

PART III

STEP 2: ESTIMATING THE VALUE OF CUSTOMERS AND PROSPECTS

1. Identify customers
and prospects

2. Valuation of
customers/
prospects

3. Creating and
delivering
messages and
incentives

5. Budgeting,
allocation, and
evaluation

4. Estimating
return on customer
investment



HOW TO DETERMINE FINANCIAL VALUES OF CUSTOMERS AND CUSTOMER GROUPS

The goal of step 2 of the IMC process is to determine the financial value of customers and prospects in order to make intelligent marcom investments. By setting this goal, it should be clear that value-based IMC differs from traditional approaches to marcom planning. Inherent in the IMC methodology is the premise that marketing communication can be raised to the level of a strategic corporate activity, not just operated as a functional tactic used on a hit-or-miss basis. As a strategic tool, IMC must be viewed as an investment the organization makes rather than as an expense it incurs. And finally, it clearly illustrates why customers are the most critical element in the firm's value chain. Customers, their value, and the income flows they create are the basis for organizational investments simply because they are one of the primary elements that generate financial returns for the organization.

Customers, in a strategic sense, have asset value for the company. While message creativity and communication delivery systems are still critically important to the success of any marcom program, they play a new role in organizations that practice IMC (see Chapters 7 and 8).

This chapter looks at customers as assets that provide firms with real and ongoing financial returns on their communication investments. Further, we provide the basic elements that allow the IMC manager to move from simply being the one who allocates corporate communication resources to the role of a steward of customer income flows.

Determining Financial Value

Step 2 of the IMC process requires the IMC manager to develop a methodology for determining the financial value of customers and prospects. This starts by understanding the purchase dynamics of each aggregated customer group and the share of their purchasing in the category that is directed to the firm or brand. The approach is based on an understanding of the current level of demand for the firm's products or services and must include an estimation of projected potential demand. As discussed in Chapter 3, a customer's demand is stated in financial terms—that is, anticipated income flows—and not volume, product units, or capacity measures. Using this financial view of customer value, the IMC manager establishes appropriate behavioral objectives for each customer group. For some groups, it may be acceptable simply to maintain current spending levels, while for others, the company may wish to increase spending or migrate customers to a different, more profitable line. For those who are not users of the product, the plan may be to obtain a trial purchase in anticipation of acquiring them as ongoing customers sometime in the future. Underlying all of these scenarios is the need for an initial baseline valuation to provide the financial footing from which the manager will determine the returns on customer investments in steps 4 and 5.

To determine returns, the manager must first have some idea of initial customer value. This is critical, for it provides a baseline to determine how much the firm is willing to invest in any customer, prospect, or group over various periods of time. It further enables the manager to measure the returns the company did or might achieve on the investments made in those customers.

Seeing Customers as Assets and Communication as an Investment

Because of accounting conventions, most organizations currently treat marketing communication as a corporate or business unit expense. The firm determines how much it is willing to spend on marketing programs for a period of time, usually a fiscal year, and then sets that amount as a budget item or at least as an expected expense. A budget management system is then developed, and management controls and financial constraints are established to control the flow of expenditures.

All this is done because, in most organizations, marketing communication is a cost-centered activity, that is, an expense that must be managed, apportioned, and monitored. Budgets are set up so that there are constraints on the marketing or communication managers that prevent them from spending more than the planned and approved amount. If budget savings can be achieved through consolidating, optimizing, or simply not spending the amount initially budgeted, then those savings become expense reductions and drop immediately to the firm's bottom line.

Since marketing communication is considered a cost function, there is generally little expectation by senior management that there will be any financial returns from the marcom investment. This is true even though management commonly asks marcom managers to "prove the value" of their marketing and communication programs. The challenge is to show that sales or margins, volume, or some other financial measure improved as a result of an investment in a marcom program. This is a critical element in the IMC process and is covered in more detail in steps 4 and 5.

Look again at the step 2 portion of Exhibit 3.7 on page 70. In step 1, customers were aggregated by their behaviors into present, competitive, and emerging categories. Step 2 lists the behavioral objectives marketers hope to gain through the communication initiative. Obviously, each of these customer or prospect groups generate differing flows of income to the firm. Some cost more to manage than others, so they may be less profitable. Some are more expensive to acquire than others, so

their income flows take longer to become profitable. Lost customers generate zero cash flows and attracting them back may require additional investment. When marketers view customers and prospects in terms of characteristics like these, they can start to consider the various types of marketing and communication programs needed to influence the behavior of each. Further, they begin to see that differing levels of investment in marketing communication will likely be required and will likely generate differing levels of return.

