselves off mass advertising and universal rebates, even though the huge choice of vehicle types and five-year purchasing cycle mean that less than 1 percent of the people seeing these messages are actually in the market for a particular vehicle in any given month.

In sum, companies in many industries are investing heavily in “database marketing,” yet they are failing to address the key elements needed to create value for customers and have true impact on their business. Many create “most valuable customer” programs, but neglect to change the behavior of front-line employees. Others succeed in making individual marketing campaigns more effective, but fail to convert responses into long-term customer relationships. A few never even get around to running CRM programs, because their IT folks believe they are always at least 18 months away from having the necessary systems capabilities.

Why have so many companies had such difficulty turning the promise of CRM into bottom-line results? The reality is that despite floods of articles and conferences about database marketing that are enough to overwhelm the most eager learner, the techniques are still new and still under development. Notwithstanding the hype, what is lacking is a synthesis of key success factors. Without it, newcomers to CRM make many common mistakes and fail to capture its potential. We hope to help by pulling together here insights from a variety of industries and experiences.

**Strategic lessons**

While CRM can certainly enhance marketing programs, excitement over higher pull rates or stronger cross-sell ratios often obscures its ultimate
objective: creating sustainably superior marketing strategies that build shareholder value. Successful companies follow several simple rules:

Use the information you gather to serve your customers better, particularly in areas where you can provide distinctive offerings and build loyalty over time. Winners in US personal insurance such as GEICO and Progressive excel at using customer data to segment risks more effectively. GEICO uses direct marketing techniques to reach motorists who are truly low risk, targeting them for insurance that is 15 to 20 percent cheaper than competing offers. Progressive has finely segmented the ranks of high-risk motorists to offer unique value to narrow groups that are not as high risk as others believe. Neither company is simply slashing prices to get business.

Focus on the true value drivers in your business. Every industry has two or three key factors that determine customer value. In telephony, for example, these are the average monthly margin, how long someone remains a customer, and the acquisition cost. Effective CRM balances all three. Low acquisition costs are not necessarily the object; if doubling them funds more targeted efforts that bring in customers who are heavy users or who have low cancellation rates, the extra investment may well be justified. Conversely, cheap offers that attract customers who quickly defect are no bargain. Similarly, leading credit card players such as Capital One have learned that encouraging existing customers to increase their charge volume can produce much higher returns than attracting new cardholders.

The various drivers can be synthesized in an explicit customer lifetime value (CLV) calculation. Whereas product marketers value an individual product sale, CLV sums the profitability of individual purchases to arrive at current customer value, and then factor in time to reflect the importance of customer retention and changes in spending. This approach may also uncover unusual sources of long-term value such as customers who bring in new business, and it allows marketers to invest in capturing this value.

CRM is most effective when it concentrates on building relationships with customers who offer attractive lifetime value. While this often means capturing those with high annual revenues and profitability, successful businesses can also be constructed around less obviously attractive customers who have yet to consolidate their value with any one company and are willing to do so in return for modest incentives. Providian Bancorp has grown profits 20 percent per year for the last decade by offering high rate credit cards to customers that others thought were unattractive.
Build customer relationships, not just databases. This means using data to identify actions that will affect value drivers. Arthur Hughes, a noted CRM expert and a loyal Chrysler buyer, once sent a note to CEO Lee Iacocca complaining that he never saw any evidence that the company knew he existed. Several weeks later, he received a call from a Chrysler manager who was pleased to inform him that he was on its Unix database. The manager had missed the point: the database meant nothing unless it was used to build a stronger relationship with the customer.

Be willing to treat customers differently. Many companies fail to treat some customers better than others despite value ten or even a hundred times greater. The airline industry has avoided this trap by creating multi-level frequent flyer programs, dedicated ticket reservation lines, priority upgrades, and so on. American Airlines gives its flight crew a list of every platinum or gold customer on the plane, along with their seat numbers. In the credit card business, it is possible to reduce cost and improve collection and customer retention by segmenting late payers. Thus, a good risk might receive a polite reminder; an habitual but dependable late payer might have his or her reminder delayed; and a poor risk might get a strongly worded letter only a few days after the due date.

Compete with skills, not capital. Leading-edge CRM practitioners recognize that sustainable competitive advantage is based on skills: understanding customer behavior by analyzing data, identifying ways to serve customers better by testing and evaluating a range of options; and, above all, building relationships with customers. USAA feels so secure in its skill-based advantage that it is willing to discuss its methods with others – confident, as one senior manager put it, that nobody else could extract so much value.

