B2b marketing: unprofitable customer essay sample

Finance, Investment

ASSIGN BUSTER

SPRINT NEXTEL sent out letters to about 1, 000 people on June 29, 2007, to inform them that they had been summarily dismissed – but the recipients were Sprint customers, not employees. For about a year, the wireless-service provider had been tracking the number and frequency of support calls made by a group of high-maintenance end users. As a Sprint spokeswoman told Reuters in July, " In some cases, they were calling customer care hundreds of times a month… on the same issues, even after we felt those issues had been resolved." Ultimately, the company determined it could not meet the billing and service needs of this tiny subset of subscribers and, therefore, waived their termination fees and cut off their service. Similarly, TXU, a large power provider in Texas, in 2005 implemented a tough-love marketing strategy in response to the competitive pressures of a deregulated energy market. It pulled the plug quickly on Brian Stauffer late-paying customers then charged them expensive reconnect fees, and it offered perks to those who paid on time. As a result, it reduced its " bad debt" from nonpaying customers and enjoyed productivity increases among employees who had previously spent a lot of time fielding calls from scofflaws.

As one senior TXU financial executive told the Wall Street Journal, " A customer who calls you every day is less profitable than one who pays on time and never calls you." Customer divestment, whereby a company stops providing a product or service to an existing customer, was once considered an anomaly. However, it is fast becoming a viable strategic option for many organizations. Certainly, the skyrocketing costs of acquiring new customers and the complexities of cross-selling to different market segments continue to make customer retention imperative. But some firms are taking advantage of new segmentation approaches and technologies that have made it easier to focus on retaining the right customers – those who will bring in the most revenue over time – and, by extension, to show problem customers the door.

To better understand recent trends in customer divestment, we took a closer look at some companies that have rid themselves of customers, as well as some of the customers they let go. We pored over news reports, press releases, and consumer blogs and magazines to explore the evolving customer-company dynamic. In 2005 and 2006, we interviewed 38 executives from 32 companies in a variety of industries, including IT, manufacturing, health care, finance, and professional services. We also surveyed a random sample of 236 customers. Of the executives, 90% said they had given serious thought to divesting customers, and 85% said they had already undertaken divestment. Of the customers, 23% indicated they had been let go by a company in the past year. Our research identified four common reasons why businesses terminate relationships with end users: the declining profitability of specific customers, the lower productivity of employees as they deal with unprofitable customers, changes in the capacity to serve large volumes of customers, and shifts in a company’s business strategy.

While most of the managers we interviewed had thought about divesting customers for one of these reasons, none wanted to acknowledge that publicly. Setting aside the immediate effects of such a strategy on profits and operations, the managers we spoke with worried about longer-term ramifications such as retaliation by clients or earning a reputation as a “ difficult” service provider or an industry rebel. Indeed, the collateral damage of divestment can be high: You may do your competitors an unintended favor by sending new business their way. You can damage relationships with the high-value customers you retain, who may come to perceive your company as being service-unfriendly. You may even violate ethical or legal obligations to customers. Before making any moves to divest, businesses would do well to walk themselves and their B2B or B2C customers through a five-part framework we’ve developed from our research. It will help executives consider the strategic impact of customer divestment beyond just profitability.

The model offers a system for objectively assessing the present and potential value of each customer or cohort – in short, for putting each customer relationship in context and deciding on the best course of action. (See the exhibit “ The Customer Divestment Continuum.”) After you have done the hard work of reassessing your present relationships with customers, educating unprofitable customers, renegotiating the value proposition, or migrating customers to other partners or providers, you will be able to more clearly evaluate the importance of such customers to the company’s long-term success. Then – and only then – should you begin terminating relationships. In certain situations, customer divestment (done right) can be an effective strategy, although it should clearly be an option of last resort. Before we examine each element of the framework in detail, let’s consider the potential benefits and risks of customer divestment.

Why Divest?

As we’ve noted, the executives we interviewed offered four critical reasons why they might consider divesting themselves of certain clients, despite the risk of degrading the overall customer base.

Vikas Mittal () is the J. Hugh Liedtke Professor of Management and Marketing at Rice University’s Jones Graduate School of Management in Houston. Matthew Sarkees () is an assistant professor of marketing at Penn State University’s Great Valley School of Graduate Professional Studies in Malvern, Pennsylvania. Feisal Murshed () is an assistant professor of marketing and e-business at Towson University’s College of Business and Economics in Towson, Maryland.