Viewing customers and prospects as current or prospective income flows to the firm is the key element in understanding the value-based IMC approach to marketing communication. The questions marketers ask now are as follows:

- What customer behaviors are to be influenced and with what result?
- What customers and prospects are to be acquired and at what cost?
- Who will return what value?
- Which customers are to be retained?
- Which customers are to be migrated to a more profitable line as a result of the firm's marcom investments?

In attempting to answer questions like these, it again becomes clear that the goal of marketing communication in an IMC approach is to influence customer income flows as a result of marcom activities. Customers are clearly positioned as assets of the organization, no different from any other asset that generates income and profit. Plants and factories are built with the idea that their output will generate future income flows for the firm. Investments in research and development and information systems are made in the expectation that their outputs—in the form of innovations, product enhancements, or cost savings—will generate positive income flows for the firm. Integrated marketing communication treats marcom activities in the same way. Thus, the assets of the organization must be used to generate income flows and profits; customers are assets because they generate income flows and should be managed as such. This is a lesson that has been well learned by compa-

nies such as FedEx, Prudential Insurance, Marriott Hotels, and the British supermarket chain, Tesco.

THE TESCO WAY

Today, grocery stores around the world use loyalty programs of some kind or other to collect data on shoppers. Yet in most cases only a very small amount, if any, of that data is ever used, and rarely is it applied in a way that can truly influence loyalty. An important exception is Tesco, the United Kingdom's leading supermarket chain. In 1994, Tesco decided its Clubcard program needed improvement. With the data analytical firm, dunnhumby associates, Tesco decided to take advantage of the data provided by Clubcard users and learn about customers' values, behavior, and needs.

Tesco's Clubcard collects data on how much customers spend, as well as where, when, and what products they buy. Based on Clubcard and merchandising information, Tesco aggregates customers into precisely defined, relevant marketing groups. Using the segmentation scheme, the company can manipulate price, product, and promotion to fit various groups of customers. According to dunnhumby,

By understanding what matters to shoppers on a budget, for example, they can be really competitive on the products they buy. By understanding what promotions work for customers, Tesco and listed suppliers can reduce the volume of promotions in-store, yet increase overall returns. The range of products on the shelf is tailored using knowledge of how customers shop across brands, with a subtlety that product data alone can never reveal.

Originally, promotions and coupons that were sent to families varied depending on the data. In 1995, only six variations existed. Today, more than one hundred thousand variations are changed weekly. Customers receive targeted offers based on what they

do and do not buy, their spending levels on particular products, their responsiveness to other offers, and much more.

Tesco is now one of the most successful grocery stores in the world, and retail chains everywhere try to emulate its use of customer data. The company's ability to apply data from all areas of the store has been the distinguishing factor that has contributed to its success.¹

Developing a Customer/Prospect Valuation Methodology

A useful customer valuation methodology must provide a view of historical, current, and future financial value. In too many cases, traditional financial valuation methodologies have been limited to historical data, that is, what the customer was worth in the past. Past value has then been used to forecast what the customer or prospect might be worth in the future. While these approaches are valuable, they do not take into consideration the limitations on customer retention and growth. In other words, they assume the marketer is in control of the customer and the marketplace as well as marketing activities.

Traditional valuation methodologies further assume that all customers are equal or have equal value. For almost every product category that has been studied from a marketing standpoint, that is simply not true. Some customers and prospects are worth more than others. They spend more in the category. They are more profitable. They are more loyal. They are simply better customers than the general customer pool.

For example, in most product categories there is what is termed the "80/20 rule," or the Pareto rule (named after Italian economist Vilfredo Pareto). The rule simply states that 20 percent (perhaps a bit more or less) of customers commonly contribute approximately 80 percent of the firm's sales, profits, or income. The importance of the 80/20 rule cannot be emphasized enough for it forms the basis for almost all market aggregation. That is, in almost every company, a relatively small group of customers is critically important to the success of the com-

pany. In *Not All Customers Are Created Equal*, Garth Halberg quotes research indicating that within the yogurt category, 16 percent of U.S. households account for 83 percent of all purchase volume.² Similarly, he cites research by Folger Coffee Company indicating that 15 percent of households account for 70 percent of sales volume. A credit card marketer with which we are familiar took the analysis a step further to examine profitability by customer group. It discovered that a mere 12.8 percent of its active cardholders accounted for 90 percent of profits.

