'AMS Voices'

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Applied Marketing Science, Inc.

An Idea Sheet from Applied Marketing Science

Courting Cautious Customers

Picture a boiled lobster, still in its shell. The first person to eat a lobster must have been really, really hungry! Either that or he got a great price. Either way, it certainly must have looked like a risky proposition.

Now that electricity deregulation is becoming a reality in some parts of the US, industry observers are perplexed as to why more people aren't taking advantage of their newfound freedom to switch suppliers.

Conventional thinking on how customers make decisions has been that a customer's *expectation* of performance drives choice. If you expect A to be better than B on the factors that are important to you, you choose A. However, if A is better but B is less *expensive,* you may choose B, because B represents a better *value.* In the face of uncertainty, sellers often cut price to convince customers to take the risk.

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But what about that lobster? If you've never had lobster before but friends have told you how great it is, you may still decide to order the hamburger because you're just not sure you're going to like lobster. For you, it just might not be worth the risk. Even if the price is the same as for hamburger (it's a "Lobster Special"), you're just not sure. Technically, you are *risk averse.*

Everyone is risk averse to some degree. Economists measure risk aversion by asking preferences between different risky alternatives ("Would you rather have $10 in cash or flip a coin for a chance to win $21? What if you could win $25? How about $50?") When the consequences of a negative outcome (like losing the certain $10) are relatively small, we often take a chance on something we have never tried before. The choice of a lobster roll vs. a Big Mac® is different than, say, lobster fra diablo vs. filet mignon at a four-star restaurant. Uncertainty clearly impacts choice.

The current upheaval in the electric utility world is a good example. In an increasing number of states, customers can now choose their electric company. The local utility still delivers the power and is responsible for reliability. The only difference is who generates the electricity. Thinking rationally, electricity is a commodity. One company's power is really no different from another's. But it's all still pretty new, and customers just aren't sure that everything will be exactly the same. Unless they can save a significant amount of money, customers are not inclined to switch. The result has been significantly slower switching to alternative suppliers than had been expected.

So, how do you sell to cautious customers? Although cutting price is the common approach, a better way can simply be to remove the uncertainty. A guarantee (with an appropriate financial payoff) can reduce or eliminate the risk that the customer perceives. Or a firm may choose to wait for customers to see that the only change is that their bill is (a little) lower and hope that word of mouth will reassure the more risk averse customers. Either way, there is clearly more to the decision process than just who's "best" at satisfying customers on average. ■

— Bob Klein

Going Overboard on Platforms

The focus on *product platforms* is the most recent in a series of “miracle cures” to make product and service development more profitable. The term “product platform” refers to the use of a common set of parts, components, or technologies to enable production of a wide range of easily customized or differentiated products. The auto industry led the way in utilizing product platforms—cars sold under different brand names can share a lot under the skin. General Motors uses many of the same basic components for cars sold as Chevrolet, Pontiac, Oldsmobile, and Buick.

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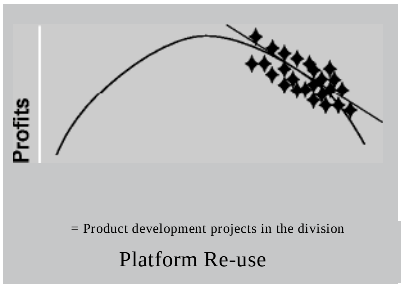
Proponents believe that platform re-use can dramatically reduce costs and, hence, increase profits. Just like *customer satisfaction* and *timeto-market*, product platforms have now become the mantra for product developers in a wide range of product and service companies.

But how far can these ideas be pushed? Certainly the return on investment for customer satisfaction is not unlimited. “100% customer satisfaction” may be a nice slogan, but it can be a poor investment strategy. Can product platforms also be pushed to the point where increases in platform re-use actually have a negative impact on profits? The answer seems to be “yes.”

Some interesting data regarding the use (and abuse) of platforms can be found in our recent MIT working paper called “Metrics Thermostat” (available on our website). First, we developed a model of the relationship between profits and various product development metrics as an inverted u-shaped curve, implying that up to some optimum point profitability would increase, but would then turn down. We then collected data at a firm with over $20B in revenues, gathering data on every product that a key division had launched in the past five years. This was a firm that had pushed platforms hard and rewarded managers for platform re-use. For every product, we gathered data on profit-to-date, projected long-term profit, customer satisfaction, time-to-market, and platform re-use.

The data and analysis showed that there can indeed be “too much of a good thing.” The graph shows that this firm was clearly operating in the negatively sloped part of the curve, i.e., where the relationship between platform re-use and profitability is negative! While many of the other metrics like *decreased cycle-time* and *customer satisfaction* had the expected positive relationship to profit, it appears that the more the product developers pushed platform re-use, the less they were giving customers exactly what they wanted.



In retrospect, we can see what is happening. Platform re-use is easy to measure, easy to reward, and very visible. Customer satisfaction, on the other hand, is harder to observe, more difficult to affect, and can only be rewarded once the product or service is actually on the market. This firm is probably valuing platform re-use to the exclusion of much-needed innovation that would satisfy customer needs. The solution must be to revisit customer satisfaction and find ways to take advantage of the tremendous profit potential of returning to a customer focus.

—John Hauser

AMS Voices is a forum for new ideas in management. It is published by Applied Marketing Science, Inc., leaders in using *Voice of the Customer* technology to develop superior products and services. We’d like to hear from you. If you have an issue you would like addressed, or have other comments, please contact us:

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