

The Myth of Customer Satisfaction

by Mark Klein and Arthur Einstein

At first glance, creating an army of satisfied customers seems an obvious way to build a business. But as a leading computer software company has learned to its surprise, satisfied customers aren't necessarily good customers. Indeed, the company discovered in a recent survey that there was no correlation between customers' satisfaction scores and their actual purchase behavior.

Why are customers who say they're satisfied not necessarily repeat customers? Because satisfaction is a measure of what people say, whereas loyalty is a measure of what they actually do. Many managers still don't recognize this fundamental difference, so they use *customer satisfaction* and *customer loyalty* interchangeably, as though they were synonyms.

What customers report in satisfaction surveys is their attitude, which usually reflects their recent experience in transactions with the business in question. The survey and the report it generates take the temperature of customer feelings about events that have already occurred. The importance that businesses ascribe to these surveys is profound. Indeed, measuring customer attitudes has become an industry in its own right, and such groups as J.D. Power and Associates, the University of Michigan Business School's National Quality Research Center, the Customer Satisfaction Institute, and other similar organi-

zations have become powerful shapers of business practices.

There's no question that satisfaction measurements can be valuable. They allow customers to vent frustrations. They can highlight problems with product quality and customer service. But satisfaction surveys also have limitations. The larger the customer base, the more expensive and time-consuming it can be to survey. Because of the time and expense they require, surveys can be conducted only periodically, which means they may not reflect current attitudes. Additionally, surveys cannot include all customers — and results can be biased when customers either are excluded or don't bother to respond. Most important, surveys measure opinion and are not reliable predictors of future behavior. Even surveys that ask customers about their intentions do not necessarily shed light on the future because customers don't always do what they say they'll do.

Loyalty (be it to a king, a brand, or a relationship) is most definitely not a matter of opinion. It is a measure of commitment and a strong indicator of future behavior. In a business setting, sales data (such as the transaction date, amount, and product description) can be used to profile customers' past behavior, and can be a reliable basis for predicting their future actions. If, for example, past measurement shows that the Ajax Partnership has been buying supplies regularly every three months for the past two years, and then it begins purchasing smaller

amounts at less frequent intervals, you can be fairly certain that Ajax's loyalty is at risk.

In a small organization with few customers, this kind of behavior measurement is usually a matter of eyeballing the records. There are, however, new and sophisticated mathematical techniques that allow an enterprise with hundreds of thousands (or even millions) of customers to extract data automatically from accounting databases and convert it into an early warning system that segments customers on the basis of their loyalty profiles, and then identifies potential defectors. In this way, enterprise accounting records can be transformed into valuable marketing intelligence.

Loyalty profiles can predict defections and the amount of revenue that will be lost as a result of those defections. Loyalty measurement can also identify when customers will buy next, what they're likely to buy, and how much revenue these sales will generate. It can identify the customers who are likely candidates to buy more than they now do, and predict how much enterprise revenues will grow if these candidates can be upgraded.

But do loyal customers generate more profits than the merely satis-

fied? There is every indication that they do, though measuring the revenue impact of satisfaction is far harder than measuring the impact of loyalty. What can be said for certain is that when a company acts on what it learns from loyalty analysis — marketing to selected customers instead of the entire customer population, targeting customers who are candidates for incremental purchases, protecting revenue by spotting potential defectors before they defect — both margins and return on dollars invested in marketing improve significantly. Tenfold returns on investments in loyalty analysis are not unusual.

Loyalty and satisfaction are decidedly different indicators of business vitality, but as management tools they complement each other. Good satisfaction measurement can help identify what's broken in your business today (although fixing it is up to you). Good loyalty measurement is an easily applied forward-looking tool that sales and marketing can use to devise strategies to hold on to customers they want to keep — and also to earn more from every relationship.

The myth that a satisfied customer will become a loyal customer is just that — a myth. +

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Is Your Company

Over-Allianced?

by Ha Hoang

Alliances represent a powerful strategy opportunity for a company to profit from new markets or new technologies. But just as firms should know they

can't buy success with multiple acquisitions, they should know they can't partner their way to success either. Every company can manage only a limited number of alliances.