Table 5.1 shows that the Pareto rule holds true for services as well. The table captures customer data from a resort hotel over a recent one-year period. Each of 19,420 customers was first classified by the total amount of money spent in the hotel during his or her stay. Customers were arranged in descending order from those who spent the most to those who spent the least. Then, all of the classified customers were aggregated into ten equal groups of 1,942 members. (This division by tens is termed *decile analysis*.) This exercise clearly illustrates that some customers are much more valuable financially to the hotel than others. Indeed, 30 percent of the customers, the first three deciles, accounted for nearly 80 percent of total spending. Decile analysis is a commonly used approach to categorize customers. We discuss this approach in more detail in later sections of this book.

Note that this analysis is limited to customer spending. There is no data on age, gender, size of family, previous spending, geography, or other information to help explain these spending patterns. But since behavior and financial value of behaviors are at the heart of IMC, this is an excellent starting point for placing values on customers as assets.

Customer Brand Valuation

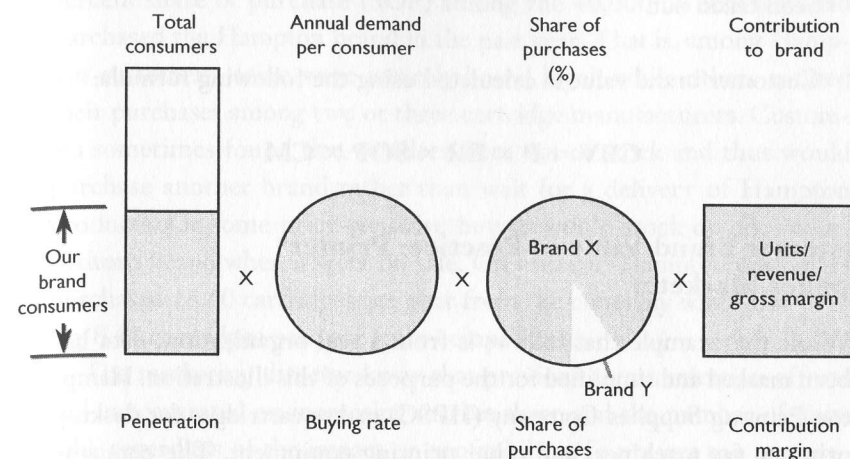
Targetbase, a database consulting group based in Irving, Texas, has developed an innovative approach to valuation that goes far beyond simple decile analysis. The method seeks to define an overall customer brand value (CBV).³ Targetbase starts with the financial value that a customer (or group of customers) could represent to the brand's profitability. As shown in Exhibit 5.1, four factors underlie the CBV valuation.

Table 5.1 Decile Ranking of Hotel Customers by Total Revenue

Decile (%)	No. of Guests	Cumulative No. of Guests	Total Revenue	Cumulative Revenue	% of Total	Minimum Expenditure	Average Expenditure
10	1,942	1,942	\$13,501	\$13,501	57.5	\$2,322	\$6,952
20	1,942	3,884	\$3,257	\$16,758	71.4	\$1,248	\$1,677
30	1,942	5,826	\$1,987	\$18,745	79.9	\$843	\$1,023
40	1,942	7,768	\$1,402	\$20,148	85.9	\$613	\$722
50	1,942	9,710	\$1,045	\$21,192	90.3	\$468	\$538
60	1,942	11,652	\$790	\$21,983	93.7	\$348	\$407
70	1,942	13,594	\$602	\$22,585	96.3	\$278	\$310
80	1,942	15,536	\$487	\$23,072	98.3	\$226	\$251
90	1,942	17,478	\$349	\$23,421	99.8	\$100	\$180
100	1,942	19,420	\$40	\$23,460	100.0	\$0	\$21
Totals	19,420		\$23,460				

30% of customers = 80%+ of total revenue

Exhibit 5.1 Calculating Customer Brand Value



$$\text{\$ CBV} = P \times BR \times SOP \times CM$$

Used with permission from Targetbase, Inc.

- **Penetration (P).** The number of customers the firm has as a percentage of the total number of customers in the category.
- **Category buying rate (BR).** The average annual (or other time period) demand for the product, service, or brand per the customer.
- **Share of purchases (SOP).** The proportion of total customer purchases that the marketing organization enjoys. In other words, what percentage of all purchases in the category do customers give to the marketer's brand or firm? For example, if customers spend \$100 per year on duct tape, what percentage do they spend on the firm's brand of tape?
- **Contribution to margin (CM).** How much of the total purchases made by the customer results in income flows at the company's contribution margin line? This is the key element in the evaluation, since it gets to the actual financial return to the organization, not just the dollar amount of the product sale at retail. Since the firm invests net dollars to purchase various forms of marketing communication, it is important to know how many

net dollars the organization actually receives once all costs have been taken out.

