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## **Meet the MasterMinds: Don Peppers and Martha Rogers Know the Real Value of Customers**

Business strategists Don Peppers and Martha Rogers are founders of the Peppers & Rogers Group and coauthors of seven books, including [Managing Customer Relationships](#), [The One to One Future](#), and [Enterprise One to One](#).

Their most recent book, [Return on Customer: Creating Maximum Value from Your Scarcest Resource](#), presents a new way to measure the long- and short-term value created by a company's most important asset—its customers.

### **MCNews: Let's begin with some definitions. What is Return on Customer?**

**Peppers:** We define Return on Customer in terms of the total value created by a customer. Start with the sales you generate from a customer in the current period, and add any increase or decrease in the customer's lifetime value during the period. Then, divide that total by the customer's lifetime value at the beginning of the period. This is just like ROI, but we're talking about customers rather than capital.

We know that a customer's lifetime value can change today as a result of today's actions. If you treat customers really well and their lifetime value goes up, that action creates value for your company, even though you don't collect cash for that until sometime in the future.

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But just because you don't collect the cash until later doesn't mean you haven't created value today. If your CEO announced today that you expect higher earnings two years from now, your stock would go up today. Return on Customer is based on that principle—that the actions you take now create value now.

### **MCNews: Can you briefly define what you mean by a customer's lifetime value?**

**Peppers:** Sure. A customer's lifetime value is the net present value of the future stream of cash flow attributable to all of a customer's behavior, both positive and negative.

For any operating company, all cash flows come from customers. If you add up all the cash flows from your current and future customers, you have the cash flow of the company. The sum of the

lifetime values of all current and future customers is a quantity that Martha and I call customer equity, and it is virtually equal to the discounted cash flow of an operating company.

**MCNews: So is the lifetime value approach to company value similar to the discounted cash flow (DCF) analyses used to evaluate investments?**

**Rogers:** It's not really that different, but it may be more reliable. When you calculate the cash flow from a particular investment, usually you're working with aggregate figures. You look at market conditions, and you make estimates, forecast trend lines, and so forth.

You may base your discounted cash flow analysis on a dozen or maybe a few dozen data points. The decisions you make using DCF could impact thousands or perhaps millions of customers.

But if you're tracking the lifetime values of those customers, you don't use just a few dozen data points. You literally have thousands or millions of data points. That calculation is a lot more stable, a lot more dependable.

Assuming that you understand lifetime value and have some experience using it, at a very minimum, it gives you a way to check the cash flow figures you came up with using general trend lines.

Focusing exclusively on return on investment may be driving less than perfect decisions. That opens up a whole new way of thinking about the challenges a Chief Marketing Officer faces.

**MCNews: Can you give us an example of how to use the Return on Customer approach?**

**Rogers:** There are many applications. For instance, we think Return on Customer is helpful in thinking about broad financial strategies, including mergers and acquisitions. Let's say one phone company is deciding whether to buy another. Of course, they look at the customer list, but they focus mostly on the infrastructure—how much wire is underground, how much is overhead, how many trucks do they have, how many phone numbers are in service?

Instead, we find it's more useful to figure out the Return on Customer at both the parent company and the target company. Then, we determine if the Return on Customer for the combined company would be higher or lower than that of the individual companies.

**MCNews: Are many companies currently using the lifetime customer value model?**

**Peppers:** According to most surveys, only about 20-25% of companies make any attempt to measure lifetime customer value.

**Rogers:** More importantly, some of the measures that are in use can paint a false picture. Some companies correlate customer equity directly with satisfaction scores. Although customer satisfaction can help determine lifetime value or even customer equity, it certainly is not something we like to rely on all the time.

**Peppers:** Yeah, you're feeling the tail to deduce that it's an elephant.

**MCNews: In general terms, how do you determine the lifetime value of a customer?**

**Rogers:** Instead of reporting where you've been, we predict where you're going to be. We don't just look at the past—how much your earnings were this quarter, or what your same source sales were for the past quarter as compared to the same period last year. We want to know how much your customer base is going to be worth.

We hold people accountable not only for current revenues but also for the changes today in the future value of customers. That's a very significant metrics breakthrough.

We rely on four measures, or leading indicators, and combine them in a way that works for a particular company and is justifiable. The four leading indicators help us understand how much your customers will be worth tomorrow. And, by the way, that includes your current customers and also the customers you don't have yet.

