



CHAPTER I

Evaluating Customer Relationship Potential

CHAPTER I: EVALUATING CUSTOMER RELATIONSHIP POTENTIAL

“Our best approaches to segmentation still don’t allow us to gauge customer relationship potential.”

“Silos in our organization make it really hard to understand the total customer opportunity.”

- *The Logical Starting Point*—Profitable relationship deepening requires suppliers to allocate scarce resources to customers most likely to yield the greatest potential “relationship ROI.”
- *Missing the Forest for the Trees*—However, most supplier segmentation schemes still focus primarily on volume- or revenue-based attributes; those approaches fail to illuminate attractive relationship-expanding opportunities because they do not account for important differences in customers’ suitability for partnering.
- *A New Segmentation Focus*—Progressive sales organizations are beginning to segment customers according to their strategic fit with supplier relationship objectives; this allows them to predictably improve share of customer wallet within targeted accounts.
- *Only Half the Battle*—In order to get an accurate understanding of relationship potential, suppliers must not only know the relationship-building proclivities of customers, but also the full sales potential that a customer represents. Product and divisional silo mentalities typically cause companies to overlook the total sales potential that a given customer may offer.

SEGMENTING FOR STRATEGIC FIT



Practice #1: Opportunity Fit Matrix

Quantitative and qualitative criteria regarding customers’ future value and strategic fit enable robust assessment of market segment and individual account potential.

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IDENTIFYING TOTAL RELATIONSHIP POTENTIAL



Practice #2: Segment Opportunity Map

A visual depiction of all cross-divisional opportunities available from specific customer segments allows the supplier to identify and capitalize on full segment potential.

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SEGMENTING FOR STRATEGIC FIT

The Challenge: Traditionally, companies have segmented accounts based on revenue and size, or perhaps profitability. However, most companies fail to adequately assess current and prospective customers' fit with their own long-term strategies and capabilities, leading to misallocation of resource investments.

Practice #1

Opportunity/Fit Matrix

Quantitative and qualitative criteria regarding customers' future value and strategic fit enable robust assessment of market segment and individual account potential.

Company Profiled: Square D



- Manufacturing
- FY2001 Sales: \$8.7 billion*
- FY2001 Net Income: \$873.8 million

Situation

Facing single-digit growth in the early '90s, Square D restructures its business around four broad industry segments. While this restructuring increases sales force knowledge, it fails to provide sufficient direction to the sales force regarding where to direct limited resources.

Action

To refine its segmentation strategy, Square D uses a scoring mechanism to rigorously assess the potential of each opportunity, as well as the company's ability to capitalize on it. The scores are indicative of how well each customer aligns with Square D's own strategic direction. Accounts are then plotted within an opportunity/fit matrix that dictates service strategy and resource allocation.

Result

Application of the opportunity/fit matrix surfaces previously unrecognized high-potential accounts. Since adopting this tool, revenue growth for some sectors analyzed by the segmentation exercise has grown at an annual rate of 67 percent. Furthermore, revenue from individual opportunities identified through this exercise has grown at an average of 54 percent, compared to a 12 percent average growth for all other accounts.

* Sales figures are for Schneider Electric, Square D's parent company.

Macro-Segmentation: Restructuring Around Industries

Like many companies, Square D seeks to achieve faster growth (just 3 percent between 1989 and 1992) by improving its understanding of customers. To achieve this objective, the company undertakes a large-scale reorganization, focusing on customer segments rather than products.