Customer brand value is calculated using the following formula:

$$CBV = P \times BR \times SOP \times CM$$

Customer Brand Value in Practice: Printer Supplies Marketer

While the example that follows is from a real organization, data has been masked and simplified for the purposes of this illustration. Hampton Printing Supplies Company (HPSC) makes cartridges for desktop printers, fax machines, and other printing equipment. The company has targeted the small office/home office market and uses a combination of retail distribution and direct marketing sales to customers and prospects. The company has high brand awareness but has seen the category become increasingly saturated and “commoditized” as other companies have entered the field. A new marketing director believed the company could better manage and direct its marketing resources against the most valuable customers in its segment. As a result, she raised several key questions typical of issues confronting many marketers:

- Which product owners are most important to HPSC now and into the future?
- What actions do we want them to take?
- How much should we invest in them?

Using an in-house database as well as external industry data, the marketing team identified 100,000 owners of compatible printers within its Southeastern region. They then found that 40,000 of those owners had purchased Hampton brand cartridges at least once within the past year. They estimated that there were a total of 200,000 printers in the region (that is, an average of two printers per customer) and that each printer required an average of 12 refills per year. Thus, the annual demand per printer owner was 24 cartridges per year.

The marketing director estimated that the company received a 65 percent share of purchase (SOP) among the 40,000 owners who had purchased the Hampton brand in the past year. That is, among Hampton customers, some were entirely brand loyal, while others rotated their purchases among two or three cartridge manufacturers. Customers sometimes found that retailers were out of stock and thus would purchase another brand rather than wait for a delivery of Hampton products. Or some price-sensitive buyers would stock up on a competitor's brand when it went on sale. On average, Hampton customers purchased 15.60 cartridges per year from the company while also buying 8.40 cartridges per year from competitors.

The marketing director knew that previous communication efforts had concentrated on increasing market share and the number of units sold, regardless of the impact on profitability. To present top management with an alternative strategy, her plan was to frame the discussion not in terms of units or volume, but in terms of profitability to the company.

Working with the company's chief financial officer, she determined that the gross margin for cartridges was \$6.50 each, in line with industry average. That meant that the typical buyer in the region was potentially worth \$156 in profit each year (24 purchases \times \$6.50). The problem was that Hampton buyers gave the company only 65 percent of their total purchases. Thus, in reality, each customer was worth an average of only \$101.40 (\$156 \times 65%). The remaining \$54.60 in gross margin sales went to competitors.

Here, we summarize the data covered so far:

Penetration (P)

Total identified customers in market = 100,000

Number of Hampton brand customers = 40,000

Penetration of Hampton brand (100,000/40,000) = 40%

Buying rate (BR)

Average printers per customer = 2

Average refills per year per printer = 12

Average annual demand per customer (2 \times 12) = 24

Share of purchase (SOP)

Hampton brand share of purchase = 65%

Hampton demand per customer ($2 \times 12 \times .65$) = 15.60

Contribution margin (CM)

Gross margin per unit sold = \$6.50

Value of a customer ($P \times BR \times SOP \times CM$)

Average value per category customer ($2 \times 12 \times 6.50$) = \$156.00

Average value per Hampton customer

($2 \times 12 \times .65 \times 6.50$) = \$101.40

The marketing director immediately saw two areas of opportunity:

- To increase the company's penetration among buyers in the region—that is, to go after the 60,000 printer owners who do not use the Hampton brand
- To increase Hampton's share of purchase, meaning to capture more of the 35 percent of Hampton-buyer purchases that is going to competitors

The marketing director, however, found these two alternatives too broad. Her resources were too limited to chase after the entire marketplace. She felt that by analyzing the company's in-house customer database she could better pinpoint specific opportunities. She aggregated customers in the database first by usage and found three distinct groups:

- **Heavy users.** Twenty percent of buyers purchased 34 or more units a year, with an average of 42.4 cartridges.
- **Medium users.** Sixty percent of buyers bought 14 to 33 cartridges per year.
- **Light users.** Twenty percent of buyers bought 13 or fewer units per year.

Next, she aggregated those customers according to their buying behavior, that is, how loyal they were to their primary brand or brands. Again, she developed three groups:

- **Loyal users.** Fifteen percent gave all or most of their share of purchases to their preferred brand.
- **Switchers.** Fifty percent rotated their purchases between two or three preferred brands.
- **Price buyers.** Thirty-five percent bought cartridges only when they were on sale, regardless of brand.