Alliances serve many purposes and vary in structure and complexi-

ty (e.g., from simple licensing arrangements to equity joint ventures). But all alliances are based on some exchange of knowledge, in addition to a flow of products, capital, or technology. In the drug industry, for example, small research-focused biotechnology firms often ally with big pharmaceutical companies that have manufacturing capabilities and sales and marketing networks. Such a relationship serves both parties well. Among the earliest of biotech alliances was the 1978 agreement between Genentech Inc.

which are used to collaborating with external partners, have only recently turned their attention to managing their alliance portfolios. Eli Lilly has led the pack by creating an alliance management function and designating an individual, the alliance manager, to capture and internally disseminate new knowledge gained across multiple relationships.

The extent to which knowledge flows between partner firms is an essential consideration when companies are thinking about adding another partnership to the portfolio.

Nestlé, Miramax, and Nike, to name a few. The contributions required of each partner in these relationships are precisely defined to ensure there are few surprises and to reduce the management demands on Lego executives.

Future Lego alliances, however, will be more ambitious and will more closely resemble the company's current collaboration, announced in December 2001, with Electronic Arts, one of the world's leading interactive entertainment software companies. Under the global agreement, Electronic Arts will copublish and provide marketing support for more than 30 Lego software titles on a minimum of four platforms over a three-year period. Collaborations like the Lego–Electronic Arts alliance will be more intensive and provide greater opportunities for learning; Lego will learn from its partners about radically different markets while it will contribute its knowledge of the young children's market and the core values that underlie its trusted brand. By thoroughly evaluating its alliance capacity when contemplating future relationships, Lego can continue to form partnerships without overwhelming its managers.

Multiple alliances still present many pitfalls, however. An organization's internal complexity can hamper its external alliance capacity. That is to say, the more compartmentalized a company's activities, the more difficult it is for the most crucial benefit of an alliance — the flow of new knowledge — to find its way to the people who can best leverage it. Pfizer Inc. tested the drug sildenafil citrate as a treatment for angina, discovered in clinical trials that it could be used to treat erectile dysfunction, and then devel-

One alliance victory doesn't mean a firm has the capacity to manage multiple relationships.

and Eli Lilly and Company, in which Lilly licensed the rights to produce and market recombinant human insulin based on Genentech's research in recombinant DNA technology. At the time, Genentech was too small to effectively bring the novel treatment to market.

But victory with one alliance doesn't mean a firm has an infinite capacity to manage multiple relationships. Although a portfolio of alliances can be powerful, too many deals or too much variety can undermine this power. That's because the ability to manage alliances does not scale. In fact, beyond a certain capacity, the returns on all of a company's alliances diminish.

It's easy to see why: Engagement in more and more alliances raises the complexity of the managerial task, overwhelming managers' ability to coordinate multiple alliances and learn from them. Yet few companies carefully consider this challenge. Large pharmaceutical companies,

The limit of alliance capacity is reached sooner when many relationships in a firm's portfolio require deep knowledge exchanges. Aventis, the pharmaceutical company formed by the merger in 1999 of Hoechst AG and Rhône-Poulenc SA, goes so far as to give its alliance managers a tool to help assess whether a relationship will require multiple interfaces with the partner to be successful. Simple licensing arrangements don't tax alliance partners very heavily, in part because the arrangements are easily codified and the scope is clearly defined. But R&D partnerships and joint ventures can place much higher demands on participants, particularly in the face of uncertainty as to the type and scope of future alliance activities.

The Danish toymaker Lego Company has actively sought partners to extend its position beyond its struggling Lego building bricks franchise. Its alliances include business partnerships with Microsoft,

oped Viagra. Would such information on desirable side effects have reached the right marketers at Pfizer had the drug been developed by a biotech partner and clinical trials been conducted by a contract research partner? These information flows are difficult enough to manage within a large organization such as Pfizer; doing so only gets harder when an alliance partner is involved. Pfizer got it right with Viagra, but how many other companies have lost opportunities because a partner was unable to convey key information to the right decision maker?

Another barrier to developing alliance capacity is the diversity of alliance partners. Experience gained from managing one partner cannot always help improve the management of another relationship. Phar-

maceutical firms, which now place a significant portion of their R&D budget in alliances with biotech partners, face an array of partnerships with firms that focus on different geographical, disease, and technological segments. The challenges of coordination and the concomitant costs of R&D are likely to increase when companies have to build bridges among multiple partners as well as between those partners and themselves.