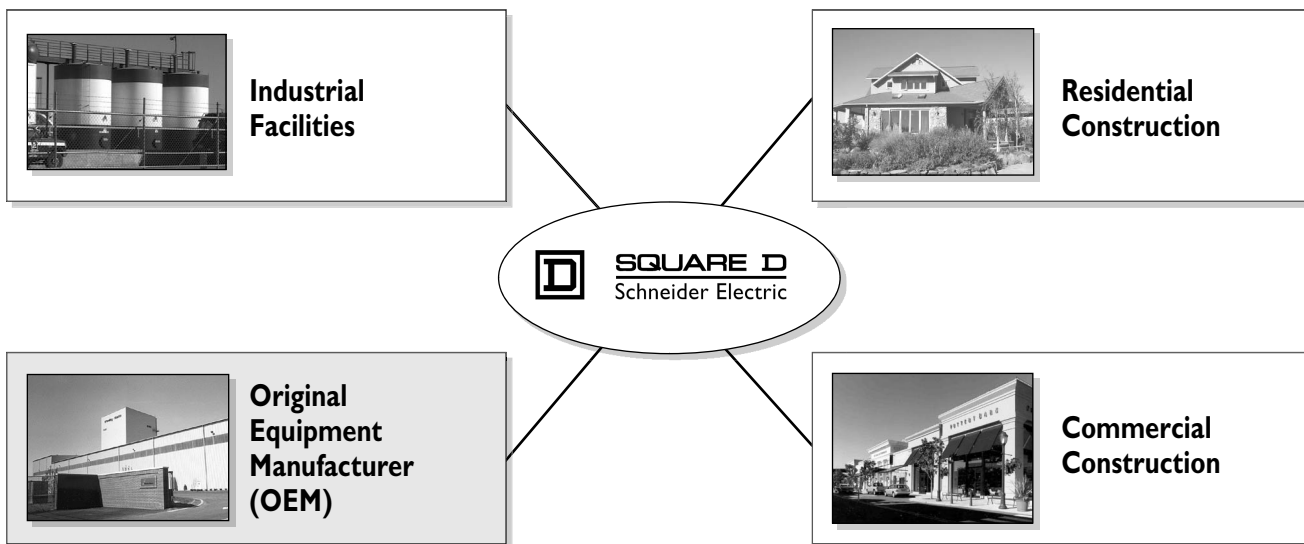
The Need to Micro-Segment: A Closer Look at the OEM Sector

While the new structure facilitates an improved understanding of customer needs, it does little to trigger revenue or profit growth. Square D discovers that knowledge of a sector does not equate with an understanding of the specific sources of value creation within that sector. A cursory look at the revenue skew within the OEM group, for example, suggests wide variance in customer value. The company decides that a much more refined view of customer value is needed in order to direct sales resources to their optimal use.

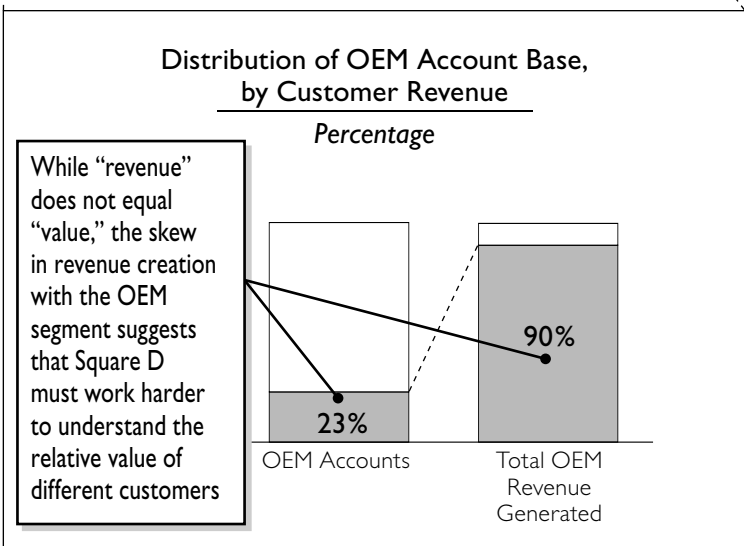
IN SEARCH OF A BETTER SEGMENTATION APPROACH

Even after restructuring around customer industry segments...

Square D's Customer Segments Post-Regulation



...Square D discovers that it needs a more focused and refined segmentation strategy to boost profitability



— CLOSE, —
BUT NO CIGAR

“We’re pretty good at picking segments, but we have a very poor track record picking individual winners.”