From here, the marketing director developed the strategy formulation matrix shown in Exhibit 5.2. She simply crossed the usage data by the buying behavior aggregation. (Again, we are using simplified data for this example and assume even distribution of each segment across the matrix.) By incorporating CBV analysis information computed earlier, she was able to determine the potential reward for each group along with the appropriate behavioral goal.

The matrix suggests three alternatives:

- **Group A.** These buyers represented highly loyal, heavy users who gave most of their purchases to their preferred brand. Because each customer used an average 42 cartridges per year, they represented a significant financial value, that is, \$273 in gross profit per customer each year rather than the \$156 of the "average" customer across the entire market. Unfortunately, this group represented only about 3 percent of the buying universe. Thus, the marketing director did not feel it offered significant growth opportunity for her investment. The

Exhibit 5.2 Strategy Formulation Matrix

	Heavy Users (20%)	Medium Users (60%)	Light Users (20%)	Total
Loyal users (15%)	3,000 ^a	9,000	3,000	15,000
Switchers (50%)	10,000	30,000 ^b	10,000	50,000
Price buyers (35%)	7,000	21,000	7,000 ^c	35,000
Total	20,000	60,000	20,000	100,000

a. Each customer is potentially worth $42 \times \$6.50 = \273 in profit.
Goal: Acquire and retain

b. Each customer is potentially worth $24 \times .65 \times \$6.50 = \101.40 in profit.
Goal: Convert to loyal users

c. Each customer is potentially worth $7.5 \times \$4.50 = \33.75 in profit (at best).
Goal: Retain as cost-effectively as possible

goal for this segment, then, would be to acquire those who were not already using Hampton products and—most importantly—make sure the company retained those it already had. The marketing director knew that it would be difficult to switch those who were strongly loyal to another brand, so she questioned whether she could better deploy marketing resources elsewhere.

- **Group B.** This group represented individuals with lighter than average consumption, only 7.5 units per year. When they did need a refill cartridge, they appeared to buy a brand only if it was on sale. Such customers, the marketing director thought, offered little financial opportunity to Hampton. Assuming that it would take a \$2.00 discount to incite their purchase, thus reducing the HSPC gross margin from \$6.50 to \$4.50 per cartridge, each customer would represent a profit of only \$33.75. And that would occur only if customers gave all of their purchases to Hampton. While the marketing director did not want to walk away from this segment, she recognized that she must retain those buyers she could using the most cost-effective means possible.
- **Group C.** This large group was attractive to the marketing director because of its size and therefore the opportunity for potential profitable growth. The economics of this group are similar to the average Hampton buyer, that is, each customer represents about \$101.40 in profitability. Because of the size of the group, however, the marketing director recognized she would have to fight hard to protect and increase her share among these current users. Additionally, because these customers were not highly loyal to other brands, she felt she likely stood a better chance of converting these switchers to the Hampton brand than converting some of the other groups.

As the experiences at HSPC clearly illustrate, CBV allows the IMC manager to identify which customers are most valuable, which have the greatest potential, which must be protected and their income flows retained, and so on. With this type of valuation analysis, which is not particularly complicated or difficult, marketing and communication managers can start to build a basic platform for their marcom programs that encompasses what the program should be designed to achieve, how

much they would or could be willing to invest, how returns could be measured, and—most importantly—how the firm should or could invest its finite financial resources among marketing communication target customers and communication alternatives.

Customer brand value is particularly suited to categories in which an identifiable group of customers and prospects makes ongoing purchases of a product or service according to reasonably predictable consumption and repurchase patterns. Thus, it is extremely useful in planning for products such as consumer packaged goods, industrial supplies, gasoline, airline travel, and so on. It is less useful in categories where purchase is spontaneous or difficult to anticipate or where customers do not spread their purchase among more than one provider, such as financial services, automobiles, home furnishings, or management consulting services.

Creating Customer and Marketplace Value

To this point, we have viewed customers and prospects primarily as passive entities that can be manipulated at the whim of the marketing communicator. In other words, the marcom manager has all the tools, all the expertise, and all the skills and capabilities to create communication programs that will manage the behavior of customers and prospects. While this is a commonly held belief, nothing could be further from the truth. Value is in the eye of the beholder. It is the customer who determines what value the product or service offers him or her individually. It is customers or prospects who determine whether or not the price/value relationship is appropriate for their use or for use by their company. It is customers or prospects who decide on brand or company loyalty. In short, the customer, not the marketer, is in control of the marketplace. The faster organizations move toward networked, interactive, and dialogue-driven marketplaces, the more true this will become.