Profitable partnerships aren't like Lego bricks that can be stacked ever higher. Companies must systematically analyze organizational complexity and partnership diversity, and identify and remove barriers to knowledge flow. That's how they can build stable — and profitable — alliance portfolios. +

Anyone is free to use GPL software (like Linux) at no charge, and is equally free to modify it. But new software that incorporates strands of code from GPL software must also be distributed under the GPL. This makes it impractical to integrate ideas from GPL software in proprietary software because anyone would be free to copy the enhancements.

The “viral” quality of GPL software is intentional: Proponents happily acknowledge that the goal is to undermine incentives to create software that carries a price tag. But for those of us without ideological qualms about software as private property, the wall that GPL erects between open source and proprietary software seems unfortunate.

It is especially unfortunate when government builds the walls. The U.S. government has long been a font of research in software that has made the leap to commercial products. But in the absence of a formal policy, some federal software is being released under the GPL. In fact, NASA, the Sandia National Laboratories, and the U.S. Department of Defense have all distributed code with GPL restrictions.

It is hard to assay the damage in terms of duplicated effort or advances in commercial software that will never be made. But the analogy to another technology-driven industry does hammer home the point: If federal research in medicine had been distributed under some equivalent of the GPL, the spectacular burst of innovation in drugs and genetic engineering by private enterprise in the last decade would have been delayed.

The distribution of GPL software by the government is largely inadvertent. But outside the U.S., resentment of American dominance

Why Open Source Stifles Innovation

by Peter Passell

Open Source Software: *It's Not Just a Good Idea, It's the Law!* No, you won't be seeing those words on bumper stickers anytime soon. But little by little, lawyers, lobbyists, and politicians are becoming very interested in open source, and they aren't likely to leave its fate to market forces. What began as a grass-roots programmer rebellion against commercial software is rapidly evolving into a political struggle that could retard innovation and balkanize the software market.

Software that costs nothing to license and comes with the underlying source code available for all to see has penetrated the mainstream.

Companies as varied as Boeing, Amazon, Google, and E-Trade are using the open source operating system Linux. Two other open source programs, Apache (for hosting Web sites) and Sendmail (for routing e-mail), are nearly ubiquitous.

This success has been good news for businesses, since it's forcing commercial software makers to price low. But the future of open source is clouded by ideology and politics.

The copyright holders of open source software — typically non-profits controlled by the principal developers — have broad discretion to set the terms for its use. And most are choosing to distribute under what is called the General Public License (GPL).

of software neatly dovetails with concerns about the superpower's disproportionate influence over high technology and foreign government's tendency to favor domestic software producers.

The German government has funded private German efforts to develop security software to be licensed under an equivalent to the GPL. In China, the *People's Daily* newspaper reported that government agencies would "join forces to encourage strengthening of the nation's software industry in a bid to pry the computer industry from the grip" of foreign commercial software companies. And Taiwan has launched an ambitious initiative to wean computers from Windows, funding R&D in open source software and training tens of thousands of workers in Linux.

The growing involvement of government in open source is most immediately the concern of the proprietary software industry. Microsoft has the most to lose because Windows sits at the top of the software food chain. But integrated hardware/software companies like IBM, which are supporting open source, could also lose as they sacrifice high-margin software licensing for scraps from the open source table.

Businesses have a stake here, too. It certainly makes sense for

firms to compare the life-cycle cost of open source and proprietary software in their procurement decisions. But government-led success of open source could undermine the network economies that have driven some software market niches toward winner-take-most outcomes.

Thus, while firms may find that the advantages of using free software outweigh the disadvantages, they have not yet had to confront the headaches of a world in which they must worry about the compatibility of files produced on different software platforms or about the need to train employees to use applications for multiple platforms.

The success of open source could also retard innovation. As noted earlier, GPL software cannot be integrated into proprietary software. By the same token, an attenuated market for proprietary software would reduce private incentives to invest in software development.

Open source is here to stay. But whether it will, in the end, prove a boon to global productivity depends on how the competition with commercial software plays out as commerce mixes with ideology, nationalism, and special-interest politics.

The bottom line for business: Enjoy something for nothing, but be wary of ideologues who would restrict your diet to free lunches. +

throes of dramatic change need brand communication to affect their employees as much as it does their customers.

