

2.3: Knowing your customers

LEARNING OBJECTIVES

1. Understand that in order to provide customer value, firms must be able to listen to the voice of the customer.
2. Comprehend that businesses must attempt to identify those customers' needs that are not being met by competitors.
3. Understand that businesses should segment their customers to better meet their needs.
4. Understand that businesses should consider the lifetime value of their various customer segments.
5. Understand that although some businesses can create products and services based on their intuitive insights, others need to conduct careful analyses.
6. Comprehend that new product or service development requires that organizations support creativity and innovation.

The perceived value proposition offers a significant challenge to any business. It requires that a business have a fairly complete understanding of the customer's perception of benefits and costs. Although market segmentation may help a business better understand some segments of the market, the challenge is still getting to understand the customer. In many cases, customers themselves may have difficulty in clearly understanding what they perceive as the benefits and costs of any offer. How then is a business, particularly a small business, to identify this vital requirement? The simple answer is that a business must be open to every opportunity to listen to the **voice of the customer (VOC)**. This may involve actively talking to your customers on a one-to-one basis, as illustrated by Robert Brown, the small business owner highlighted at the beginning of this chapter. It may involve other methods of soliciting feedback from your customers, such as satisfaction surveys or using the company's website. Businesses may engage in market research projects to better understand their customers or evaluate proposed new products and services. Regardless of what mechanism is used, it should serve one purpose—to better understand the needs and wants of your customers.

Video Clip 2.3.1:

Robin Lawton—Voice of the Customer—What Do Customers Value?



International Management Technologies introduces Robin Lawton on the topic of “What Do Customers Value?”

Video Clip 2.3.2:

Robin Lawton—Voice of the Customer—Basis for Satisfaction Keynote



The customer-centered organization begins the transformation process by understanding how to uncover and understand the VOC.

Research

The chapter on "Marketing Basics" of this text will focus on the topic of marketing for small business. Naturally, it will include significant materials on the subject of market research. In this section, the focus will be on how a business may gain better insight into what constitutes the benefits and the costs for particular customers. It will take a broad view and leave the details of market research for "Marketing Basics".

Good research in the area of customer value simply means that one must stop talking to the customer—talking through displays, advertising, and/or a website. It means that one is always open to listening carefully to the VOC. Active listening in the service of better identifying customer value means that one is always open to the question of how your business can better solve the problems of particular customers.

If businesses are to become better listeners, what should they be listening for? What types of questions should they be asking their customers? Businesses should address the following questions when they attempt to make customer value the focus of their existence:

- What needs of our customers are we currently meeting?
- What needs of our customers are we currently failing to meet?
- Do our customers understand their own needs and are they aware of them?
- How are we going to identify those unmet customer needs?
- How are we going to listen to the VOC?
- How are we going to let the customer talk to us?
- What is the current value proposition that is desired by customers?
- How is the value proposition different for different customers?
- How—exactly—is our value proposition different from our competitors?
- Do I know why customers have left our business for our competitors?

Who Your Customer Is—and Is Not

At the beginning of this chapter, it was argued that your central focus must be the customer. One critical way that this might be achieved is by providing a customer with superior value. However, creating this value must be done in a way that assures that the business makes money. One way of doing this is by identifying and selecting those customers who will be profitable. Some have put forth the concept of **customer lifetime value**, a measure of the revenue generated by a customer, the cost generated for that particular customer, and the projected retention rate of that customer over his or her lifetime. Jack Schmid, "How Much Are Your Customers Worth?," *Catalog Age* 18, no. 3 (2001): 63. Jonathon Lee and Lawrence Feick, "Cooperating Word-of-Mouth Affection Estimating Customer Lifetime Value," *Journal of Database Marketing and Customer Strategy Management* 14 (2006): 29.

This concept is popular enough that there are lifetime value calculator templates available on the web. The Harvard Business School created the calculator used in Exercise 2.1. It looks at the cost of acquiring a customer and then computes the **net present value** of the customer during his or her lifetime. Net present value discounts the value of future cash flows. It recognizes the time value of money. You can use one of two models: a simple model that examines a single product or a more complex model with