How, then, does the marketer create value in the eyes of the customer? In most marcom planning approaches, it is assumed that certain forms of customer value are inherent in the product or service the orga-

nization is vending. Therefore, historically, the task of the marcom manager has been to identify those values and communicate them to customers and prospects. Or, in some cases, the benefits or values may be latent in the product or service and the communicator must identify them and then use them to persuade customers and prospects of the desirability and value of the product or service. In either case, value is determined by the marketer, or—at least—the marketer determines in advance the value the customer or prospect should consider or the features that should be of value. The focus of traditional advertising on finding a unique selling position, or “inherent drama,” in every brand is based on the age-old assumption that the marketer is in control of the offering and its value. The marketer determines what the composition of the product or service will be, how it will be distributed, what price will be asked, who will be told about the value, when the value will be communicated, and so on.

Associated with this assumption is the common marketer belief that any product or service can be “sold” to consumers if the marketer has enough money, is clever enough with the marcom program, and is given sufficient time. That’s why much of the present promotional planning is based on such notions as “creativity,” “share of voice,” “ubiquity of distribution,” and other factors over which the marketer has control. As noted in Chapter 1, the outdated but seemingly immovable Four Ps marketing model is all about control. If the marketer can get the product, price, place (distribution), and promotion right, the customer will buy and continue to buy over time. In short, it is a marketer-controlled system in which the marketer assumes power over all marketplace elements: money, raw materials, manufacturing technology, information technology, channels, media, and communication. The consumer is little more than a pawn to be manipulated by the marketer and influenced by the company’s communication programs.

The reality, however, is that in today’s interactive environment, control is quickly slipping away from the marketer. In the new marketplace, driven by the Internet, mobile and wireless communication, instant messaging, and other technological advances, customers have the upper hand. They can view, shop, and buy from all types of alternative systems, ranging from bricks and mortar retail outlets to E-commerce sites. People are no longer restricted to goods and services that are

immediately available geographically or during certain time periods. Indeed, customers and prospects are able to identify, evaluate, and purchase products and services from all over the world using their own time frames and through processes they set up. Control over time and distance, once the domain of marketers, simply disappears or shifts into the hands of individual customers and prospects.

The companies that have been successful in pleasing this new breed of customers have enhanced the value of their brands in the eyes of consumers, often by finding ways to personalize mass-produced products. Lee Jeans stores, for instance, will take a customer’s measurements and make a pair of jeans especially for that individual, exactly the way he or she wants. A customer can order a Dell computer with the specific components that he or she needs. In Asia and Europe, the wide variety of cell phone covers and personalized rings is Nokia’s way of personalizing the cell phone. Even My Yahoo attempts to personalize its brand of Web services for the customer.

As well as control over the product, traditional marketing also sought control over the value chain. In *Competitive Advantage: Creating and Sustaining Superior Performance*, Michael Porter describes the traditional process whereby the marketer, the channels, and the media commonly created “value chains” in which desirable features and elements were added along the way as the product or service moved from seller to buyer.⁴ According to Porter, in the traditional value chain, the marketer or marketing system and its partners delivered customer value for the basic product or service through assembly, distribution, stocking, and other methods. In each step, it was assumed the marketer added value for the ultimate customer. Of course, the value-adding organization expected to take a margin or generate some income for its efforts. Therefore, the actual product itself, by the time it was available to the end user, commonly cost three to twenty times more than it actually cost to manufacture. Traditional marketing further assumes the value chain is linear, that is, it flows from the manufacturer through all the value-adding steps on the way to the end user.

The problem with this view, of course, is that in many cases some of that costly “added value” is not wanted or needed by the consumer. In today’s interactive marketplace, the consumer—not the marketer—controls much of the value chain. For example, the end user may decide that

buying a book through a local bookshop really provides little extra value. As an alternative, amazon.com offers wide selection, competitive service, and an easy purchase and delivery system. Similarly, a wooden door manufacturer may decide to choose from a wide variety of suppliers for a certain standardized group of hinges and door hardware. FreeMarkets On-Line will organize a widely dispersed group of suppliers, qualify them in terms of their capacity to provide the required hardware at the necessary quality level, and then set up an online auction in which various suppliers bid for the door manufacturer's order. Here, roles are reversed. The hardware manufacturer does not target and market to its ultimate customer, the door maker; instead, with the help of FreeMarkets, the customer is in control of the buying process. Potential sellers are then left to make bids to provide that value at the price they are willing to offer.

