



Harvard Business Review

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SPOTLIGHT ON REINVENTION

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Rethinking Marketing

by Roland T. Rust, Christine Moorman, and
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Rethinking Marketing

Idea in Brief

Companies have powerful technologies for understanding and interacting with customers, yet most still depend on mass media marketing to drive impersonal transactions.

To compete, companies must shift from pushing individual products to building long-term customer relationships.

The marketing department must be reinvented as a “customer department” that replaces the CMO with a chief customer officer, makes product and brand managers subservient to customer managers, and oversees customer-focused functions including R&D, customer service, market research, and CRM.

These changes shift the firm’s focus from product profitability to customer profitability, as measured by metrics such as customer lifetime value and customer equity. This organizational transformation will uproot entrenched interests and so must be driven from the top.

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Rethinking Marketing

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Imagine a brand manager sitting in his office developing a marketing strategy for his company's new sports drink. He identifies which broad market segments to target, sets prices and promotions, and plans mass media communications. The brand's performance will be measured by aggregate sales and profitability, and his pay and future prospects will hinge on those numbers.

What's wrong with this picture? This firm—like too many—is still managed as if it were stuck in the 1960s, an era of mass markets, mass media, and impersonal transactions. Yet never before have companies had such powerful technologies for interacting directly with customers, collecting and mining information about them, and tailoring their offerings accordingly. And never before have customers expected to interact so deeply with companies, and each other, to shape the products and services they use. To be sure, most companies use customer relationship management and other technologies to get a handle on customers, but no amount of

technology can really improve the situation as long as companies are set up to market products rather than cultivate customers. To compete in this aggressively interactive environment, companies must shift their focus from driving transactions to maximizing customer lifetime value. That means making products and brands subservient to long-term customer relationships. And that means changing strategy and structure across the organization—and reinventing the marketing department altogether.

Cultivating Customers

Not long ago, companies looking to get a message out to a large population had only one real option: blanket a huge swath of customers simultaneously, mostly using one-way mass communication. Information about customers consisted primarily of aggregate sales statistics augmented by marketing research data. There was little, if any, direct communication between individual customers and the firm. Today, companies have a host of options

at their disposal, making such mass marketing far too crude.

The exhibit “Building Relationships” shows where many companies are headed, and all must inevitably go if they hope to remain competitive. The key distinction between a traditional and a customer-cultivating company is that one is organized to push products and brands whereas the other is designed to serve customers and customer segments. In the latter, communication is two-way and individualized, or at least tightly targeted at thinly sliced segments. This strategy may be more challenging for firms whose distribution channels own or control customer information—as is the case for many packaged-goods companies. But more and more firms now have access to the rich data they need to make a customer-cultivating strategy work.

B2B companies, for instance, use key account managers and global account directors to focus on meeting customers’ evolving needs, rather than selling specific products. IBM organizes according to customer needs, such as energy efficiency or server consolidation, and coordinates its marketing efforts across products for a particular customer. IBM’s Insurance Process Acceleration Framework is one example of this service-oriented architecture. Customer and industry specialists in IBM’s insurance practice work with lead customers to build fast and flexible processes in areas like claims, new business processing, and underwriting. Instead of focusing on short-term product sales, IBM measures the practice’s performance according to long-term customer metrics.

Large B2B firms are often advanced in their customer orientation, and some B2C companies are making notable progress. Increasingly, they view their customer relationships as evolving over time, and they may hand off customers to different parts of the organization selling different brands as their needs change. For instance, Tesco, a leading UK retailer, has recently made significant investments in analytics that have improved customer retention. Tesco uses its data-collecting loyalty card (the Clubcard) to track which stores customers visit, what they buy, and how they pay. This information has helped Tesco tailor merchandise to local tastes and customize offerings at the individual level across a variety of store formats—from sprawling

hypermarts to neighborhood shops. Shoppers who buy diapers for the first time at a Tesco store, for example, receive coupons by mail not only for baby wipes and toys but also for beer, according to a *Wall Street Journal* report. Data analysis revealed that new fathers tend to buy more beer because they can’t spend as much time at the pub.