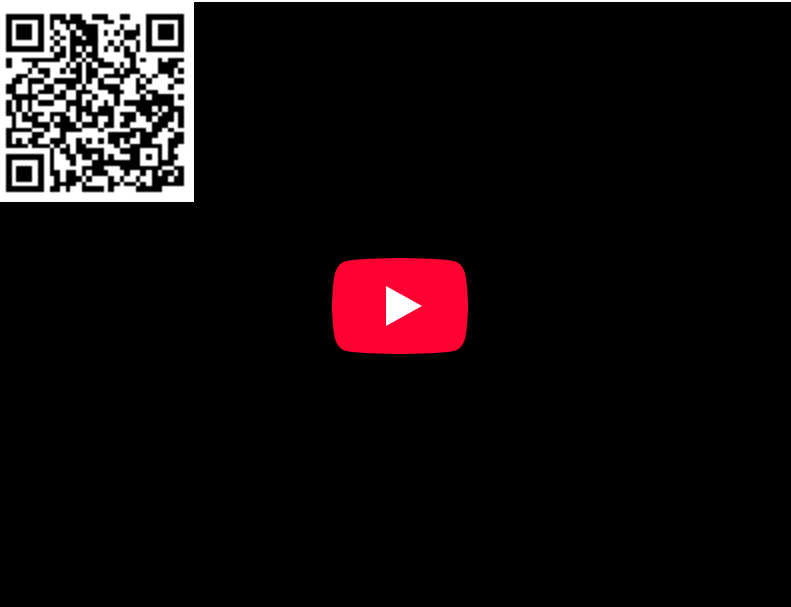
additional variables. One of the great benefits in conducting customer lifetime value analysis is combining it with the notion of market segmentation. The use of market segmentation allows for recognizing that certain classes of customers may produce significantly different profits during their lifetimes. Not all customers are the same.

Let us look at a simple case of segmentation based on behavioral factors. Some customers make more frequent purchases; these loyal customers may generate a disproportionate contribution of a firm's overall profit. It has been estimated that only 15 percent of American customers have loyalty to a single retailer, yet these customers generate between 55 percent and 70 percent of retail sales. "Loyalty Promotions," *Little & King Integrated Marketing Group*, accessed December 5, 2011, www.littleandking.com/white_papers/loyalty_promotions.pdf. Likewise, a lifetime-based economic analysis of different customer segments may show that certain groups of customers actually cost more than the revenues that they generate.

Having segmented your customers, you will probably find that some require more handholding during and after the sale. Some customer groups may need you to "tailor" your product or service to their needs. "Determining Your Customer Perspective—Can You Satisfy These Customer Segments?," *Business901.com*, accessed October 8, 2011, business901.com/blog1/determining-your-customer-perspective-can-you-satisfy-these-customer-segments. As previously mentioned, market segmentation can be done along several dimensions. Today, some firms use data mining to determine the basis of segmentation, but that often requires extensive databases, software, and statisticians. One simple way to segment your customers is the customer value matrix that is well suited for small retail and service businesses. It uses just three variables: recency, frequency, and monetary value. Its data requirements are basic. It needs customer identification, the date of purchase, and the total amount of purchase. This enables one to easily calculate the average purchase amount of each customer. From this, you can create programs that reach out to particular segments. Claudio Marcus, "A Practical yet Meaningful Approach to Customer Segmentation," *Journal of Consumer Marketing* 15, no. 5 (1998): 494.

Video Clip 2.3.3:

Customer Lifetime Value



Jack Daly presents the "client for life" concept, featuring Continuity Programs BCL programs of customer loyalty outsourced service.

Video Clip 2.3.4:

Lifetime Customer Value



Patrick McTigue explains how critical the lifetime value of a customer is to your business. He covers some tips to integrate superb customer service into your business model.

What Your Gut Tells You

The role of market research was already discussed in this chapter. For many small businesses, particularly very small businesses, formal market research may pose a problem. In many small businesses, there may be a conflict between decision making made on a professional basis and decision making made on an instinctual basis. Malcolm Goodman, “The Pursuit of Value through Qualitative Market Research,” *Qualitative Market Research: An International Journal* 2, no. 2 (1999): 111. Some small business owners will always decide based on a gut instinct. We can point to many instances in which gut instinct concerning the possible success in product paid off, whereas a formal market research evaluation might consider the product to be a nonstarter.

In 1975, California salesman Gary Dahl came up with the idea of the ideal pet—a pet that would require minimal care and cost to maintain. He developed the idea of the pet rock. This unlikely concept became a fad and a great success for Dahl. Ken Hakuta, also known as Dr. Fad, developed a toy known as the Wallwalker in 1983. It sold over 240 million units. “What Are Wacky WallWalkers?,” *DrFad.com*, accessed December 2, 2011, www.drfad.com/fad_facts/wallwalker.htm. These and other fad products, such as the Cabbage Patch dolls and Rubik’s Cube, are so peculiar that one would be hard pressed to think of any marketing research that would have indicated that they would be viable, let alone major successes.