SVP, Sales
U.S. High-Tech Firm

A Traditional Approach

As its first step to get a more sophisticated understanding of account value, Square D decides to employ a version of an often-used Opportunity/Fit analysis. Square D plots all accounts in a three-by-three matrix (on the opposite page) that assesses the following key variables:

- 1) *Opportunity*: Long-term revenue stream obtainable from current accounts or prospects
- 2) *Fit*: Supplier's ability to capitalize on an opportunity given its own strategy and resources

Linking Customer Value to Servicing

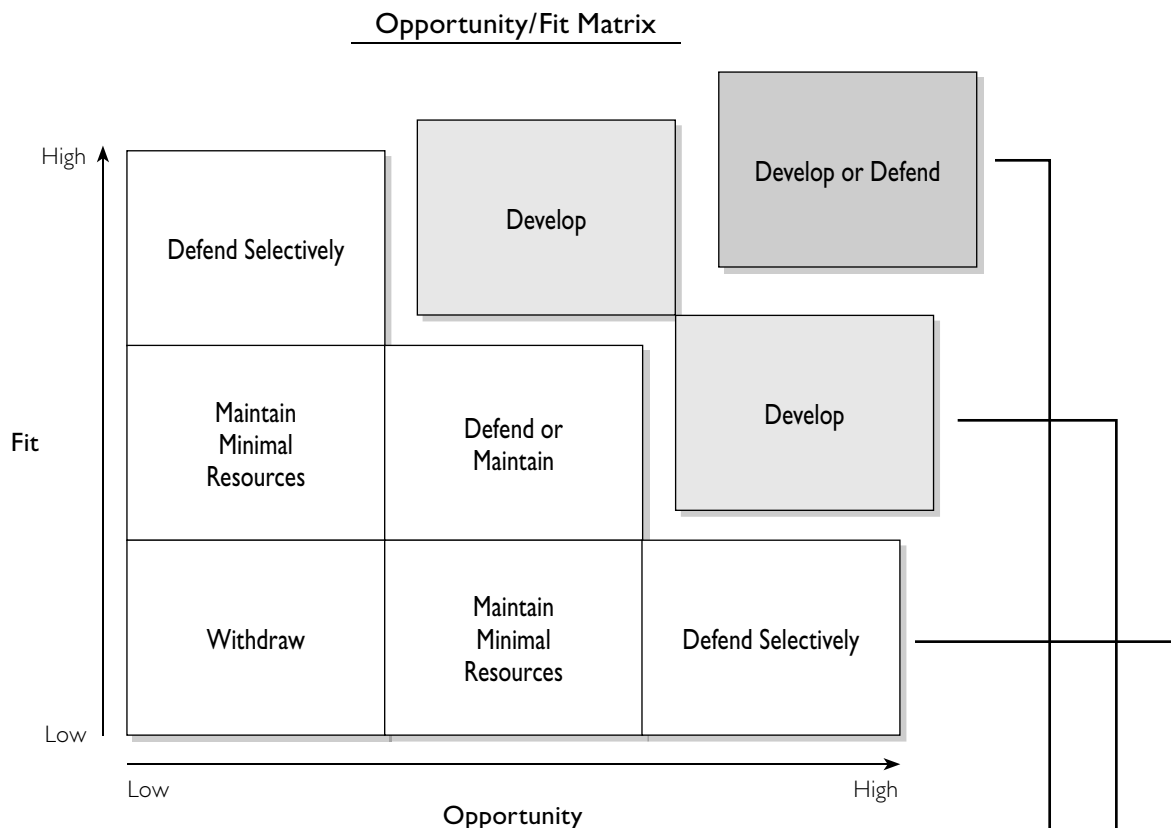
The opportunity/fit matrix serves as a tiering framework, helping Square D to decide the service strategy for each account. Thus, accounts with high growth potential (opportunity) and compatible strategies for achieving that growth (fit) receive the greatest commitment of time and resources.