The Customer Divestment Continuum

Before deciding to sever ties with problem customers, you should ask yourself key questions about the contexts in which those clients are operating. Understanding those contexts can help you determine how – and even whether – to divest. It’s not a black-orwhite decision.

CONTEXTS

Has the company misunderstood or mishandled customers, regardless of their profitability? Are the customers inclined to understand the company’s position? Can the customers and the company find new ways to reap value from each other? Might the customers be profitable for subsidiaries or other providers? Is the value incompatibility between the customers and the company truly beyond repair?

CONTINUUM

REASSESS the relationships

EDUCATE the customers

RENEGOTIATE the value proposition

MIGRATE the customers

TERMINATE the relationship

The first reason to divest is, of course, profitability. The popular press is filled with stories about B2B and B2C companies that have divested themselves of customers that no longer provide sufficient returns on investment. This is a fairly common situation in the finance and insurance industries, where profits depend so much on clients' risk factors. In 2005, Allstate and Nationwide divested themselves, respectively, of 95, 000 and 35, 000 home owner's insurance customers in Florida for fear of massive losses in the future. That's because in 2004 and 2005, areas of the state were significantly affected by seven major hurricanes. Citing highrisk factors, the insurance industry subsequently reviewed and terminated hundreds of thousands of home owner policies across the United States. Companies in the retail and service sectors have also divested themselves of customers in order to stem losses. In a widely publicized example, Boston-based Filene's Basement in 2003 banned two longtime customers from its stores nationwide because of their excessive returns and complaints, which were eating up sales associates' valuable time and other resources. In the same vein, retailers like Sears and

Best Buy charge restocking fees on selected items to discourage customers from returning products that the store must then mark down because they are, say, out of season or missing their original packaging.

Car rental agencies understandably reject out of hand customers who have damaged their vehicles in the past. One agency manager told us that this practice is “ an absolutely necessary function” of his business. “ If someone is going to take advantage of our [high-cost assets],” he said, “ we need to protect ourselves.” Some organizations are systematic about separating the profitable customers from the unprofitable ones. They use analytical tools and approaches to compute customer lifetimevalue scores and other relevant metrics. For instance, FedEx in the late 1990s crunched the numbers on its 30 largest clients – a group that generated about 10% of the shipping firm’s total revenues and volume. According to a 1999 Wall Street Journal article, the company “ found that certain clients, including some who required lots of residential deliveries, weren’t bringing in as much revenue as they had promised when they first negotiated discounted rates with FedEx.” So the company raised these customers’ rates. Several clients who balked at the hike were, over time, asked to take their business elsewhere.

A similar situation was described in a 2003 Wall Street Journal article about the University of Texas Medical Branch in Galveston, which had identified in its database approximately 64, 000 patients with unpaid medical bills. After considering the social impact of divesting them, Joan Richardson, then the chief medical director at the 800-bed hospital, developed a plan for rationing care among these patients – essentially, restricting them to certain drugs and procedures and requiring that they pay up front for doctor visits. The plan helped to reduce the facility's percentage of nonpaying patients among the total care population from 26% in 1998 to about 17% in 2003. Another reason to divest is to increase employee productivity and morale. Unduly rude and habitually obnoxious customers can impede employees' ability to get their work done and even their desire to stay with a company. Think of a frequent diner at a restaurant, for instance, who spends a lot on food and wine every evening but condescends to the waitstaff and disturbs the other patrons. For the sake of employee retention (and possibly to keep other profitable customers in the fold), he's got to go.

Especially in B2B services, executives risk increasing employee turnover and losing institutional knowledge if troublesome customers are not cut loose. An executive from a large service firm told us, " It was a question of whether or not we wanted to keep our employees. The client was working them too hard, and mutiny was upon us. We value our people. We gently told the client that we could no longer assist them." A senior partner at a research and consulting firm shared with us an anecdote about a client in the consumer packaged-goods industry who " was all about winning. [The clients] never felt they had won until everyone else around them lost. Even if we gave them the best product, they always had to find some fault. It was wearing us all down." The partner brought these concerns to the firm's CEO, who ultimately decided the consultancy would stop bidding on projects for this client.