Sometimes it is an issue of having a product idea and knowing where the correct market for the product will be. Jill Litwin created *Peas a Pie Pizza*, which is a natural food pizza pie with vegetables baked in the crust. She knew that the best place to market her unique product would be in the San Francisco area with its appreciation of organic foods. Susan Smith Hendrickson, “Mining Her Peas and Carrots Wins Investors,” *Mississippi Business Journal* 32, no. 21 (2010): S4.

This notion of going with one’s gut instinct is not limited to fad products. Think of the birth of Apple Computer. The objective situation was dealing with a company whose two major executives were college dropouts. The business was operating out of the garage of the mother of one of these two executives. They were producing a product that up to that point had only a limited number of hobbyists as a market. None of this would add up to very attractive prospect for investment. You could easily envision a venture capitalist considering a possible investment asking for a market research study that would identify the target market(s) for its computers. None existed at the company’s birth. Even today, there is a strong indication that Apple does not rely heavily on formal marketing research. As Steve Jobs put it,

It’s not about pop culture, it’s not about fooling people, and it’s not about convincing people that they want something they don’t. We figure out what we want. And I think we’re pretty good at having the right discipline to think through whether a lot of other people are going to want it, too. That’s what we get paid to do. So you can’t go out and ask people, you know, what’s the next big [thing.] There is a great quote by Henry Ford, right? He said, “If I had asked my customers what they wanted, they would’ve told

me ‘A faster horse.’”Alain Breillatt, “You Can’t Innovate Like Apple,” *Pragmatic Marketing* 6, no. 4, accessed October 8, 2011, www.pragmaticmarketing.com/publications/magazine/6/4/you_cant_innovate_like_apple.

The Voice of the Customer—QFD

Quality function deployment (QFD) is an approach that is meant to take the VOC concept seriously and uses it to help design new products and services or improve existing ones. It is an approach that was initially developed in Japan for manufacturing applications. It seeks “to transform user demands into design quality, to deploy the functions forming quality, and to deploy methods for achieving the design quality into subsystems and component parts, and ultimately to specific elements.”Yoji Akao, *Quality Function Deployment: Integrating Customer Requirements into Product Design* (New York: Productivity Press, 1990), 17. To put it more clearly, QFD takes the desires of consumers and explores how well the individual activities of the business are meeting those desires. It also considers how company activities interact with each other and how well the company is meeting those customer desires with respect to the competition. It achieves all these ends through the means of a schematic; see Figure 2.3.1: , which is known as the house of quality. The schematic provides the backbone for the entire QFD process. A comprehensive design process may use several houses of quality, moving from the first house, which concentrates on the initial specification of customer desires, all the way down to developing a house that focuses on the specification for parts or processes. Any house is composed of several components:

- **Customer requirements (the *whats*).** Here you identify the elements desired by customers; this section also contains the relative importance of these needs as identified by customers.
- **Engineering characteristics (the *hows*).** This is the means by which an organization seeks to meet customer needs.
- **Relationship matrix.** This illustrates the correlations among customer requirements and engineering characteristics. The degree of the correlation may be represented by different symbols.
- **“Roof” of the house.** This section illustrates the correlations among the engineering characteristics and reveals synergies that might exist among the engineering characteristics.
- **Competitive assessment matrix.** This is used to evaluate the position of a business with respect to its competition.
- **“Basement.”** This section is used for assessing the engineering characteristics or setting target values. The “basement” enables participants to instantly see the relative benefits of the activities undertaken by a company in meeting consumer desires by multiplying the values in each cell by the weight of the “why” and then adding the values together.