The Devil Is in the Details

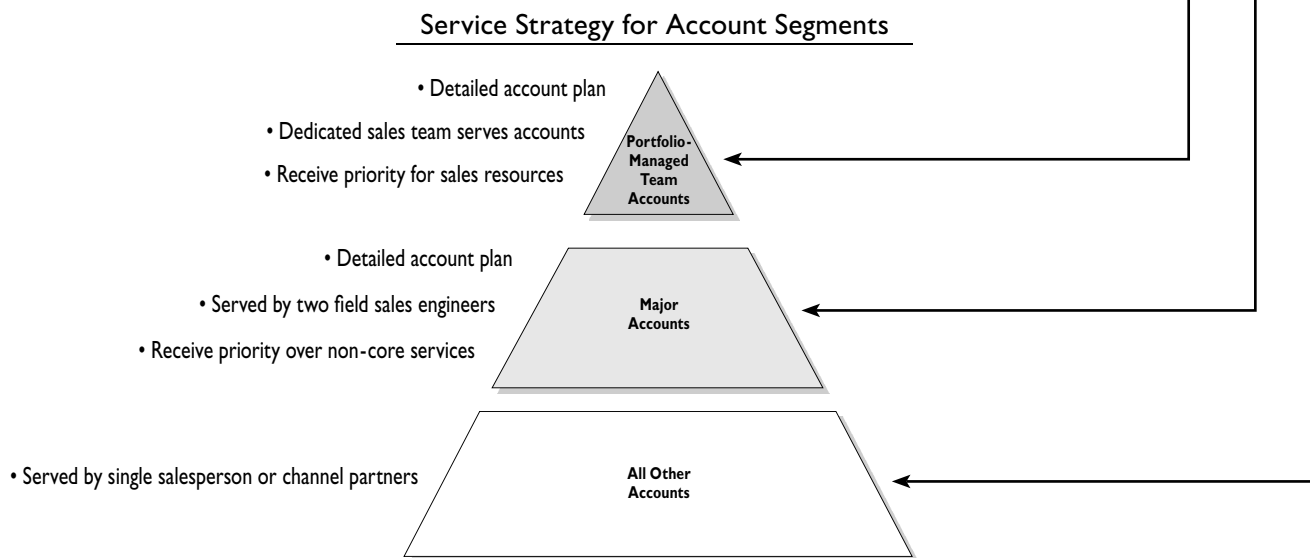
While the opportunity/fit framework is an important lens through which to assess customer value, the real difficulty is in the analysis required to achieve an accurate understanding of “fit” and “opportunity.” The criteria Square D uses are outlined on the following pages.

TEXTBOOK SEGMENTATION

By considering both market opportunity and customers' strategic fit with Square D's own business model...



...the company ensures that resources go to accounts with the greatest relationship potential



Focusing on Strategic Fit

The power of Square D's fit assessment lies in the granular approach the company has taken to understanding customers' "fit" with its strategy and capabilities, not just generic attractiveness of a company or segment. By breaking down the notion of "fit" into discrete categories and developing quantitative assessment criteria, Square D accomplishes two objectives:

- 1) Improved assessment of value of a customer to Square D specifically, not just anyone
- 2) Increased objectivity and accuracy in discussion of customer value

Granular Assessment Criteria

Each account is evaluated using a "Fit" Assessment Form, containing 13 different criteria deemed important to Square D. These criteria, selected by a team of marketers and sales managers, help determine the likelihood that a customer will become a long-term profitable partner based on Square D's unique strategy. Examples of the key elements of the "fit" assessment are described below:

- *Relationship Depth*—Square D begins by assessing the relationship depth with its current customers. Accounts where Square D already sells to senior executives at the enterprise level, for example, receive higher scores than those where contact is relegated to a functional level (e.g., procurement).
- *Cross-Sales Potential*—By targeting customers with the greatest number of product lines and engineering locations, Square D maximizes the likelihood of increasing share of wallet in the medium and long term. Focusing reps on the future potential of a customer is critical as reps tend to pursue short-term sales, foregoing the more profitable long-term opportunities.
- *Willingness to Partner*—Square D considers customers' procurement structure and their disposition toward suppliers. Armed with this kind of information, Square D avoids wasting resources on customers attempting to commoditize suppliers, as opposed to those that are open to partnerships.

A Rating and Weighting

Each criterion has a corresponding set of metrics that helps the team rate customers objectively. Furthermore, as some criteria are more important than others, Square D assigns a weight factor to each criterion in order to account for varying degrees of importance. A carefully designed weighting system facilitates alignment with the company's strategy and provides some flexibility, as weights can easily be adjusted to reflect changes in strategic direction.