The automotive industry offers another good example that recognizes the shift of power from seller to buyer. In 2000, DaimlerChrysler, Ford Motor Company, and General Motors announced efforts to work together to form a single global business-to-business supplier exchange. The results of their efforts emerged under the name of a new company called Covisint, with the goal to become the central hub where original equipment manufacturers (OEMs) and suppliers of all sizes could come together in a single business environment using the same tools and user interface. When the company was formed, Covisint was envisioned as an Internet leader, similar to eBay, with a bidding and purchasing system for everyone who sells products to the automobile industry. The company would help increase supply chain efficiencies and reduce costs for both the supplier and the automobile manufacturer. While there have been several challenges for the newly formed company, it was formed with this twenty-first-century concept: there is an increase in power and knowledge for both suppliers and manufacturers when they combine and cooperate.

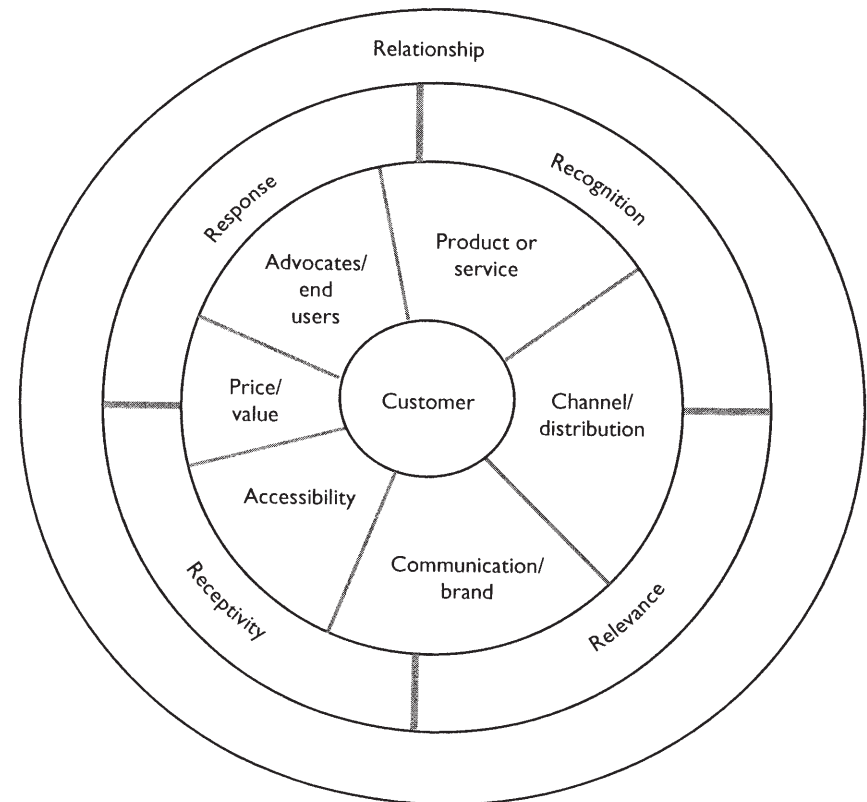
Learning the Five Rs of IMC

This switch in the determination of "value add" that reverses the traditional value chain is critical to understanding IMC. Since IMC puts

the customer at the center of the organization, it changes the entire concept of value. No longer is value added sequentially as in the traditional model. Instead, the customer determines value and selectively adds that value from the marketing system using only those elements that provide the greatest value to him or her. One might refer to this as a demand chain rather than a supply chain. In Exhibit 5.3, we visualize this "customer value add" as a series of circles surrounding the customer or prospect from which he or she or the firm can select, combine, and organize products and services in ways that create the greatest personal or organizational value.

At the center of the system is the customer or prospect. Surrounding the customer are the traditional marketing value-add systems,

Exhibit 5.3 IMC Circular Value Add



including product/service specifications, price, channel or distribution system, communication and information, and so on. The initial value-added elements shown include the traditional Four Ps. However, we have added others that become more relevant, such as the influence of advocates, endorsers, and communities of interest, as well as accessibility, or the ways in which the product or service can be obtained. While the added values we have shown in the first ring around the customer are not exhaustive, they are illustrative of the new concept of the customer or prospect selecting the value to be added and essentially creating much of the value enhancement for themselves.

The second concentric ring includes the first of what we call the new Five Rs of IMC. Where traditional marketing focused on the Four Ps—product, price, place, and promotion—IMC concentrates on the following:

1. **Relevance.** This term is used to determine how relevant the marketing firm can be to the customer in terms of making products and services the customer wants and needs. Beyond this, the marketer must further provide relevant, compelling, and meaningful communication as well as relevant, competitive pricing and relevant distribution systems through which the customer can acquire the product or service.
2. **Receptivity.** This term has two meanings in the context of strategic IMC. On one hand, marketers want to be able to reach customers and prospects when they will be most receptive to the message. That is, if a marketer is selling hamburgers, the best time to reach them will be when they are hungry. So, the question is when and at what point of brand contact will the customer or prospect be most receptive to the message or incentive? Receptivity also encompasses how open the organization is to new ideas, new concepts, and new methods of doing business. Inherent in this is the idea that IMC is not simply about how the company wants to communicate; it is, instead, about how the customer wants to communicate or be communicated with. This requires receptivity to new approaches on the part of the marketer.

