WHERE PROFITS GO TO DIE

THE FRONT OFFICE
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THE FRONT OFFICE HAS MORE RESPONSIBILITY FOR GROWTH, PROFITABILITY AND TRUST THAN ANY OTHER PART OF THE COMPANY. YET, IT IS THE MOST UNPREPARED FOR THIS MISSION.
Part of ZBx\(^1\) (zero-based mindset), ZBFO optimizes front office costs (marketing, sales, customer service) without a negative impact on the customer experience. It drives profitable pricing strategies and uses customer economics to define the right customer experiences.
Achieving profitable growth has always been a challenge—and it is becoming ever more difficult in today’s digital economy. The influence of the Amazon business model on both business-to-business (B2B) and business-to-consumer (B2C) industries is lowering barriers-to-entry for competitors and providing greater choices to customers. This in turn significantly erodes profitability and makes these customers less sticky. A jaw-dropping $6.6 trillion changed hands in 2017 thanks to consumer switching.²

Many companies are responding to this profitability challenge with strategic cost reduction efforts. Reducing costs is vital to reclaiming profitability, but there are other issues to address. For one, traditional cost reduction techniques often have less impact in the front office due to limited fact-based and data-driven analyses, and insufficient understanding of how cost reduction will impact the company’s growth strategy. There’s also the fact that cutting front-office costs can damage the customer experience and exacerbate customer switching. And while cost reduction is important, no lever improves profitability more than price. A single one-percent price increase drives a seven to 14 percent improvement in operating margin.³
Ignoring these issues can negatively impact the P&L, leaving companies worse off than when they started. Companies find themselves stuck between a rock and a hard place, trying to square cost management and growth agendas. ZBFO (zero-based front office) can change this because of how it addresses customer profitability. By understanding the economics of each customer—and investing in their most profitable ones—companies can drive greater economic returns than the competition. ZBFO makes zero-based budgeting actually work in the front office in a way that is good for growth, and good for society and trust.
TOTAL CUSTOMER UNDERSTANDING

Executives can easily calculate the profitability of products and business units. But ask them which customers are destroying the bottom line, and by how much, and you get radio silence. In addition, companies often lack the capability to differentiate between strategically-important and transactional customers. This goes beyond traditional customer segmentation. It involves linking the type of customer relationship to the means and measures that drive enterprise profitability. In a cost-conscious, growth-focused environment, high-value customers—those that are profitable and strategic—should be the priority. If only companies could understand who they are.

Businesses that have cracked this code have used ZBFO to build an actionable and sustainable customer economics model. This model enables the enterprise to define the right customer experiences and price points for each profit segment and evaluates total share of wallet to optimize front office costs in a way that does not negatively impact revenue.

How does the ZBFO customer economics approach work? Companies establish a P&L for each customer, calculating the total cost-to-serve based on acquisition, sales force coverage, customer service, billing and shipping costs among others. They then stratify the profitability of the entire customer base.

This is an eye-opening exercise. Executives are often surprised to discover the degree to which a small number of highly-unprofitable customers can drag down the entire company’s economics, or the dilutive impact that large-volume, low-profit customers can have on profitability. Insights like these are invaluable because they help the front office reshape the customer portfolio to improve profitability, and rebalance customer experiences to align with value.
TAKE THE EXPERIENCE OF AN ENERGY UTILITY COMPANY. CUSTOMER ECONOMICS HELPED IT UNCOVER THE FACT THAT SEVEN PERCENT OF ITS CUSTOMERS GENERATED THE SAME PROFIT AS THE ENTIRE CUSTOMER BASE—AND NEARLY A QUARTER NEGATIVELY IMPACTED PROFITABILITY.4

So the company defined treatment strategies around each of these value segments, resulting in more than $70 million in margin improvement, a 55 percent uplift.

An industrial distributor improved margins by five percent (as a percentage of sales) using customer economics for strategic planning.5 Low-margin customers now pay more for extras beyond base offers, and high-value customers receive more robust base packages.
WHEN IT COMES TO
PROFITABILITY,
NOT ALL CUSTOMERS ARE CREATED EQUAL

A SMALL GROUP OF CUSTOMERS DRAGS DOWN THIS UTILITY COMPANY’S ENTIRE CUSTOMER ECONOMICS.

- **7% of customers** generate the same value as the overall customer base.
- **25% of customers** destroy 60% of total value.
- **5% of customers** destroy 85% of total loss.

The maximum value is larger the total value.
DIFFERENT CUSTOMER TYPES REQUIRE DIFFERENT TREATMENT STRATEGIES.

1. MINIMIZE CHURN
2. MONETIZE ADVOCACY
3. IMPROVE DESTRUCTIVE CXs
4. OPTIMIZE PRICING
5. MINIMIZE SERVICE COST
6. MINIMIZE BAD DEBT

THE VALUE CREATORS
These customers are the most profitable, and keeping them happy and creating new paths for growth is priority one. Transforming these customers into “advocates” can influence the spending patterns of other customers, which increases the size of this group.

THE VALUE DESTROYERS
These customers do not deliver the revenue to cover the cost-to-serve them, and corrective actions are essential to either fix or fire them.

THE INCREMENTAL MIDDLE
This is the largest customer group, but the most heterogeneous. The opportunity here is to identify the customer segments within the group that can be transformed into value creators, and the levers to do so.
Getting customer economics right is a necessary step toward driving sustainable profitability in the digital age. But it does not address the difficult changes required to drive lasting results. There are other inherent front-office challenges that can set companies up to fail if they are not addressed.