For the many companies attempting to make the shift from selling lower-margin goods and services to offering higher-margin customized solutions, branding can serve a powerful internal purpose. When we were faced with this very challenge, our branding strategy was critical in uniting formerly divided business-unit and product-oriented management factions behind new shared goals and strategies to deliver solutions.

Five years ago, we established the Construction Information Group to tie together the six strong, existing brands representing McGraw-Hill's construction-related service companies and publications: F.W. Dodge, Architectural Record, Sweet's Product News, Design-Build, Engineering News-Record (ENR), and construction.com. Our strategy at the time was to loosely endorse each of the brands in association with the Construction Information Group name. But we rapidly found that just creating an organizational layer and tacking it onto our brands was not enough to motivate our people to collaborate, or to gain new attention in the market.

Building product manufacturers (BPMs, companies that produce windows, doors, paints, etc., and that sit in the middle of the commercial construction food chain) are less and less interested in buying products or plain-vanilla services. Increasingly, they want integrated solutions, including help in marketing their products through our advertising vehicles online and offline, projecting information through our databases that will help

External Branding's Internal Impact

by Victoria Pao and Steve Lawrence

Conventional wisdom says branding is for external communication; it aims to

influence current and prospective customers. But this view is too narrow, especially when a company is trying to fundamentally alter its business strategy. Companies in the

them target leads, and distributing product information to various end-user segments. The trouble was that managers handling each of our existing brands continued to pursue their own goals independently, leaving the “solution sale” out of the discussion with the customer.

To provide solutions, a company must cut across business units to customize offerings — content, objectives, and pricing — for individual customers. We weren’t organized to do that. Each of our account managers called on BPMs independently, and focused on selling products only under their brand. There was limited information sharing or effort to help drive cross-product sales. There was no single point of contact for the BPM customer.

After surveying our customers on their perceptions of our brands in the fall of 2001, we looked at three options to strengthen the collection of brands associated with the Construction Information Group:

1. Use one of the strongest existing brands — Sweet’s Product News or F.W. Dodge — as the name of the entire collection.

2. Create a new name for the collection of brands, an appealing way to signal major change internally and externally.

3. Use the most recognizable brand name — McGraw-Hill — in the new name, strongly emphasizing its value above the prior collection of brands.

After some testing, we concluded that the first option risked creating winners and losers internally, a dubious way to achieve collaboration. It also didn’t supply a sufficiently strong external message about our new approaches. And creating a new brand looked to be expensive. The McGraw-Hill name

already had an image with the broadest range of customers, and had the best potential to pull the separate business units together. Choosing the third option, we came up with the name McGraw-Hill Construction. With it, the equity of the old brands remained intact in a system designed to channel future equity into the single brand.

Clearly, promoting a cohesive image to the outside world was only a first step: We needed to unify our operations so that everyone internally (1,700 professionals worldwide are employed at the company) identified first with the enterprise as a whole. Key customers needed to see a unitary brand before they en-

- Created new product platforms to connect content from our different business units.

- Consolidated and centralized customer invoicing and customer service processes.

- Launched new advertising, marketing collateral, trade exhibits, and internal communications that for the first time demonstrated a unified image.

These changes would have been impossible without the new McGraw-Hill Construction brand, which ties together our people, products, and value proposition. It has given us the vehicle to organize internal change and the credibility we needed when approaching our

Branding was the key to creating collaborative sales teams and product/service bundles.

countered a subbrand (i.e., McGraw-Hill Construction Dodge instead of F.W. Dodge) every time a sales or service person contacted them. We needed to accomplish this while continuing to leverage the equities in our existing construction publications and information-company brands.

Internally, we had to introduce specific structural changes and inducements to promote unity, not simply ask for it. To do this, we:

- Articulated a clear vision and mission statement.

- Rolled up individual brand financial targets into group targets, making them internally public for the first time.

- Created a new Integrated Solutions and Consulting sales team to bring group solutions directly to customers.

key customers with offers to solve their problems.

Five years ago, we had separate business silos pushing independent product lines to meet standard customer needs. Today, we have collaborative sales teams operating under a single brand offering product and service bundles to solve selected customer problems. Our branding initiative was the key activity behind these improvements, which are now paying off in double-digit annual growth in profits.

Why is branding critical? Because it gives us a competitive advantage in challenging economic times. And because internally it reinforces our strategy and motivates our people to be focused on clear, shared goals. +