Organizational hurdles

The greatest obstacles, in our experience, are organizational. True CRM requires delivering value to customers in ways the organization does not expect. Most companies have entrenched beliefs and approaches that create obstacles which must be explicitly addressed (Exhibit 2):

Make senior leaders the champions of change. CRM inspires the same fears that any major change can evoke – concerns about performance, the “ownership” of business functions, and perceived inadequacies when new
skills are required. Traditional marketing departments feel threatened because product managers are losing autonomy to customer managers. Advertising managers feel uneasy when micro-marketers talk in terms of hundreds of targeted offers. The IT department is apprehensive about more flexible approaches to data capture. Financial people are skeptical of efforts to estimate probable lifetime customer value.

In such situations, the best way to start is with highly visible and symbolic actions by the leadership team: personal appearances at key meetings, a constant focus in internal communications, the introduction of new performance measures such as retention rate, and so on.

One major department store chain looking to introduce CRM plans to scale down its traditional practice of announcing its sales in newspapers. Since many staff believe these mass promotions have worked well in the past, the senior team has had to go to great lengths simply to try out a new approach.

Emphasize the customer dimension in marketing. Many marketing organizations possess a product orientation that makes CRM a difficult fit. One major personal financial services firm discovered that its financial planning service, currently paid for by clients, acts as a terrific lead product for building total customer profitability because it promotes broader and

<table>
<thead>
<tr>
<th>From</th>
<th>To</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy</td>
<td>Market to major customer segments</td>
</tr>
<tr>
<td>Shared values</td>
<td>Serve customers well</td>
</tr>
<tr>
<td>Structure</td>
<td>Product orientation with focus on current period economics</td>
</tr>
<tr>
<td>Skills</td>
<td>Analytical orientation toward major segments and their collective behavior over long periods</td>
</tr>
<tr>
<td>Staff</td>
<td>Marketing analysis managed statically; information technology acts as support, but not as an active partner</td>
</tr>
<tr>
<td>Systems</td>
<td>Detailed, segmented, but relatively static decision support tools</td>
</tr>
<tr>
<td>Style</td>
<td>Marketing plan orientation with emphasis on programs for major segments delivered within standard period; mass media focus Leading measures of success: • Market share • Current period profits • Period-based marketing programs</td>
</tr>
</tbody>
</table>

Exhibit 2

Changing the organization
deeper product holdings. However, the manager of this service is evaluated on her P&L, which rules out the more profitable strategy of pricing the service more cheaply, or even giving it away.

Superb CRM practitioners adopt a customer-driven perspective. Direct mail marketers already have organizations that put customers at the center of things. Department stores, by contrast, have a strong product orientation and will undoubtedly encounter difficulty in adopting a CRM focus.

These are not changes that an organization can engineer overnight. The process is a slow one, and begins with educating your people about the importance of a customer orientation. With product-focused businesses, this will involve introducing new profitability and retention measures. One high-end retailer rewarded a sales assistant who went not only outside her department but outside the store to get a customer the right accessories for her outfit. Among airlines, American and United give their top customers thank-you certificates that they can give to employees for which they receive gifts and rewards. Since platinum, gold, or premier status is clearly identified on reservation records, boarding passes, and flight manifests, employees are encouraged to treat these customers well.

**Drive CRM through a crossfunctional approach.** The narrower elements of CRM – improving direct mail promotions, say – can be handled within individual functions. However, broader programs, especially those that call for front-line behavior change, will not happen without the involvement of a crossfunctional project team.

Imagine how much less impactful Hertz’s #1 Club Gold offer would have been if only marketing had been involved. The best customers might still have received extra mailings and discount coupons, but would operations have been rebuilt to save customers going to a counter, and to provide covered pickup spots that identify users by name? Both these initiatives required strong crossfunctional cooperation.

**Combine analytics with creativity.** Analytics and information management are vital, but they must focus on developing and exploiting insights into customer behavior. Since few individuals possess the required mix of analytical ability and creativity, teams will again be needed.
In most credit card companies, marketing and credit underwriting are separate departments, often at odds with one another. Credit has sophisticated modeling skills and an analytical mentality it sometimes uses to set arbitrary bad debt limits that cause the loss of profitable customers. Marketing generates creative ideas about how to attract, grow, and retain customers, but it cannot easily assess the impact of bad debt on customer value, and frequently makes the mistake of assuming that any customer is worth having. Some institutions have closed this gap by bringing marketing and credit underwriting together in one group with a shared mission: to maximize profitability by using statistics to optimize the balance of revenues and bad debt, and creativity to pull in newly attractive customers.