On the services side, American Express actively monitors customers’ behavior and responds to changes by offering different products. The firm uses consumer data analysis and algorithms to determine customers’ “next best product” according to their changing profiles and to manage risk across cardholders. For example, the first purchase of an upper-class airline ticket on a Gold Card may trigger an invitation to upgrade to a Platinum Card. Or, because of changing circumstances a cardholder may want to give an additional card with a specified spending limit to a child or a contractor. By offering this service, American Express extends existing customers’ spending ability to a trusted circle of family members or partners while introducing the brand to potential new customers.

American Express also leverages its strategic position between customers and merchants to create long-term value across both relationships. For instance, the company might use demographic data, customer purchase patterns, and credit information to observe that a cardholder has moved into a new home. AmEx capitalizes on that life event by offering special Membership Rewards on purchases from merchants in its network in the home-furnishings retail category.

One insurance and financial services company we know of also proved adept at tailoring products to customers’ life events. Customers who lose a spouse, for example, are flagged for special attention from a team that offers them customized products. When a checking account or credit-card customer gets married, she’s a good cross-selling prospect for an auto or home insurance policy and a mortgage. Likewise, the firm targets new empty nesters with home equity loans or investment products and offers renter’s insurance to graduating seniors.

Reinventing Marketing

These shining examples aside, boards and C-suites still mostly pay lip service to customer

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relationships while focusing intently on selling goods and services. Directors and management need to spearhead the strategy shift from transactions to relationships and create the culture, structure, and incentives necessary to execute the strategy.

What does a customer-cultivating organization look like? Although no company has a fully realized customer-focused structure, we can see the features of one in a variety of companies making the transition. The most dramatic change will be the marketing department's reinvention as a "customer department." The first order of business is to replace the traditional CMO with a new type of leader—a chief customer officer.

The CCO. Chief customer officers are increasingly common in companies worldwide—there are more than 300 today, up from 30 in 2003. Companies as diverse as Chrysler, Hershey's, Oracle, Samsung, Sears, United Airlines, Sun Microsystems, and Wachovia now have CCOs. But too often the CCO is merely trying to make a conventional organization more customer-centric. In general, it's a poorly defined role—which may account for CCOs' dubious distinction as having the shortest tenure of all C-suite executives.

To be effective, the CCO role as we conceive it must be a powerful operational position, reporting to the CEO. This executive is responsible for designing and executing the firm's customer relationship strategy and overseeing all customer-facing functions.

A successful CCO promotes a customer-centric culture and removes obstacles to the flow of customer information throughout the organization. This includes getting leaders to regularly engage with customers. At USAA, top managers spend two or three hours a week on the call-center phones with customers. This not only shows employees how serious management is about customer interaction but helps managers understand customers' concerns. Likewise, Tesco managers spend one week a year working in stores and interacting with customers as part of the Tesco Week in Store (TWIST) program.

As managers shift their focus to customers, and customer information increasingly drives decisions, organizational structures that block information flow must be torn down. The reality is that despite large investments in acquiring customer data, most firms underutilize what they know. Information is tightly held, often because of a lack of trust, competition for promotions or resources, and the silo mentality. The CCO must create incentives that eliminate these counterproductive mind-sets.

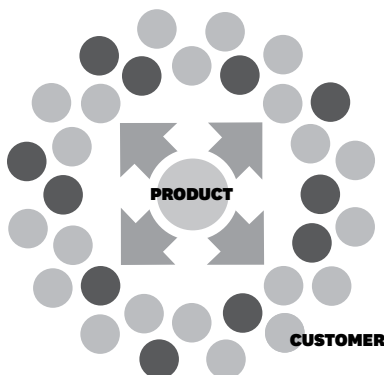
Ultimately, the CCO is accountable for increasing the profitability of the firm's customers, as measured by metrics such as customer lifetime value (CLV) and customer equity as well as by intermediate indicators, such as word of mouth (or mouse).

Customer managers. In the new customer department, customer and segment managers identify customers' product needs. Brand managers, under the customer managers' direction, then supply the products that fulfill those needs. This requires shifting resources—principally people and budgets—and authority from product managers to customer managers. (See the sidebar "What Makes a Customer Manager?") This structure is common in the B2B world. In its B2B activities, Procter & Gamble, for instance, has key account managers for major retailers like Wal-Mart. They are less interested in selling, say, Swiffer than in maximizing the value of the customer relationship over the

Building Relationships

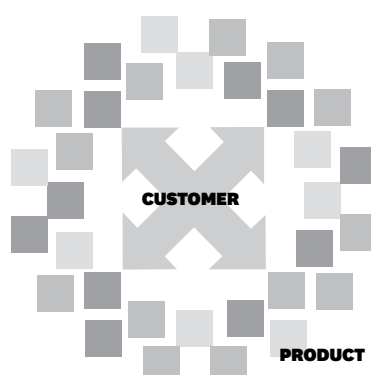
Product-Manager Driven

Many companies still depend on product managers and one-way mass marketing to push a product to many customers.