Capacity constraints are a third reason for divesting customers. Some companies lack the appropriate expertise, physical capacity, or financial resources to continue providing a particular service; others underestimate customer demand or the effects of new regulations or environmental forces. Partners in two accounting firms told us their institutions divested themselves of hundreds of U. S. customers after passage of the Sarbanes-Oxley Act significantly increased the time that employees had to spend on compliance matters for large, publicly traded clients. “ We simply don’t have enough manpower to serve smaller, privately owned clients,” one of the partners said. “ Not that we want to, but we have had to walk away from, raise fees for, or just not pay enough attention to the smaller companies,” some of which were driven away. Finally, some companies view customer divestment as a natural, if somewhat intentional, consequence of their evolving strategies. When organizations decide to stop offering certain products and services, or when they exit entire business segments, they’re indirectly telling customers to find other vendors that can meet their needs.

AT&T, for instance, decided in 2004 to focus more on the commercial market and less on residential customers. The company didn’t actively set out to terminate relationships with individuals, but the combination of natural attrition and some poaching by competitors considerably reduced the company’s base of residential customers. Some organizations shed customers to correct for past strategy miscues. One manager at a world-class telecommunications firm told us that during the late 1990s, his company had indiscriminately signed up large numbers of smallbusiness clients in an attempt to gain market share quickly. By 2004, he said, many of those customers had either gone out of business or proved to be unprofitable. He acknowledged that the company is now paying for that landgrab: “ It has become a wrenching exercise in customer divestment, internal job cuts, and reorganization.” Similarly, in response to scandals and SEC investigations, insurance giant Marsh & McLennan in 2005 jettisoned thousands of clients worldwide after a long-overdue profit audit showed that the company was losing money on about 25% of its customer base. “ The short-term solution was obvious,” CEO Michael G. Cherkasky told the Wall Street Journal. The company divested itself of its unprofitable customers and of the employees who supported them.

When Is Customer Divestment Risky?

Firing your customers can make sense in certain situations, but more often than not the risks of such a strategy outweigh the rewards. It’s not just profits that are at stake; multiple constituencies are affected when businesses decide to divest. Companies with high fixed costs, for example, risk placing more of the cost burden on their remaining clients. A doctor we interviewed said after she dropped two unprofitable patient segments, she had trouble filling the empty slots in her schedule. Staffers sat idle, but she was loath to fire them – many had been with the practice a long time. Eventually, this physician ended up buying another practice to get her business back up to its original breakeven point. Companies that get rid of customers may lose valuable sources of information, experimentation, and innovation. After all, end users’ ideas and suggestions can help companies quickly identify new products and services and develop best practices. For their part, customers let go by one firm can usually be accommodated by a rival company, thereby changing the competitive dynamics. There was obviously no shortage of phone service options for customers who felt displaced by AT&T's new focus on the commercial space, for instance. However, in some scenarios, remaining customers may become insecure and wonder whether they are next in line.

Sometimes customers can construe divestiture as a form of discrimination, and they clearly are influenced by offers to other customers. In 2000, for instance, Amazon received bad publicity for its foray into dynamic pricing: It was offering different customers slightly different discounts on a particular product. When they found out, the customers involved (as well as those who weren't) were outraged, and the company volunteered to issue refunds. Frontline employees are not left unscathed when companies shed their customers. As the Marsh & McLennan case illustrates, a downsized customer base can lead to a downsized employee base. For the remaining employees, the sudden departure of clients who may also be friends can be traumatic – after all, in most cases employees worked long hours to acquire, nurture, and develop the now-broken relationships. At Marsh & McLennan, the frustrated and angry brokers who weren't fired were so disgusted at how their former clients and colleagues had been treated that they defected to competitors. The lesson is that a company's treatment of its customers sends a powerful message – intended or not – about how well management treats its employees.

