

What's Worth It, and What's Not?

Pointers on Value, Costs, and Pricing

Customer loyalty is a thing of wonder—and it's a hard-nosed kind of wonder that you can take to your accountant. Loyalty makes customers less price sensitive, more willing to spend money with you, more willing to take a chance on extensions to your product line (assuming you don't abuse this trust in inappropriate ways), and much more immune to competitive entreaties. But no company can afford to spend all of its revenue trying to maximize the customer experience or guarantee customer loyalty. Fortunately, there isn't a need to. In Chapter 6 we explained how systems derived from manufacturing can help service-focused companies minimize their costs behind the scenes. In this chapter, we work through some of our clients' most common concerns about how to control costs while still providing superior service.

What Does Loyalty-Enhancing Service Really Cost?

We would argue that service that wins you loyal customers is well worth it at nearly any cost—because of its immense benefits. Still, what *does* it cost? In some cases, superior service clearly *does* cost more to

deliver than average service. For example, the ESF group of summer camps in Pennsylvania and Connecticut employs counselors and staff who are older and more experienced than the “kids counseling kids” you often find in competing institutions. Even the greenest counselor you’ll encounter at an ESF camp will be a college student pursuing a degree in early childhood, elementary, or secondary education, child psychology, social work, counseling, or another child-related field. The staff-to-camper ratio is among the lowest in the industry and is cleverly allocated: for example, while one nurse is on premises throughout the day, *two* nurses are put on duty during all peak periods.

Is this approach more expensive than the customary approach? Absolutely. But parents are devoted to the camps; the farthest thing from their minds would be to compare it on a commodity/price point basis with other summer options. Plus, like loyal customers everywhere, *they promote the camps tirelessly to their friends and neighbors*. Recently, in fact, a group of 35 “expat” camp families who had moved from Pennsylvania to Connecticut due to job relocation suggested a new camp location up there to ESF. Even better, they then signed up enough of their New England neighbors and friends to ensure the camps were able to successfully carry off the expansion. (Imagine that: loyal customers who encourage and facilitate your business expansion by serving as your “siting service” and “advance team”—*pro bono*.)

This last point is fundamental: For a fuller accounting of the net cost of maintaining loyalty-building standards such as quality of staffing, you must consider the various kinds of expenses saved and revenue earned through energetic word of mouth marketing, unusually low staff turnover, unusually low client (in this case camper) turnover, lower insurance rates, and elimination or reduction of negligence lawsuits.

Well-trained, well-equipped, and well-treated personnel have longer company tenures, lower accident rates, and fewer behavior problems. When you hire and train the right kind of employees—those who embrace their underlying service purpose in your company—you receive back far more productive work than is achieved by a typical employee in a typical organization. Like the purpose-driven security

guard posited in Chapter Seven, patrolling the mall and *also* guiding lost shoppers to their destinations, super-staffers can be—and want to be—everywhere that a customer needs them. They can do this for you, and they *will*. Similarly, solid facilities, high quality tools and materials, strong safety programs, and other key supports for staff and customers: Are they hard to justify sometimes? Hard *not* to justify if you want repeat business—and repeat staff showing up every day and giving you their best performance.

Gilding the Lily

As discussed in Chapter 6 features our customers value need to be shielded from willy-nilly cost cutting. At the same time, there are undoubtedly excesses built into some customer encounters and services. A specific sort of excess you should tune your antennae for is called *lily gilding*. (The term comes from compressing a Shakespeare phrase; the original quote from his *King John* is “To gild refined gold, to paint the lily”—to overdo the already perfect.) Lily gilding is the brilliantly hand-polished finish on an end table—when the end table is always hidden by a tablecloth. It’s an air conditioning compressor too powerful for the space it cools.

In customer interactions, lily gilding often takes the form of fancying up your offering beyond what your customers are interested in (or interested in paying for). This has both obvious and hidden costs. The hidden costs include excess features that can make your offering less attractive by complicating it for customers or implying to customers that they’re paying for something they don’t need.

Finding Gold in De-Gilding

Sometimes, de-gilding will bring a surprise benefit to your customers—and you, in addition to bottom-line savings. In a recent tradition-breaking example, famous glassmaker Riedel realized

that the *bowl* was the essence of the wine glass and that the stem, rather than being a necessary feature, was ornamentation that carried drawbacks with it. Mass retailer Target then saw the benefit to themselves in Riedel's new approach, including reduced storage costs and inventory breakage for the retailer, and they brought the product to consumers on a scale that Riedel could never have done by itself. And once a few customers took them home and realized how well they fit into the cupboard and dishwasher and how rarely they broke (having no stem to snap off), they spread the word for free.