Customer-Manager Driven

What's needed is customer managers who engage individual customers or narrow segments in two-way communications, building long-term relationships by promoting whichever of the company's products the customer would value most at any given time.



long term. Some B2C companies use this structure as well, foremost among them retail financial institutions that put managers in charge of segments—wealthy customers, college kids, retirees, and so forth—rather than products.

In a customer-cultivating company, a consumer-goods segment manager might offer customers incentives to switch from less-profitable Brand A to more-profitable Brand B. This wouldn't happen in the conventional system, where brand and product managers call the shots. Brand A's manager isn't going to encourage customers to defect—even if that would benefit the company—because he's rewarded for brand performance, not for improving CLV or some other long-term customer metric. This is no small change: It means that product managers must stop focusing on maximizing their products' or brands' profits and become responsible for helping customer and segment managers maximize theirs.

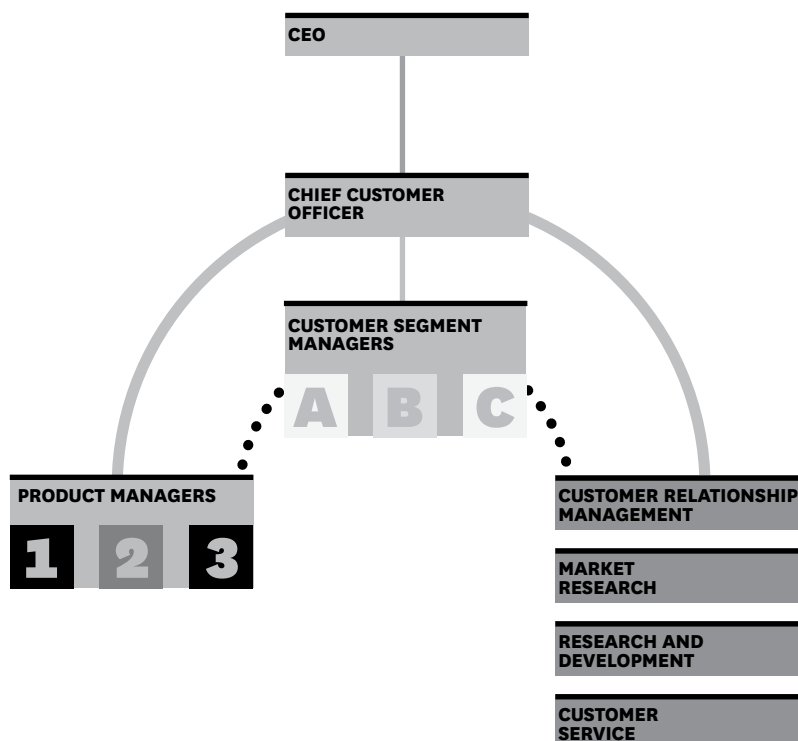
Customer-facing functions. As the nexus of customer-facing activity, the customer department assumes responsibility for some of the customer-focused functions that have left the marketing department in recent years and some that have not traditionally been part of it.

CRM. Customer relationship management has been increasingly taken on by companies' IT groups because of the technical capability CRM systems require, according to a Harte-Hanks survey of 300 companies in North America: 42% of companies report that CRM is managed by the IT group, 31% by sales, and only 9% by marketing. Yet CRM is, ultimately, a tool for gauging customer needs and behaviors—the new customer department's central role. It makes little sense for the very data required to execute a customer-cultivation strategy to be collected and analyzed outside the customer department. Of course, bringing CRM into the customer department means bringing IT and analytic skills in as well.

Reimagining the Marketing Department

The traditional marketing department must be reconfigured as a customer department that puts building customer relationships ahead of pushing specific products.

To this end, product managers and customer-focused departments report to a chief customer officer instead of a CMO, and support the strategies of customer or segment managers.