Clearly, ethical and legal issues can arise when companies decide to divest customers. Such a strategy may directly contradict the principles of corporate social responsibility deeply embedded in many organizations. Consider that citizens of Western nations generally expect certain services (electricity, water, sanitation, and heating) to be universal, regardless of one's ability to pay. Then look at Embratel, a leading phone service provider in Brazil: The high cost of debt collection made the company want to stop serving customers who hadn't paid their bills in more than six months. Regulatory agencies blocked the move, however, citing hardships for the masses. The telecommunications company later offered these customers financial incentives to cancel their Embratel phone service and switch to prepaid calling cards. Because differentiation and segmentation are the cornerstones of most customer divestment programs, such initiatives may be perceived by regulators, activists, and consumer watchdog groups as discriminatory – regardless of the strength of the business cases behind them.

Managing the Divestment Process

Obviously, customers and firms must engage in a transaction that is mutually beneficial. However, this equitable exchange of value can be difficult to maintain over the long term. Divestment creeps into management's thinking when the value provided to customers grossly exceeds the value extracted. Nevertheless, this strategy should be exercised only after carefully studying relationships with customers in context and making every effort to restore equilibrium. Our customer divestment framework can guide you through that process (see the exhibit “ How to Approach Customer Divestment”). Reassess the present customer relationship. First, executives should thoroughly review the information, beyond profitability, that was used to identify an individual or customer segment as a problem. That includes not only financial metrics, such as the customer’s current and future spending, but also a broader view of the context in which the customer and the company are operating. For example, have the customer’s needs changed? Conversely, has the company’s focus changed? Would the customer benefit from being switched to another service the company provides?

The way the company answers such questions will inform its decision about whether to divest. For B2B companies, such analysis is relatively easy to conduct because they typically have a narrow range of large customers and lots of detailed information about the costs, revenues, and profitability of each. By contrast, B2C companies generally have indirect relationships with a broad range of consumers and may lack qualitative and quantitative data on each customer segment. Sometimes companies will find that they have misjudged customers. Consumers who have been identified as unwilling to spend – and therefore unprofitable – may simply be unaware of the range of services available. In other cases, a customer’s unwillingness may be a by-product of the company’s own myopia.

That can happen in both B2C and B2B environments. For example, in a bid to cater to its larger Fortune 500 accounts, an advertising agency we studied was paying less attention to its smaller clients in its portfolio, particularly the local nonprofit agencies, many of which slowly started shifting their business elsewhere. The CEO of the ad agency eventually took steps to reassess relationships with these nonprofit clients – but only after he got an earful from a Fortune 500 client, who also happened to serve on the board of one of the small nonprofits that was being ignored. The CEO realized that the ad firm's inadvertent divestment of clients was tarnishing the company's reputation and attempted to renegotiate terms with these customers.

A critical aspect of fostering profitable tions of the relationship. The managers at a financial services relationships with customers is managing their expectations: company we studied, for instance, told us they often inform If customers have the information they need to navigate a potential customers up front, during the negotiation phase, complicated product or service situation, they will have fewer about exactly how they create value for the company – and questions and less need to draw on the company's valuable exactly which trigger points could tip the scales toward unresources. Managers therefore should consider the following profitability. Customers are told, for example, about the minquestions: What are customers' relevant knowledge gaps, imum balances they need to maintain in different types of and what is the best way to fill them? Instead of being candiinvestment accounts for this firm to serve them profitably. dates for divestment, some customers may merely need to be taught how to use the company's prodRenegotiate (don't just communiucts and services better and to interact cate) the value proposition.

RenegoHow to Approach with company representatives effectively. tiation is an outgrowth of the reassessCustomer Divestment Consider the situation at Fidelity Investment and education processes and is ments. A few years ago the financial serespecially attractive in markets where We've developed the following vices organization identified a group of the company can offer different pricframework to help you objectively low-margin customers who were making ing and service strategies for various determine how unmanageable a high number of service calls. Instead subsets of customers without affecting your problem customers really of cutting ties with these customers, Fidelits relationships with other customers. are.

This guide encourages you ity attempted to educate them about its For instance, brokers and mutual fund to look beyond profitability as you other lower-cost troubleshooting options. companies such as Charles Schwab consider the strategic impact of Specifically, the company's call center and Fidelity can charge higher fees customer divestment. representatives taught the customers to use Fidelity's automated phone lines and website. If these customers still wanted EDUCATE REASSESS to talk with a service representative, the Share the company's perspective Understand why the customer (or phone system identified them and routed with customers. customer segment) is being considthem to longer queues. ered for divestment.