"Compared to What?": Value Is Relative

Customers often judge your value relatively. That is, they judge each interaction with your company against their previous interactions with you—and with your competitors. For example, when a passenger gets on an airplane in first class, he expects to be offered his choice of beverage. If he isn't, the service feels wrong. This isn't something each airline can make its own decision about without understanding that its customers' expectations are determined by an *industry-wide standard* for what first-class service means.

To make sure you understand the comparative expectations of your customers, shop the competition—your *best* competition. (Truly shop. Don't just wander in; spend some money, and take a transaction from beginning to end. You may be amazed at what you learn.) Survey the customers of your competition. Survey your *own* customers, or at least customers in your market segment, about the competition. (Do this only anonymously. Never insert questions about the competition into one of your own branded surveys. You damage your brand when, unbidden, you bring up the competition.)

Don't let resentment or insularity lead you to dismiss a competitor's innovations. Think rationally about whether there is value there you could make use of for your own customers.

Pricing Is Part of Your Value Proposition

A good equation for value is “Value = Personal Benefit minus Cost and Inconvenience.” But the Personal Benefit variable can easily override the cost factor for a significant sector of the market, at least up to a certain point. Not everybody values money the same, clearly: If commerce were all about low pricing, there would be no space for retailers like Nordstrom; everyone would be shopping at Walmart. Instead, for Nordstrom customers, quality, personal shoppers, and a great return policy provide a Personal Benefit that make the equation—for them—work out in favor of paying more to get more.

Therefore, in product and service design, it helps to focus on the personal benefit you provide for customers in return for the price you charge. In fact, the closer you get to your customer, the more you can minimize price as a consideration—unless, in fact, high price *is* part of the benefit you are providing. (If Tiffany had a “crazy markdown sale” every weekend, would their blue boxes have the same cachet? At Tiffany, the famously high prices themselves confer a benefit to the customer purchasing a gift.)

A loyal customer is the least price-sensitive customer of all. But almost all customers are at least somewhat sensitive to pricing. To unsophisticated customers, a high price is generally a sign of quality. (Homer Simpson never stoops to choosing the *cheapest* wine on the menu; connoisseur that he is, he always picks the *second* cheapest wine on the menu.) But price doesn't always equal quality, and a sophisticated customer often understands this. For example, Costco, a discount chain whose customers skew to well-above-average per capita incomes, has changed the meaning of low prices to “We work hard all the time to find you better value.” They stick so consistently with this message that they have elevated it to the level of high theater. On a recent trip there, Micah saw *stamps* discounted at the checkout counter. Costco was apparently happy to lose five cents a roll (not even Costco is able to negotiate with the U.S. Postal Service) to ensure that the very last impression their customers get leaving the store is one of value.

Don't Charge a Customer for Performing the Heimlich

A touchstone in pricing is that your charges should demonstrate that you care about the customer. Goal 1, therefore, is to avoid making customers feel misused—for example, by overcharging them at vulnerable moments. There's a *New Yorker* cartoon we love with two friends walking out of a restaurant. One turns to the other after looking at the check and says, "You're right—they *did* charge you for the Heimlich maneuver." The fact that he *expected* that line item tells you what he thought of the establishment.

Avoid nickel and diming customers by using the rule of thumb that Texas car dealer Carl Sewell made famous long ago: Is this something a friend would charge for? "If you locked yourself out of your car and you called a friend, would he charge you for running a key over?" asked Sewell. "No. Well, we won't either." Ignore Sewell's rule (the way hotels do that not only charge you for long distance calls and bottles of water but do so at rapacious rates) and you'll be tripping yourself up on the path to customer loyalty. Go the extra mile, for free and with a smile, and you'll be helping yourself out as well.

Lots of companies, of course, begin their lives treating customers like friends and avoiding nickel-and-dime insults. But as they evolve, they shift to a different model: They attract customers with a base product that is fairly priced, and then they alienate them with a slew of hidden charges for necessary features. To the extent that you can get away from this model, you will have more loyal customers in the long run. For example, a consultant will do well to look at a project from the viewpoint of the client. A project for an East Coast consulting company quoted as costing \$120,000—but requiring that most of the work be done in Seattle—will actually cost significantly more. If the consultant doesn't include the additional, say, \$30,000 travel charge in the estimate, the customer is going to feel short-changed when it comes up later. No amount of friendliness will keep them from feeling that you pulled a quick one. You hosed them with a smile—but you still hosed them.

If your pricing policies are not transparent, you also put your work-

ers in a very tight spot defending them. You risk creating angry, distrustful customers *and* a disenchanted work force.

Money Isn't Everything, But Money Issues Matter—Especially How You Present Them

Pricing is a major issue because pricing, like service, is one of the elements of value. It needs to be delivered correctly: Pricing must be presented appropriately, with sensitive language, without surprises, in a way that engenders trust. In this manner, you maintain and grow the value of your service, the trust you have been building with your service, and, ultimately, the loyalty toward which you have been working so hard.