We use the right combination of variables and weight them properly to see where you're going. We think the most important variables are behavioral, life stage, attitudinal, and then the usual measures such as churn rate, share of customer, and others.

**Peppers:** The leading indicators point to the right financial answer. And that is a financial justification for the principle we started out with: to create the maximum possible value for shareholders, companies ought to concentrate on creating maximum possible value from their customers.

**MCNews: Do the leading indicators influence a company's customer practices?**

**Peppers:** Customers are the productive resource. I can push a customer to try to get him to buy now, please buy—here, how about some money off? The more I do that, the more likely I am to damage his long-term value. And yet at the same time, I do need to harvest some money from him today. I can't live just on future value.

It's a balancing act—like farming. Do I replenish the land, practice conservation, and keep the land productive for many years? Or do I plant cash crops on every acre every year and burn my land up? Most farmers don't do the latter because that's stupid. They know that the land is a scarce resource for a farm just like customers are a scarce resource for businesses.

**MCNews: So is there an optimum balance between short-term, aggressive marketing and long-term value creation?**

**Peppers:** That balance is different for different customers. You have to optimize for each customer.

Is there a single criterion you could apply that would make it appropriate for each customer? Perhaps it would be this: Any given customer is going to create the most value for your business at about the time he's thinking that your business creates the most value for him.

Of course, you must have the right product, price, and service. But assuming that price, service, and quality are on a par with your competitors, whom do customers prefer to deal with? They prefer to deal with companies they trust. What customers really want is a company they can trust to act in their interests.

Research confirms this, but it's only logical. If I think you're acting in my interest, then I'm going to want to deal with you more, not less. Every time I deal with you I benefit.

So this leads us to a very basic argument: If you want to maximize Return on Customer, you have to create a culture in your organization designed around earning and keeping your customer's trust. And keeping that trust may mean giving up short-term opportunities for gain.

Perhaps refusing a refund is a short-term opportunity for gain that might destroy long-term value. Maybe an overly aggressive sales approach leads to long-term value destruction.

**MCNews: Isn't the pressure on executives to produce short-term earnings so great that they often sacrifice long-term value to achieve those earnings?**

**Rogers:** Yes. They know they're in a vise and they come up with all sorts of non-financial metrics—things like the balanced scorecard—to solve the problem.

Duke University ran a study and found that of the 400 senior executives who were interviewed, more than 75% of them said that, if it would help produce the earning they needed this quarter, if it would help them get the results that Wall Street demands, then they would be willing to give up economic value of their companies.

Now that's appalling because, in theory, that short-term reporting is supposed to be for the shareholders' benefit. When high-level executives admit they would be willing to give up economic value to improve performance for this quarter, that's not good for shareholders. But that's what we've driven everyone to.

We'd all be better off if those executives used a measure that would give them credit for the numbers that they make this quarter but, at the same time, hold them accountable for how much of the company's real value they had to use up to achieve those earnings.

**MCNews: If you had just one piece of advice for an executive embarking on a Return on Customer journey or process, what would it be?**

**Peppers:** Martha and I might have different answers. I would say that it depends on the type of company we're talking about. If a company doesn't have great data, systems, modeling or statistical capabilities—if they have to work hard just to get any customer numbers—I would say focus on the philosophy of earning customer trust first.

Change your organization so that you put the customer truly at the center of it, and then adjust the metrics as and when you can get the data. For data-rich companies, I would suggest that they try measuring Return on Customer and begin holding people accountable for it. What do you think, Martha?

**Rogers:** We've had clients who said something like this to us: We don't know how long it will be before Wall Street starts demanding that we measure Return on Customer and, of course, we want to be ready when it comes. But we'll just be a better company if we put this in place.

**“Even before it's demanded by Wall Street, Return on Customer will help us make better decisions about the kind of company we need to be.”**

Even before it's demanded by Wall Street, Return on Customer will help us make better decisions about the kind of company we need to be. We'll have a better business model and our people will be better. We'll be able to balance short-term with long-term issues and hold people accountable for the right things.

**MCNews: Thanks to both of you for your time. It's a great concept.**

Find out more about Don Peppers and Martha Rogers at [www.1to1.com](http://www.1to1.com) and at [www.returnoncustomer.com](http://www.returnoncustomer.com).