Market research. The emphasis of market research changes in a customer-centric company. First, the internal users of market research extend beyond the marketing department to all areas of the organization that touch customers—including finance (the source of customer payment options) and distribution (the source of delivery timing and service). Second, the scope of analysis shifts from an aggregate view to an individual view of customer activities and value. Third, market research shifts its attention to acquiring the customer input that will drive improvements in customer-focused metrics such as CLV and customer equity.

Research and development. When a product is more about clever engineering than customer needs, sales can suffer. For example, engineers like to pack lots of features into products, but we know that customers can suffer from feature fatigue, which hurts future sales.

To make sure that product decisions reflect real-world needs, the customer must be brought into the design process. Integrating R&D and marketing is a good way to do that. Few companies have done this better than Nokia in Asia, where its market share exceeds 60%. In an industry where manufacturers must introduce scores of new offerings every year, the group's ability to translate customer input about features and value into hit product offerings is legendary. Among its cus-

tomers-focused innovation tools is Nokia Beta Labs, a virtual developer community that brings users and developer teams together to virtually prototype new features and products, inviting even “wacky ideas” that may never make it to the marketplace. (Nokia adopted a different strategy in the United States, using far less customer input, and has seen its market share slide.)

Examples abound of companies that create new value through the collaboration of users and producers: Mozilla's Firefox in the web browser category, P&G's Swiffer in the home cleaning category, and International Flavors and Fragrances' partnership with B2B customers like Estée Lauder in the perfume market. In a world in which the old R&D-driven models for new product development are giving way to creative collaborations like these, R&D must report to the CCO.

Customer service. This function should be handled in-house, under the customer department's wing—not only to ensure that the quality of service is high but also to help cultivate long-term relationships. Delta Airlines, for example, recently pulled out of its call centers overseas because cultural differences damaged the airline's ability to interact with North American customers. Delta concluded that the negative impact on the quality of customer relationships wasn't worth the cost savings. Now, when customer service gets a call, a rep-

What Makes a Customer Manager?

In a sense, the role of customer manager is the ultimate expression of marketing (find out what the customer wants and fulfill the need) while the product manager is more aligned with the traditional selling mind-set (have product, find customer).

Jim Spohrer, the director of Global University Programs at IBM, hires what UC Berkeley professor Morten Hansen calls “T-shaped” people, who have broad expertise with depth in some areas. Customer managers will be most effective when they're T-shaped, combining deep knowledge of particular customers or segments with broad knowledge of the firm and its products. These managers must also be sophisticated data interpreters, able to extract insights from the

increasing amount of information about customers' attitudes and activities acquired by mining blogs and other customer forums, monitoring online purchasing behavior, tracking retail sales, and using other types of analytics. While brand managers may be satisfied with examining the media usage statistics associated with their product, brand usage behavior, and brand chat in communities, customer managers will take a broader and more integrative view of the customer. For instance, when P&G managers responsible for the Max Factor and Cover Girl brands spent a week living on the budget of a low-end consumer, they were acting like customer managers. The experience gave these managers important insights into what P&G, not just

the specific brands, could do to improve the lives of these customers.

We'd expect the most effective customer managers to have broad training in the social sciences—psychology, anthropology, sociology, and economics—in addition to an understanding of marketing. They'd approach the customer as behavioral scientists rather than as marketing specialists, observing and collecting information about them, interacting with and learning from them, and synthesizing and disseminating what they learned. For business schools to stay relevant in training customer managers, the curriculum needs to shift its emphasis from marketing products to cultivating customers.

representative immediately identifies the caller's segment and routes her to a customer-service specialist trained to work with that segment. The interaction is captured in the customer information system and used, in turn, by the customer department to divine new customers' needs and create solutions.

If customer service must be outsourced, the function should report in to a high-level internal customer manager, and its IT infrastructure and customer data must be seamlessly integrated with the company's customer databases.

A New Focus on Customer Metrics

Once companies make the shift from marketing products to cultivating customers, they will need new metrics to gauge the strategy's effectiveness. First, companies need to focus less on product profitability and more on customer profitability. Retailers have applied this concept for some time in their use of loss leaders—products that may be unprofitable but strengthen customer relationships.