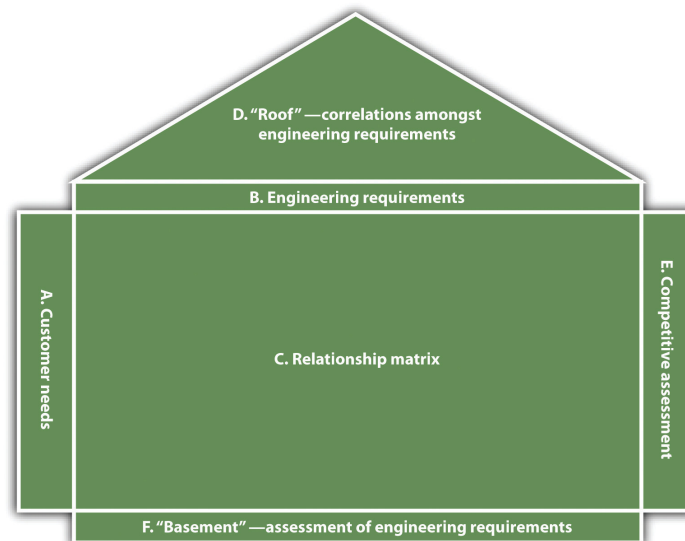


Figure 2.3.1: House of Quality

Although it might initially appear to be complex, QFD provides many benefits, including the following: (1) reduces time and effort during the design phase, (2) reduces alterations in design, (3) reduces the entire development time, (4) reduces the probability of inept design, (5) assists in team development, and (6) helps achieve common consensus. Gerson Tontini, “Deployment of Customer Needs in the QFD Using a Modified Kano Model,” *Journal of the Academy of Business and Economics* 2, no. 1 (2003).

Unfortunately, QFD is most often associated with manufacturing. Few realize that it has found wide acceptance in many other areas—software development, services, education, amusement parks, restaurants, and food services. (For examples of these applications

of QFD, go to <http://www.mazur.net/publishe.htm>.) Further, company size should not be seen as a limitation to its possible application. The QFD approach, in a simplified form, can be easily and successfully used by any business regardless of its size. Glen Mazur, “QFD for Small Business: A Shortcut through the Maze of Matrices” (paper presented at the Sixth Symposium on Quality Function Deployment, Novi, MI, June 1994). Its visual nature makes it extremely easy to comprehend, and it can convey to all members of the business the relative importance of the elements and what they do to help meet customers’ expectations. Figure 2.3.2: illustrates this by providing a simplified house of quality chart for a restaurant.

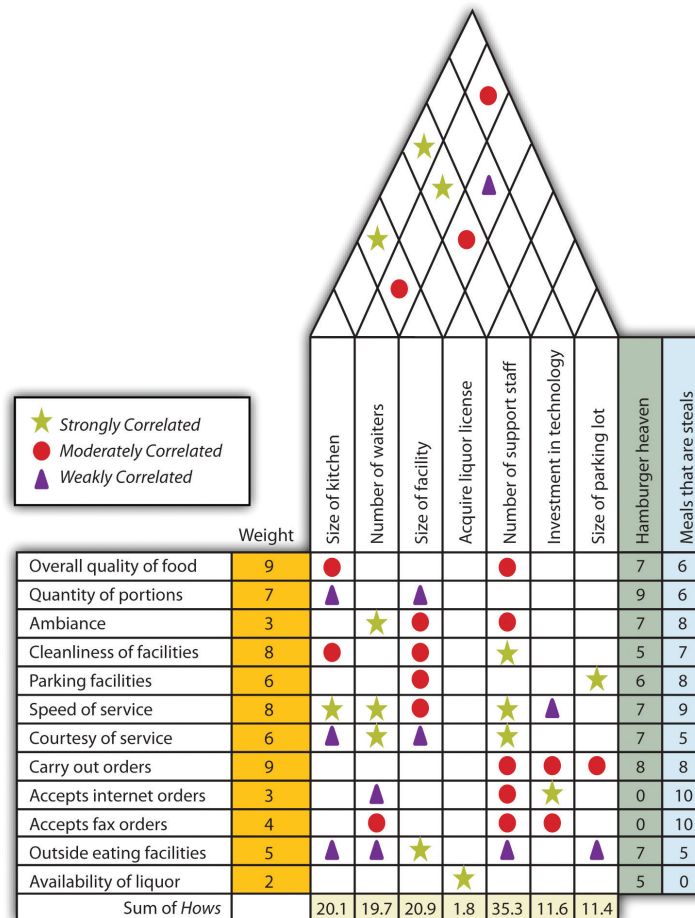


Figure 2.3.2: Simplified House of Quality for a Restaurant

Video Clip 2.3.5:

Quality Function Deployment Tutorial



This gives a brief overview of QFD.

QFD Analysis and Excel

Some companies provide Excel-based software that can assist in conducting a QFD analysis. This shows a template in the QI Macros software to help structure your thinking, making sure nothing is left out. For more information and to download a 30-day trial of the QI Macros, including the QFD template, see www.qimacros.com/six-sigma-articles.html.