A CUSTOMER BLUEPRINT

Segmentation Criteria Assess the Degree of "Fit" Between Customer Attributes/Preferences and Square D's Specific Business Strategy

Square D's OEM Fit Evaluation Form

Criteria weightings can easily be manipulated to reflect changes in corporate strategy

Major Account Name: Wenger Company¹

"FIT" ASSESSMENT

Criteria ¹	Rating Interpretation ²	Rating	Rating Applied	Weight	Total	Rationale/Explanation
1. Current Relationship at Account	<ul style="list-style-type: none"> Account Relationship with Single Function at One Level Relationship with Two Functions at Two Levels Relationship with > Two Functions and > Two Levels Thorough Relationship with Executive Contacts 	1 2 3 4	1	7	7	At procurement manager level
2. Primary Market Segment for the OEM	<ul style="list-style-type: none"> Not a Target OEM Segment for Square D Target Segment for Square D OEM 	0 3	0	6	0	
3. Account Profitability (Contribution Margin Rate at the Account)	<ul style="list-style-type: none"> < 30 percent 30-40 percent 40-50 percent > 50 percent 	0 1 2 3	1	6	6	Trend is slight profit erosion
4. Multiple Location Activity	<ul style="list-style-type: none"> One Location for All Functions Two Locations for Manufacturing Design Engineering and Manufacturing Different Locations More Than Two Manufacturing/Engineering Locations 	1 2 3 4	1	6	6	Chicago plant
5. OEM Business Type	<ul style="list-style-type: none"> Project Job = > 50 percent of OEMs Base Business Project Job = 30-50 percent of OEMs Business Repetitive Manufacturer 	0 1 2	0	5	0	
6. Potential for Lead Product Sales	<ul style="list-style-type: none"> One Main Product Line Two to Three Main Product Lines Four to Six Main Product Lines 	1 2 3	1	5	5	Primarily switches
7. Specification Influence	<ul style="list-style-type: none"> OEM Has 30 Percent or Less Influence in the Specification OEM Has Some Influence Over Spec. (50-70 percent) OEM Has Total Control Over the Specification 	0 2 4	0	5	0	Mainly driven by HVAC provider
8. Supplier Initiatives (Openness to a Partnership)	<ul style="list-style-type: none"> No Programs Supplier Reduction Is a Goal Supplier Reduction Program with Vendor Qualifications Actively Pursuing a Supplier Partnership 	0 1 2 3	1	4	4	Currently on third supplier reduction effort in four years
9. Support Requirements Versus Square D Resources/Capabilities	<ul style="list-style-type: none"> Customer Expects Square D to Engineer Solution and Options Expects Ongoing Technical Support and Problem Resolution Customer Expects Limited Technical Support Customer Expects Little or No Technical Support 	0 1 2 3	2	4	8	Historical trend
10. Decision Making/Purchasing	<ul style="list-style-type: none"> Decentralized Decision Making and Purchasing Centralized Technical or Purchasing Decisions Centralized Decision Making, Purchasing, and Control 	0 2 3	2	4	8	
11. Product Development Needs	<ul style="list-style-type: none"> Requires New Products to Be Developed Multiple Product Modifications Needed Requires One Product Modification Requires No New Product Development 	1 2 3 4	1	3	3	Tends to offer customized configurations
12. International Scope	<ul style="list-style-type: none"> More Than Two Manufacturing/Engineering Locations OEM Sells < 50 Percent Outside the United States OEM Does Not Sell Outside the United States 	0 1 2	1	2	2	≈ 10 percent to Europe
13. Accounts Organization Stability	<ul style="list-style-type: none"> Ownership Change Expected No Change in Ownership/Organization Changes Expected No Change in Ownership/No Organization Changes Anticipated 	1 2 3	2	2	4	

Case Example: Although Wenger Co. shows good profitability levels, other "fit" indicators signal that it may not be a strong relationship bet

Total Possible Potential: 191 Total Fit Score= 53

¹ Hypothetical customer.

² Some specific rating criteria have been disguised.

Beyond Volume

In addition to strategic fit, Square D also considers revenue opportunity into its micro-segmentation exercise. The “opportunities” scorecard incorporates the typical criteria one might expect—volume and total revenue—but goes beyond these to truly reflect the best long-term potential of an opportunity. Examples of key elements of the “opportunity” assessment are described below:

- *Betting on Winners*—By evaluating a customer’s future product growth (criterion D) and its future leadership position in the market place (criterion G), Square D improves the odds of developing a relationship with future winners—and consequently—those most likely to maximize Square D’s long-term profitability.
- *Customer’s Perceived Value*—Square D believes that customers with a greater likelihood to make repeat purchases prove more profitable over the long term. The “opportunity” assessment form takes this factor into account by examining the customer’s cost of switching suppliers, as well as how customers perceive Square D relative to competitors (criterion C). This criterion helps to identify customers that value Square D’s proposition more than competitors’ and are less likely to defect in the future.