**Outsource where appropriate.** Many established organizations are biased against outsourcing, especially where systems are concerned. Yet such key elements of CRM as data management can be handled quite effectively by expert providers.

Outsourcing will be risky, however, if it involves compromising access to proprietary and strategic knowledge, or if institutional memory is important. This is particularly true of analytical capabilities; unique insights into drivers of consumer behavior should be jealously guarded. In such cases, companies need either to retain internal resources or to negotiate strict confidentiality and noncompete agreements with vendors.

**Create a learning organization.** Traditional packaged goods marketers have always viewed learning as a crucial skill. Because they have direct contact with consumers and use sophisticated information technology, CRM marketers are able to conduct much deeper testing programs that take this learning to new levels. Tests usually involve dozens if not hundreds of options, the results of which are rigorously tracked and analyzed to uncover the drivers of consumer behavior. This is not an isolated activity, but part of a continuous feedback process.

The net result is marketing that delivers much higher returns on investment. One leading direct marketer receives response rates up to ten times the industry average. How? First, it has figured out what to send to whom. Second, it has learned how best to promote its offer to these customers. And third, it knows when to do it. The company uses the same process during
product development, sending prototypes to core customers to gauge their reactions and using this feedback to create more desirable products.

IT lessons

While IT plays a vital role in making CRM happen, it must be driven by a general management perspective. Too often, companies seeking to build CRM capabilities start by designing a powerful IT system. They would do better to begin by articulating likely profit drivers and key behavior to produce a shortlist of data requirements, and then identify appropriate systems tools.

One of the main causes of oversized and underproductive IT budgets is the failure to recognize that four separate IT elements are required for CRM. These are: a marketing database; analytical tools; implementation management coordinators; and links to operating systems. Understood individually, they can be created and integrated more effectively.

Create a separate marketing database. A dedicated marketing database will pull key data from several operating systems (such as a retailer’s transaction system or a bank’s deposit system) and consolidate it with information from external sources, such as census demographics. Trying to use an operating system as a marketing database results in costly, incomplete, and inflexible CRM systems and constrains marketers’ access to the data due to conflicts with operating requirements.

USAA has always had the mission of serving the financial needs of its customers (active and retired military officers) and selling as much as possible to each customer, rather than trying to sell to as many people as possible. Fulfilling this mission is enabled by its dedicated marketing database, an integrated source of customer data, both behavioral and demographic, that is easily (and therefore frequently) accessed by marketing managers.

Let hypotheses, not tools, drive analysis. Depending on the size of your marketing database, your analytical tools may or may not require a separate system. In any event, the aim is to direct analysis by using informed hypotheses about a business’s value drivers. While sophisticated techniques exist for analyzing customer databases, basic techniques and sound thinking often reveals opportunities for value creation. What is important in the initial stages is ease of use, ready access, and quick response. If testing every simple hypothesis against the data turns into a mini IT project, your marketer’s creativity will be cut off at the knees.
Consider the difficulty of analyzing phone bills so as to segment customers: the variables are almost infinite, particularly for heavy users. Undirected data mining might take forever. One long-distance company hit upon the idea of mining its database for customers who did their calling just before rates rose in the morning and straight after they fell in the evening. This created the opportunity to direct cheap offers to this price-sensitive segment while avoiding customers who, though happy to have the savings, would neither change their behavior nor become more loyal to the company.

Create an interactive conversation with customers. This calls for systems that pull together all the various marketing activities for any individual customer. Such systems use predetermined rules and the results of previous efforts to inform decisions about what approach to try next. They also measure the effectiveness of initiatives so that marketers can learn what works and what doesn’t.

The objective is to exploit technology to learn from the complex sequence of customer interactions – perhaps across several different channels – so that customers will perceive these interactions as a tailored dialogue, not an unrelated series of sales pitches. Customers of First Direct, a UK direct bank, find it refreshing when telephone service representatives ask if they have received the credit application they requested by mail a week earlier. They may not expect integrated communication, but they enjoy it, and are likely to respond.

Tailoring and integrating offers brings a further benefit: you interact more often with your customers, and you can sell them more. Fingerhut sends its best customers over a hundred mailings a year. Another leading direct marketer is so skilled at identifying the right product sequence to offer its customers that it has increased and captured the bulk of their category purchases.