3. **Response.** There are two aspects to this term in the IMC context. First, response raises the question of how easy it is for the customer or prospect to respond to the company's offerings. Is the company easy to do business with, and does it effectively facilitate the transaction process at every possible point of contact? Second, response refers to how well the organization can sense, adapt to, and answer the needs and wishes of its customers and prospects. In an interactive marketplace, the key skill of the marketer is no longer his or her ability to plan, develop, and implement marketing and communication programs. Instead, it is to be able to respond appropriately to customer needs and wants.
4. **Recognition.** As with receptivity and response, recognition has dual meanings. First, it reflects the firm's ability to recognize a customer at important points of contact and to immediately connect to the firm's stored knowledge about that customer. In other words, when a customer calls its toll-free number, can the answering representative immediately draw on the customer's transaction and service history to facilitate the call? Or does the company recognize a returning visitor to its website, and does it have the ability to link that visit to previous activity? Second, recognition has to do with the customer's ability to recognize and select the organization's brand from a given array of alternatives. Are prospects and customers aware of the brand? Do they associate it with particular needs and uses? Are they able to understand what differentiates this brand from those of competitors?

Exhibit 5.3 shows the first four Rs as surrounding the customer or prospect. Depending on how the customer or prospect wants to obtain value through the first circle, the second circle illustrates the types of additional value he or she can receive from the company because of its organizational structure, company focus, willingness to change, and so on. In short, the first four Rs reflect the additional value the marketer wants to provide for the customer.

At the outer edge of the new value-add circle system is the single element of relationship, the fifth R.

5. Relationship. This term has come to mean many things in marketing. Trends like customer relationship management (CRM), customer relationship marketing, and one-to-one marketing all revolve around *relationship*. Unfortunately, as it is used in marketing, the term essentially suggests the marketing firm can create a relationship with customers based on data, analysis, and various forms of communication primarily based on the use of information technology. In value-based IMC, the customer is the one who creates the relationship, not the marketer. It is the customer who decides with whom he or she will do business and under what time and situation constraints. The power of the customer is key in understanding the customer-centric view of IMC: the customer decides, the marketer responds.

Let's look at a real-world example to review the Five Rs. The online community website, women.com, offers editorial content and E-commerce services on issues that are important to women. Through chat rooms and bulletin boards, the site can obtain insights about consumers, including demographic, psychographic, and behavioral information. This information is used to understand how the customer thinks. By collecting more than just demographic data, the site can offer advertisements, promotions, and editorial articles tailored to individual consumers. In this way, women.com achieves both *relevance* and *recognition*. The member can access the site at a time that is most convenient for her, when she is most interested in receiving information, which equates to *receptivity*. The site builds a dialogue with the consumer, in which the consumer talks and women.com listens and learns, achieving *response*. A brand such as women.com that listens and has a *relationship* with the consumer is more effective than a brand with no relationship at all.

Using the Five Rs of IMC rather than the Four Ps of traditional marketing changes the way in which managers think about and develop marcom programs. Just as we suggested changing the model of how customers and prospects are valued by the firm, so too must the planning of marketing and communication programs change.

Three Key Questions

After working through steps 1 and 2 of the IMC process, the marcom manager should be able to answer three critical questions based on the customer and prospect data assembled so far:

- Who are the firm's best customers, and why?
- Who are the firm's best prospects, and why?
- What information does the marketer need to be more relevant to customers and prospects?

Moving On

A marketer who can answer these three questions is almost ready to move to step 3. Before we do that, however, it is important to summarize the approach to customer valuation. Valuation starts with the marketer's view of customers, particularly in terms of customer income flows and their contribution to margin. Defining customers in these terms tells the marketer who the company's most important customers and prospects are or might be. But to develop effective marcom programs, the marketer must also understand the customer's view of the brand, product, or firm. This introduces a reciprocal view of the marketplace, requiring the marketer to look at value through the eyes of the customer, not just from the standpoint of the organization. The strategic, value-based IMC approach demands this total view of the customer if effective marcom programs are to be developed and delivered. Therefore, before moving on to step 3, we will discuss the concept of reciprocity and how it relates to the challenges of integration. This is the topic of the next chapter.