A THUMBNAIL SKETCH OF SQUARE D’S GRADING EXERCISE

Square D takes the following process steps to generate the opportunity/fit matrix:

Step #1: Brainstorming—Square D convenes a team of sales managers, executives, and marketing experts for one-day brainstorming sessions in order to come up with a comprehensive list of customer factors to be considered in the opportunity/fit matrix.

Step # 2: Defining Parameters—The team broadly defines “fit” and “opportunity” and classifies each criterion as one or the other. Definitions for both “opportunity” and “fit” should be comprehensive but flexible, as the meaning of the terms might change during the course of the exercise.

Step #3: Assigning Ratings to Each Criterion—The team decides the rating interpretation for each criterion and assigns a weight factor. Wording is as precise and specific as possible in order to avoid confusion.

Step #4: Scoring Accounts—After designing the scorecard, Square D divides the pool of accounts among different teams, asking them to fill out a scorecard for each account. Responses are sent to a marketing point person, who is responsible for plotting all the accounts in the opportunity/fit matrix.

Step #5: Analyzing the Matrix—The original team reconvenes to stress-test the completed matrix. Based on cross-calibration, the team adjusts account scores accordingly. Objective criteria ensure that individuals do not play “favorites” with customers that may not represent the best long-term fit for the company.

Step #6: Designing a Sales Plan—Square D insists on implementing a detailed sales plan for its major accounts—or those that fall within the upper-right quadrant of the matrix.

MORE THAN JUST SIZE

“Opportunity” Evaluation Criteria Assess Customers’ Value Specifically to Square D

Square D’s OEM Opportunity Evaluation Form

**Case Example:
Wenger Company¹**
While revenue potential might be high for this customer, a declining market share suggests opportunity is not as attractive

“OPPORTUNITY” ASSESSMENT						
Major Account Name: <u>Wenger Company¹</u>						
Criteria ²	Rating Interpretation ²	Rating	Rating Applied	Weight	Total	Rationale/Explanation
A. Future Sales Volume (Realistically Achievable)	<ul style="list-style-type: none"> • Less Than \$1 M • \$1 M–\$2.5 M • \$2.5 M–\$4 M • Greater Than \$4 M 	1 2 3 4	2	7	14	Stuck in procurement
B. Total Potential at the Account	<ul style="list-style-type: none"> • Less Than \$1 M • \$1 M–\$2.5 M • \$2.5 M–\$4 M • Greater Than \$4M 	1 2 3 4	4	6	24	Customer resists partnering with one supplier
C. Switching Cost/Competitive Situation	<ul style="list-style-type: none"> • High Switching Cost and Entrenched Competition • High Switching Cost but Competition Vulnerable • Low Switching Cost and Competition Vulnerable • Low Switching Cost and Competition Disliked by Account 	0 1 2 3	2	5	10	
D. Estimated Growth in Customer’s Product to Their Markets (Over the Next Three Years)	<ul style="list-style-type: none"> • Less Than 5 percent • 5–10 percent • 10–20 percent • Greater Than 20 percent 	0 1 2 3	1	5	5	
E. Trend of Square D Share at the Account (Over the Past Three Years)	<ul style="list-style-type: none"> • Declining Share, Lost to Competition or Other Reason • Stable Share, No Change • Increasing Share, Square D Gaining More Business 	0 2 3	2	5	10	Declining trend
F. Estimated Time Frame to Achieve Incremental Business	<ul style="list-style-type: none"> • Longer Than 24 Months • 12–18 Months • 6–12 Months • Less Than 6 Months 	0 1 2 3	1	4	4	Current supplier reduction efforts are a concern
G. Account’s Position in Marketplace	<ul style="list-style-type: none"> • Non-Industry Leader • Not the Industry Leader but Innovative Product • Industry Leader Although Mature Product • Industry Leader With Innovative Product 	0 1 2 3	0	3	0	
Total Possible Potential: 118					Total Fit Score = 67	

¹ Hypothetical customer.

² Some specific rating criteria have been disguised.

Growing Accounts...