How to Become a Better Listener

Although some succeed by listening to their instincts—their inner voices—it is highly advisable to all businesses to be proactive in trying to listen to the VOC. Listening to the customer is the domain of market research. However, it should not be surprising that many small businesses have severe resource constraints that make it difficult for them to use complex and sophisticated marketing and market research approaches. David Carson, Stanley Cromie, Pauric McGowan, Jimmy Hill, *Marketing and Entrepreneurship in Small and Midsize Enterprises* (Hemel Hempstead, UK: Prentice-Hall, 1995), 108. To some extent, this is changing with the introduction of powerful, yet relatively low cost, web-based tools and social media. These will be discussed in greater detail in Section 2.4.2 "Digital Technology and E-Environment Implications" of this chapter. Another restriction that a small business may face in the area of marketing is that the owner's marketing skills and knowledge may not be very extensive. The owners of such firms may opt for several types of solutions. They may try to mimic the marketing techniques employed by larger organizations, drawing on what was just mentioned. They may opt for sophisticated but easy to use analytical tools, or they may just simply take marketing tools and techniques and apply them to the small business environment. Malcolm Goodman, "The Pursuit of Value through Qualitative Market Research," *Qualitative Market Research: An International Journal* 2, no. 2 (1999): 111.

The most basic and obvious way to listen to customers is by talking to them. All businesses should support programs in which employees talk to customers and then record what they have to say about the product or the service. It is important to centralize these observations.

Other ways of listening to customers are through comment cards and paper and online surveys. These approaches have their strengths and limitations (see Note 2.31 "Video Clip 2.11"). Regardless of these limitations, they do provide an insight into your customers. Another way one can gather information about customers is through loyalty programs. Loyalty programs are used by 81 percent of US households. Shallee Fitzgerald, "It's in the Cards," *Canadian Grocer* 118, no. 10 (2004/2005): 30. Social media options—see Section 2.4.2 "Digital Technology and E-Environment Implications"—offer a tremendous opportunity to not only listen to your customer but also engage in an active dialog that can build a sustainable relationship with customers.

Video Clip 2.3.6:

Listen to Your Customers and Express How Much You Care



This video details how easy and simple it is to show that you listen to your customers and care about them.

Video Clip 2.3.7:

Ask, Listen, and Retain Video #4: Listening and Analyzing What Your Customers Say?



This is the fourth in a series of videos on listening to customers. This video covers how to analyze any disengaged or disgruntled customers. Once a customer is identified, our process ensures that action is taken to reengage the customer by dealing with the concerns at hand. But most importantly, the process encourages the development of a relationship between the customer and branch level management.

Website

Cisco Website for Innovation

A web forum for small businesses to share information:
communities.cisco.com/community/technology/collaboration/business/blog/tags/innovation.

KEY TAKEAWAYS

- Businesses must become proactive in attempting to identify the value proposition of their customers. They must know how to listen to the VOC.
- Businesses must make every effort to identify the unmet needs of their customers.
- Businesses should recognize that customer segmentation would enable them to better provide customer value to their various customers.
- Businesses should think in terms of computing the customer lifetime value within different customer segments.
- Intuition can play an important role in the development of new products and services.
- Tools and techniques such as QFD assist in the design of products and services so that a business may be better able to meet customer expectations.
- Innovation can play a key role in creating competitive advantage for small businesses.
- Innovation does not require a huge investment; it can be done by small firms by promoting creativity throughout the organization.
- Small businesses must be open to new social and consumer trends. Readily available technology can help them in identifying such trends.

EXERCISES

1. The Harvard Business School provides an online customer lifetime value calculator at hbsp.harvard.edu/multimedia/flashtools/cltv/index.html. You provide some key values, and it computes the net present value of customer purchases. Go to the site and use the following data. What impact does changing the customer retention have on the value of the customer?

Average spent per purchase	\$250.00
Average number of purchases per period	4
Direct marketing cost per period per year	\$30
Average gross margin	20%
Average retention rate	25%, 35%, 50%, 70%, 80%, and 90%
Annual discount rate	10%

2. Imagine you are planning to open a boutique clothing store in the downtown section of a major city in the United States. You are interested in using a QFD chart to help you design the store. Identify the customer requirements (*whats*) in the engineering characteristics (*hows*). You need not to conduct a full-blown QFD analysis but at least show the degree of relationship between customer requirements and engineering characteristics.
3. You are the owner of a children's clothing store in a prosperous suburban community. What methods and techniques might you use to become more adept at listening to the VOC? Outline specific programs that go beyond just talking to your customer that might enable you to better understand their notion of value.

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