MANAGING CUSTOMERS AS INVESTMENTS: THE STRATEGIC VALUE OF CUSTOMERS IN THE LONG RUN

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Back in the late 1980s, while serving as a kind of sorcerer's apprentice at the marketing department of a large business school, I helped run a telephone survey of CEOs asking them how they were responding to the tough competitive climate. One respondent, the CEO of a plastics manufacturing company, told me that he and his board were responding by cutting out all unnecessary costs. Could you give me an example? I asked. "Well," he responded, "for a start, we've just closed the entire marketing department."

During the 1990s, marketing departments fought hard against this sort of attitude, and even established a kind of dominant paradigm in which it was customary to describe one's business as being marketing-led (rather than market-led, which is not quite the same thing). But since the millennium, marketing departments have come under new pressure to justify themselves.

Partly, this is marketing's own fault. Marketers have had some spectacular failures, not least during the dot-com boom when they promised that "Internet marketing" would "revolutionize" customer relationships. It didn't, and hundreds of companies with badly thought-out business models collapsed. More recently, concepts such as customer relationship management (CRM) have become widespread, with tens of millions, even hundreds of millions ploughed into CRM programmes. Too late, executives have realized that they have no way of measuring the return on this investment, or even proving conclusively if there is any return at all. In dark corners, senior finance execs are beginning to grumble that maybe closing the marketing department is not such a bad idea after all.

The response has been a series of attempts to provide metrics and methods of quantification that marketers can use. *Managing Customers as Investments*, by two senior figures from Columbia Business School, is the latest such attempt. It is also one of the best. It starts from the very simple premise that no business can exist without customers, and therefore the customer ought to be at the center of the business model. Very few senior executives would disagree with this premise in theory. In fact, however, many companies behave as if this were not so, as if customers were not only *not* the top priority, but in some cases barely in the top five.

In order to square the circle, the authors develop on the concept of the "lifetime value of a customer" (LVC), or in other words, the estimated present and future value of all profits generated from a particular customer. As the authors point out, LVC is not a new approach, and there is a substantial literature on the subject. However, most previous concepts of LVC and methods of its calculation have been highly

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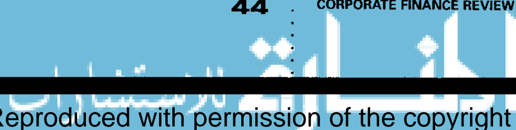
technical, even arcane, and mostly confined to the darker areas of market research.

However, the authors argue, a simple and easy-to-use method of calculating LVC will have two benefits. First, it will help marketing executives themselves better understand the relationship between marketing expenditure and the value of the company; second, it will help finance executives make the link between the value of customers and the value of the company. Both parties, and indeed everyone else in the company, should then have a clearer idea of what is going on, which customers are most valuable and which least, where the profits of the business are actually coming from and will come from in the future, and a host of other useful things besides. Chapters 3 and 4, the heart of the book, are devoted to explaining how to calculate the lifetime value of a customer, and how to use the resulting information.

All of this is highly laudable, of course. One of the major causes of friction and misunderstanding during strategy and decision-making processes is the fact that different parties from different functions often tend to speak in different languages. Developing a common metric that can be used equally by both finance and marketing departments should ensure that all parties are singing from the same hymn sheet. More information—and more information presented in a commonly understandable format—is crucial to good decision making. If marketers know where their budget is going, and finance executives know where their revenue is coming from, and both are pretty much agreed on both points, then that can only be a good thing.

Caveats are essential, of course. LVC is pretty good at predicting the present value of a customer, but extrapolating from that to predict future value is an altogether more chancy thing. Customer trends and moods change quickly and unpredictably and cannot be easily factored into such models. Also, the quality of calculation of LVC is entirely dependent on the quality and quantity of information gathered before the calculation is made. Marketing executives, who are usually the ones who calculate LVC, should be required to show their work: what assumptions were made, what data was gathered and analyzed, during the calculation? Assumptions in particular should be questioned at every point.

As a method of linking customer value to company value, this is pretty good. It does not take the heat off the marketing function entirely, of course, but then that can be a good thing. Marketing departments, like every department—yes, even including finance departments—should have their activities scrutinized at every step. For some forms of marketing expenditure, notably advertising, it remains very difficult to calculate the return on investment with absolute accuracy, and probably always will. But this is a good first step. The simplified LVC concept described here provides a way of linking marketing expenditure, customer value, and firm value under one umbrella, and should provide a useful platform from which to make decisions and think about strategy. It is not a magic bullet, but it is a very useful tool. ■



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