Link support systems to operating systems. Marketing systems must be linked to operating systems in a thoughtful manner. Not all data need to be available in real time all the time, and customer profiles do not have to be updated instantly. But enabling an organization to respond to customer-specific events (such as a large deposit in a checking account at the end of the year) and find out about recent changes in customer or prospect status (a telemarketing prospect who purchased the product you are trying to sell

from a branch yesterday) can be critical requirements for a marketing database. Managers must be guided by their insights into value drivers in reconciling the inevitable tensions between speed, cost, and timeliness.

Operating systems links must also be interactive. CRM depends on two-way internal communication; it is not enough simply to upload relevant data and use it to analyze, score, and promote to customers. The link must allow critical information to be fed back to operational systems. Real impact can be achieved by putting a few basic facts in the hands of frontline personnel and encouraging them to use this information in their everyday work.

Start small, and demonstrate value before making large investments. Established practitioners of CRM often spend tens of million of dollars a year on IT, but early on, companies can usually build substantial capability without spending more than $2 or $3 million. Don’t pour money down the drain.

Consider how MCI tested its successful Friends and Family program. It filled a room with clerks who calculated each bill individually. Efficient? Hardly. Effective in helping the company assess the value of a systems redesign? Very! And MCI got a new idea on the market much more quickly than it could have done through a systems redesign. Even when the business case for a new system is clear, creating the desired capabilities need not break the bank. One retailer at the forefront of CRM uses Sun SPARC workstations that cost $400,000 to develop and begin running programs that market to tens of millions of customers and has demonstrated the ability to raise profits by over 30 percent among its best customers.

Operating insights

A CRM program has multiple components, which all operate simultaneously, and each of which has its own set of best practices (Exhibit 3). While each component is important in its own right, the key to using CRM to drive high-performance marketing is the ongoing nature of the process. Successful practitioners offer a few important lessons:

Real impact can be achieved by putting a few basic facts in the hands of front-line personnel and encouraging them to use it

---

**Exhibit 3**

Key components of the CRM process

1. Collecting information on current and prospective customers (purchase history, program responses, demographics)
2. Conducting customer analysis (behavior segmentation, response modeling, definition of trigger actions or events, rigorous economic evaluation)
3. Designing and developing marketing programs (proactive and responsive)
4. Designing and implementing statistically valid tests
5. Managing program execution (multi-product, multi-channel, responsive inbound activity, proactive outbound activity)
6. Conducting continuous, rigorous measurement and analysis of results (collection, economic analysis, needs and behavior analysis)
You are no better than your data – and data can be pretty bad. It will take money and effort to maintain the quality of your database. Every year, twenty percent of North American households move, for instance, while virtually all families experience events that change their economic value, including marriage, divorce, the birth of a child, and income fluctuations. Tracking and using this information can make the difference between success and failure.

Maintaining accurate records can be difficult. Companies that create strong relationships with their customers often find this task easier. USAA gets its customers to update their details by sending out simple questionnaires with no incentives attached. Such is customer loyalty that it achieves a response rate of up to 70 percent.

Once the value of information is clear, companies can justify spending more money to collect data. Many retailers give customers a big discount on their first purchase of selected items if they sign up for a store card. Though expensive initially, this is worthwhile if it allows the company to identify and market to valuable prospects; if not used to do so, this expense is likely to be a drain on profits.

Focus the analysis on behavioral data. Not surprisingly, the best predictor of future behavior is past behavior, such as an individual’s transaction history. Such information is normally far more important than detailed demographic data because demographics are rarely indicative to customer needs. All the same, a few critical demographic triggers do exist. In the US auto market, no behavioral information about past car purchases is anything like as accurate a predictor of a household’s likelihood of buying a minivan as a single piece of demographic data: the imminent birth of a third child.

Never stop testing. CRM is about continuous learning, not finding the “right” answer. No matter how much insight they have, managers will never get it right the first time. Answers emerge gradually, and keep improving. Companies that do not realize this may abort a program prematurely because they are seeking a one-shot answer. Leading companies use pilots and skunkworks to pioneer learning in a cost-effective manner. They are guided by a pragmatic desire to do things better, while avoiding the temptation to reach for perfection. They also recognize the value of
institutional memory, keeping their best people in one place long enough to have real impact.

Industry pioneers have discovered that CRM is both a tool and an organizational philosophy. Our lessons reflect the simple truth that excellence in marketing has always flowed from understanding how to deliver what customers need – profitably. While CRM can be used as a tool to improve marketing impact, its real power is as a lever to help businesses expand by acting on insights about customer needs. It requires both creativity and rigor. Realizing this power is a major organizational challenge. It requires a new approach to integrating marketing and IT. In short, it requires leadership of change. That is the biggest single lesson from the continuous relationship pioneers.