Take governance. It is imperative to govern the healthy tension between growth and profitability, as changing business needs alter the calculus between the two. Doing this is challenging when decision makers close to customers are disconnected from P&L owners. Appropriate governance must be implemented to ensure a healthy tension between budget owners and cost category owners, who ensure application of best practices across the company, and focus on ROI across their categories. Without this interlock, benefits erode quickly.

In many front offices, there’s also the issue that operating models are organized around internal structures such as functions, geographies, products and channels—not customer journeys. These siloed operating models make it hard for the front office to see customers from an end-to-end value perspective—to treat them how they should be treated. The operating model must also be agile, so it can respond to customer economics insights.

FINALLY, ORGANIZATIONAL INCENTIVES CAN OFTEN CONFLICT, AND CAN HAVE THE COMPANY WORKING AT CROSS PURPOSES. FOR EXAMPLE, SALES IS INCENTED TO GROW REVENUE WHILE OPERATIONS IS INCENTED TO LOWER COST-TO-SERVE. STRANGE THAT NO ONE IN THE FRONT OFFICE—THE CUSTOMER-FACING PART OF A COMPANY—IS TYPICALLY INCENTED ON CUSTOMER PROFITABILITY. A MISSED OPPORTUNITY. COMPANIES THAT DELIVER TWICE THE RETURN ON INVESTMENT ON CUSTOMER EXPERIENCE PROGRAMS COMPARED TO THEIR PEERS—WHAT WE CALL B2B MASTERS—ARE MORE LIKELY TO LINK PERFORMANCE REVIEWS AND COMPENSATION TO CUSTOMER EXPERIENCE OUTCOMES.
As companies establish a customer economics capability and address operational challenges that impede sustainable change, they must also look for the next generation of front office transformations. After all, customer dynamics are only going to get more complicated in the post-Amazon world. A departure from cost optimization programs that focus on incremental reductions, past performance and gut instinct, ZBFO transforms the front office across several fundamentals to win in the future:

**INSIGHT INTO ACTION**

Our research reveals that B2B Masters perform better at understanding customers and turning insights into actions (98 percent) than all companies combined (68 percent).\(^8\) A big part of this is delivering the preferred customer experience at the right price. ZBFO provides the necessary insight to do this. This is what a European building products supplier did to improve EBIT to fund M&A. The company used advanced analytical tools to align pricing and sales enhancements with specific customer segments and behaviors. The result was a one percent improvement in EBIT in the first year and a sustained 1.4 percent of revenue annually thereafter.\(^9\)

**PARTNERS AND ECOSYSTEMS**

The platform economy is changing the role of different players in the front office. Ninety-one percent of B2B executives say ecosystem partners will have a bigger role in driving customer experience in the next two years.\(^10\) To ensure that its partner relationships were driving profitability, a US telecom company examined them with a zero-based lens to assess partners’ alignment with strategic objectives. The company developed a new segmentation and treatment plan for the ecosystem and consolidated dealers for a 10 percent improvement in sales productivity and growth.\(^11\)

**QUARTILE ZERO**

Companies cannot ignore the impact of digital technologies on the front-office cost structure and performance. ZBFO does not. It resets costs to a zero base with a forward-looking approach that assesses what costs “should be” as a result of dynamic forces of change like digital. It uses these should costs to achieve a new quartile zero. Consider how AI-powered digital assistants can take over some customer interactions on the telephone and via webchat. This is just one example of how digital blows up traditional front-office cost profiles. An Italian government agency cut front-office costs by 45 percent and improved speed of service by 30 percent by using digital assistants for some customer inquiries.\(^12\)
Does your current budgeting process consider revenue growth or the impact of cost reductions on the customer experience?

Do you understand the profit contribution and strategic value of each of your customers?

Are your strategic cost initiatives compromising the customer experience?

Are you providing differentiated treatment strategies to maximize the profitability of each of your customer groups?

Do you know the extent to which digital capabilities could improve your “should cost” structure?
ZBFO is a welcome alternative to focusing on efficiency alone with traditional cost reduction efforts. With ZBFO, the front office can embrace growth as much as it does efficiency, redirecting resources without the unintended consequence of strangling growth. Here are some no-regrets moves for getting started:

**LIVE, BREATHE AND LOVE DATA**
Companies will make no progress by relying on fragmented data or guesswork. The front office must be a ZBFO insight hub where end-to-end data is king, and visibility is complete. Being data-rich and data-driven, the front office can quantify, monitor, perform analytics and conduct scenario planning to drive customer profitability. It is also essential to understand ROI on transformation investments and assets.

**CLEAN SHEET THE FRONT OFFICE**
The focus must be on rethinking the front office from a blank slate. This means building offers and treatment strategies to reshape the customer portfolio. It is re-pricing with purpose and discounting as an investment, not in desperation. The front office must spend against what costs should be instead of last year’s levels and choose partners because they are right-fit and profitable, not because they have always been there in the past.

**GET REAL ABOUT SHOULD COSTS**
Companies can use technology, such as artificial intelligence (AI), to help establish what costs should be. With AI, the front office can finally anticipate and act on customer preferences in real time. AI investments can be funded through profits from quartile zero savings and a better customer portfolio to enable more precise pricing, discounting, sales decisions and forecasting accuracy. AI also frees up the front office to focus on analytics and insights, weaving customer profitability into daily decision making.

TIME IS OF THE ESSENCE TO GET STARTED WITH ZBFO. COMPANIES THAT SUCCEED IN COMPLEX MARKETS WILL MAKE CUSTOMER PROFITABILITY THE FOUNDATION OF EVERYTHING THE FRONT OFFICE DOES AND EXCEL AT STRIKING THE RIGHT BALANCE BETWEEN COST AND GROWTH.
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NOTES


2 2017 Accenture Global Consumer Pulse Research

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11 Accenture client experience

12 Accenture client experience

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