SPECIAL COLLECTION

CUSTOMER INTELLIGENCE

Creating the Customer Experiences That Build Brand Loyalty

Turn customer data into profitable, personalized interactions — that delight and keep customers on board.

Brought to you by:

FALL 2021

CONTENTS

SPECIAL COLLECTION

Creating the Customer Experiences That Build Brand Loyalty

1 **Why Smart Companies Are Giving Customers More Data**
By Barbara H. Wixom, Ronny M. Schüritz, and Killian Farrell

6 **Competing on Customer Outcomes**
By Marco Bertini and Oded Koenigsberg

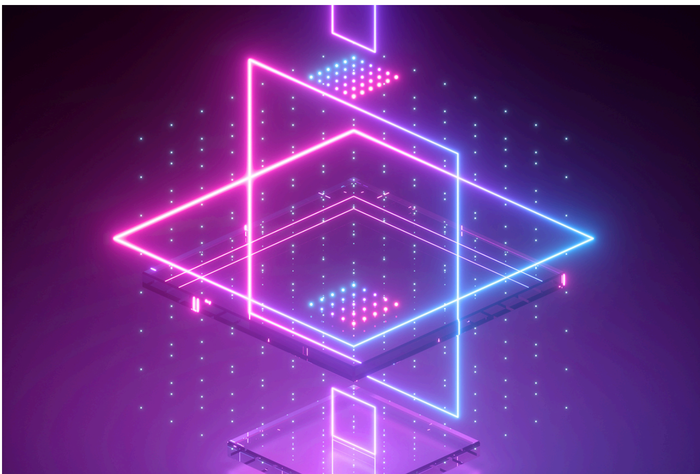
13 **Why Pricing Decisions Need More Than Management Intuition**
By Daniel Deneffe and Herman Vantrappen

16 **The Retail Profitability Paradox**
By Rodney R. Sides and Lupine Skelly

Why Smart Companies Are Giving Customers More Data

Barbara H. Wixom, Ronny M. Schüritz, and Killian Farrell

Companies are discovering the benefits of data wrapping — packaging their products with data analytics features and experiences that delight customers and increase profitability.



In 2016, Spanish banking group BBVA offered to its Spain-based customers a personal finance management app. One of the app's tools used machine learning algorithms to sort customer transactions into common budgeting categories such as rent, food, and entertainment, and then it displayed a customer's expenditures broken down as a simple chart. BBVA promoted the categorizer on its digital banking website as a way for customers to better manage their personal budgets. In just a year and a half, the tool became the most utilized feature on the BBVA website, second only to funds transfer.

And in 2019, the global consumer packaged-goods company PepsiCo formally launched a suite of data analytics capabilities called Pep Worx that supported a variety of use cases — such as how to successfully launch and manage innovative marketing programs and how to optimize total store space — that helped retail customers increase product turns, profit realization, and net price realization (the latter because there was less of a need to discount products that weren't selling). PepsiCo developed the capabilities over a four-year period as the company solved problems for select retail customers using data analytics-based shopper insights. PepsiCo has used Pep Worx to help transform the nature of its retail customer relationships from transactional to collaborative by creating a "three-audience win" whereby sales or marketing activities simultaneously deliver value for the shopper, the retailer, and PepsiCo.

These examples demonstrate how companies benefit from an emergent approach to data monetization we refer to as data wrapping. With this approach, a company's products are "wrapped" in data analytics features and experiences that help and delight customers, with profitable results. The tendency for most companies is to draw upon preexisting business intelligence groups, data platforms, and analytics talent for data wrapping. However, the capabilities, processes, and skills that historically helped the company use data analytics to do things better, cheaper, and faster are insufficient for producing data analytics that delight customers.

What Makes Data Wrapping a Distinct Data Monetization

Approach?

Companies are data wrapping when they give data and analytics to customers as product features and customer experiences — such as spend categorizers, automatic sound optimizers, and shopper insights — with the goal of increasing a product's value proposition. There are four key characteristics that make data wrapping distinctive:

- The data analytics "users" are a company's customers, not employees.
- Product owners, not IT, lead the product road map because analytics must be developed as a part of the product's overall feature and experience portfolio.
- Economic returns result from a lift in sales, not from an internal business process improvement.
- It's risky; unless companies deliver accurate, valued data wrapping, they could confuse, irritate, offend, or drive away the customers they serve.

In a 2018 survey of 511 product managers by the MIT Center for Information Systems Research (CISR), 85% reported they were developing data analytics-based features or had deployed features to the marketplace. The research indicates that companies that get data wrapping right follow three steps that keep their efforts on track.

Step 1: Assemble a multidisciplinary team, led by product. Product owners and managers deeply understand a product's cost structure and the customers being served — and key risks to mitigate. They also have access to customer-facing processes and channels that help the company sense and respond to customer needs.

To illustrate the advantage of cross-collaboration in product development, take the example of Cochlear. In 2017, the Australian hearing solutions manufacturer released its Nucleus 7 Sound Processor, a device used for patients with hearing implants. The company paired the device with a mobile app offering scene classifier technology, which allowed users to automatically adjust their sound settings based on their surrounding environment (for example, a crowded street corner or quiet waiting room). These types of changes to processer settings had previously been made manually by the patient, but product use data suggested people may not always choose the optimal settings.