Second, companies need to pay less attention to current sales and more to CLV. A company in decline may have good current sales but poor prospects. The customer lifetime value metric evaluates the future profits generated from a customer, properly discounted to reflect the time value of money. Lifetime

value focuses the company on long-term health—an emphasis that most shareholders and investors should share. Although too often the markets reward short-term earnings at the expense of future performance, that unfortunate tendency will change as future-oriented customer metrics become a routine part of financial reporting. An international movement is under way to require companies to report intangible assets in financial statements. As leading indicators such as customer-centered metrics increasingly appear on financial statements, stock prices will begin to reflect them. Even now, savvy analysts are pushing firms to understand customer retention rates and the value of customer and brand assets.

Third, companies need to shift their focus from brand equity (the value of a brand) to customer equity (the sum of the lifetime values of their customers). Increasing brand equity is best seen as a means to an end, one way to build customer equity (see "Customer-Centered Brand Management," HBR September 2004). Customer equity has the added benefit of being a good proxy for the value of the firm, thereby making marketing more relevant to shareholder value.

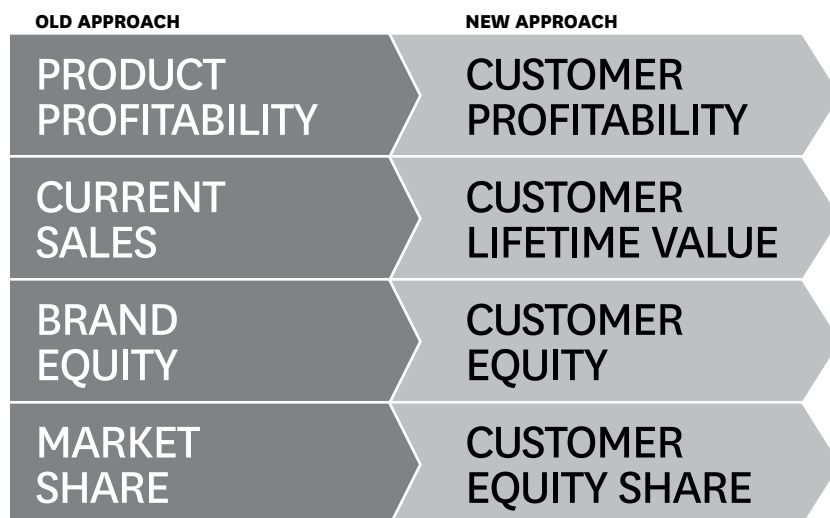
Fourth, companies need to pay less attention to current market share and more attention to customer equity share (the value of a company's customer base divided by the total value of the customers in the market). Market share offers a snapshot of the company's competitive sales position at the moment, but customer equity share is a measure of the firm's long-term competitiveness with respect to profitability.

Given the increasing importance of customer-level information, companies must become adept at tracking information at several levels—individual, segment, and aggregate. Different strategic decisions require different levels of information, so companies typically need multiple information sources to meet their needs.

At the individual customer level the key metric is customer lifetime value; the marketing activities tracked most closely are direct marketing activities; and the key sources of data are customer databases that the firm compiles. At the segment level the key metric is the lifetime value of the segment (the lifetime value of the average customer times

New Metrics for a New Model

The shift from marketing products to cultivating customers demands a shift in metrics as well.



the number of customers in the segment); the marketing activities tracked most closely are marketing efforts targeted at specific customer segments, sometimes using niche media; and the key sources of information are customer panels and survey data. At the aggregate market level, the key metric is customer equity; the marketing activities tracked most closely are mass marketing efforts, often through mass media; and the key sources of information are aggregate sales data and survey data. We see that firms will typically have a portfolio of information sources.

Clearly, companies need metrics for evaluating progress in collecting and using customer information. How frequently managers contribute to and access customer information archives is a good general measure, although it doesn't reveal much about the quality of the information. To get at that, some firms create markets for new customer

information in which employees rate the value of contributions.

Like any other organizational transformation, making a product-focused company fully customer-centric will be difficult. The IT group will want to hang on to CRM; R&D is going to fight hard to keep its relative autonomy; and most important, traditional marketing executives will battle for their jobs. Because the change requires overcoming entrenched interests, it won't happen organically. Transformation must be driven from the top down. But however daunting, the shift is inevitable. It will soon be the only competitive way to serve customers.

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