By focusing on nontraditional customer attributes, the opportunity/fit matrix helps to identify a subset of companies with much greater long-term potential than Square D's previous segmentation methodology did. For instance, a previously unrecognized account that was flagged with a high opportunity/fit score was assigned a dedicated team to develop a detailed account plan. Consequently, share of wallet for that account doubled in the first year and was expected to triple again for 2002.

...and More

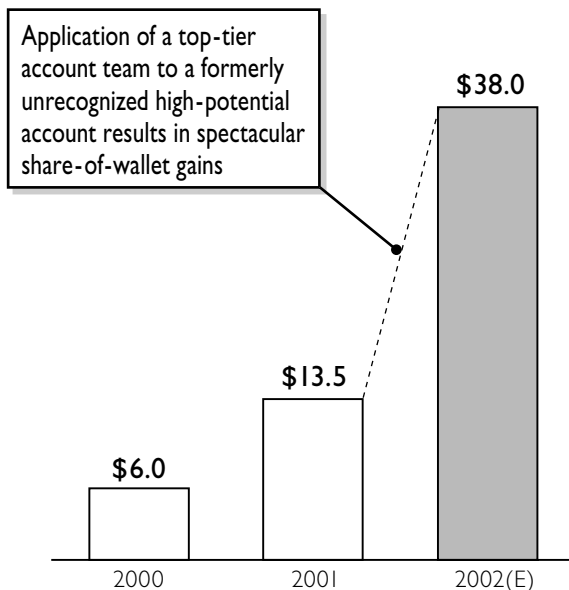
Segmenting by relationship potential has also increased revenue in the overall OEM segment, yielding a 67 percent compounded annual growth rate from 1999 to 2001. Furthermore, revenue growth in major accounts has achieved 54 percent, a spectacular growth rate compared to an average 12 percent growth from non-major accounts. Square D attributes much of the growth to added resource investment as a result of the segmentation exercise.

ELECTRIFYING RESULTS

A “relationship lens” on customer potential opens new opportunities for Square D...

Revenue Growth: Three Rivers* Account

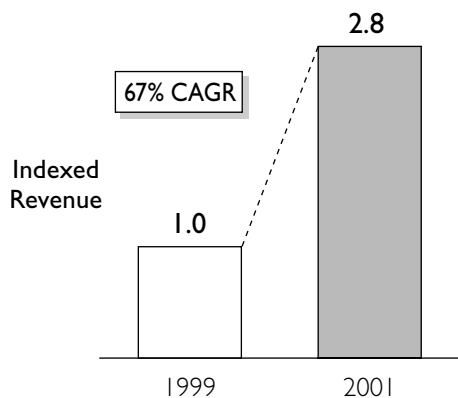
Millions of U.S. Dollars



...leading to impressive segment growth

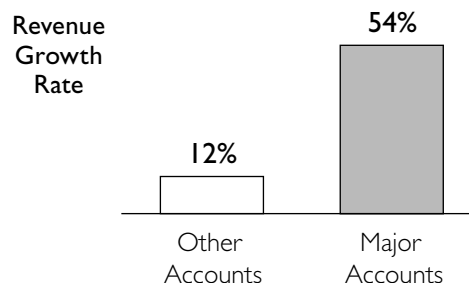
Average Revenue Growth per Major Account, OEM Segment

1999 Versus 2001



Three-Year CAGR, OEM Segment

1998–2001



* Pseudonym.

COUNCIL ASSESSMENT

- The Council recommends some form of the opportunity/fit matrix tool for virtually all companies that view a “relationship” strategy to be an important growth lever. The tool is especially important in an environment of constrained resources where corporate focus is necessarily limited to “most likely winners.”
- The practice is most valuable in companies where significant spread exists in the profit contributions across the customer base. Companies may want to focus the segmentation exercise exclusively on top accounts, as below a certain level, it may not radically influence resource deployment.
- The costs of this practice are fairly low, consisting mostly of management time invested in developing the criteria for the matrix. Some additional management oversight will also be needed to push through the required changes in customer strategy that arise from the use of the matrix.
- *Caveat:* This practice assumes customers are already classified into groups sharing elements in common—such as industry subsegments. For customers that do not share a common set of traits, establishment of meaningful evaluative criteria may be difficult.
- *Implementation Tip:* Companies might consider performing a win–loss analysis of past sales opportunities to expand the range of customer criteria that should be included in the opportunity/fit scorecard.