Cochlear product managers evaluated data-wrapping opportunities using established market research techniques, patient focus groups, and clinical trials. They explored data-wrapping ideas while they visited clinics and talked to customers. The conversations helped product managers move from dozens of possible data analytics use cases to a handful that customers actually wanted, such as a "find my sound processor" capability for times when the physical unit (a costly device to replace) falls off a user's ear.

Although product teams need to lead the charge, data analytics and IT colleagues are critical for shaping, developing, and deploying the data wrapping efforts. At Cochlear, product managers meet regularly with members of data analytics to review and interpret processor usage data, which informs possible changes to existing features — and helps prioritize needs that may need to be served in the future. IT colleagues help product managers assess features for technical feasibility, and they make sure the company's technology can support data analytics features after they "go live."

Step 2: Design features and experiences that inspire customer action. The value of data wrapping hinges on customer action and experience. Thus, a key design element for data wrapping involves prompting and guiding customers to use the product features and ensuring their experience meets a compelling need, such as saving time, money, or gaining information. MIT CISR research identified four key design characteristics (See "Four Design Characteristics for Data Wrapping") that help make this happen:

These four design characteristics — anticipate, advise, adapt, act — are reflected in the data wrapping in Cochlear's sound processor. The device's scene classifier technology *anticipates* that an end user's hearing needs will require adjustments as the person changes environments throughout the day and *adapts* to contexts, such as to a crowded street corner or quiet room. The feature *advises* the user of optimal settings through an app and *acts* by

automatically adjusting the sound processor's settings to deliver the best hearing for the conditions.

According to our research, product features and experiences that anticipate, advise, adapt, and act are more useful and engaging to customers and more likely to motivate customers to participate with or respond to data wrapping. The research also found that companies with the most useful and engaging data-wrapping features achieve top performance in product sales lift — whether through selling more of the product, raising product price to reflect customer value add, or raising customer retainment rates.

In 2015, PepsiCo established a cross-functional shopper insights unit drawing on nearly 200 people from across the company, including those focused on category management, shopper insights, space optimization, and shopper marketing. The new unit created and delivered standardized, data-driven marketing services to PepsiCo sales and marketing teams — and to PepsiCo's retail customers. One customer solution helped retailers optimize store-level product assortment. Typically, retailers assorted their stores one way across the country, or possibly across a region. A store in urban Denver, however, could have a shopper profile more in common with a store in urban Phoenix than with a suburban Denver store just 15 minutes away. PepsiCo created a data analytics approach to tag individual stores with an identifier that reflected their local shopper base. Then, the team created distinct plans for where to place products on shelves based on a retailer and its store profiles.

Step 3: Measure impact to both the customer and the organization. Top-performing product managers measure — and report — how much value data wrapping generates for both the customers and the company. But, measuring these returns can be tricky. A company may not have visibility into exactly how and when a customer benefits — and the company's own returns may happen indirectly or over time. Companies tend to draw upon a portfolio of techniques such as usage tracking, A/B testing, controlled experiments, customer surveys, and pilot studies to get a good sense of their data-wrapping outcomes.

At BBVA, the data analytics unit that supported data wrapping developed an economic impact framework to classify data analytics projects according to their intended goal, such as increased revenues. Product owners were accountable for measuring and achieving the appropriate kind of value for the data-wrapping projects, and a director of finance and operations helped the product owners create measurement metrics and methodologies and validate results. Other companies across different sectors can similarly adapt existing testing methods and measurements to monitor and evaluate data-wrapping success.

The BBVA categorizer, for example, encouraged customers to adjust their spending habits based on a better understanding of where their money was going. BBVA conducted A/B testing on new features, which involved providing a subset of customers a new feature and comparing their response with that of a subset of customers who received the preexisting offering. Specific outcomes, such as customer satisfaction, were measured and compared across the two groups over time.

Reaping Rewards From Data Wrapping

On average, data wrapping represents 26% of the value a company creates from data monetization. [1] Data wrapping is not only becoming an essential component of the data monetization portfolio but also for the product value proposition. In a fast-moving market, the approach is particularly appealing and useful for companies that need to distinguish products under attack from commoditization.

Companies that report data wrapping more effectively than peers achieve an average return on investment of 61% from data-wrapping projects, versus 5% for those reporting that they wrap less effectively than peers. It's time for companies to pay attention to data wrapping or else be left behind. In today's digital world, customers increasingly expect value from data analytics. If we don't deliver it, our competitors will.

About The Authors

Barbara H. Wixom (@barbwixom) is a principal research

scientist at the MIT Center for Information Systems Research (CISR) in Cambridge, Massachusetts. Ronny M. Schüritz (@ronnyms) is cofounder and co-CEO of the AI startup prenode and a senior research adviser and lecturer at the Karlsruhe Institute of Technology. Killian Farrell (@killian_j_f) is a graduate student in business analytics at the MIT Operations Research Center.

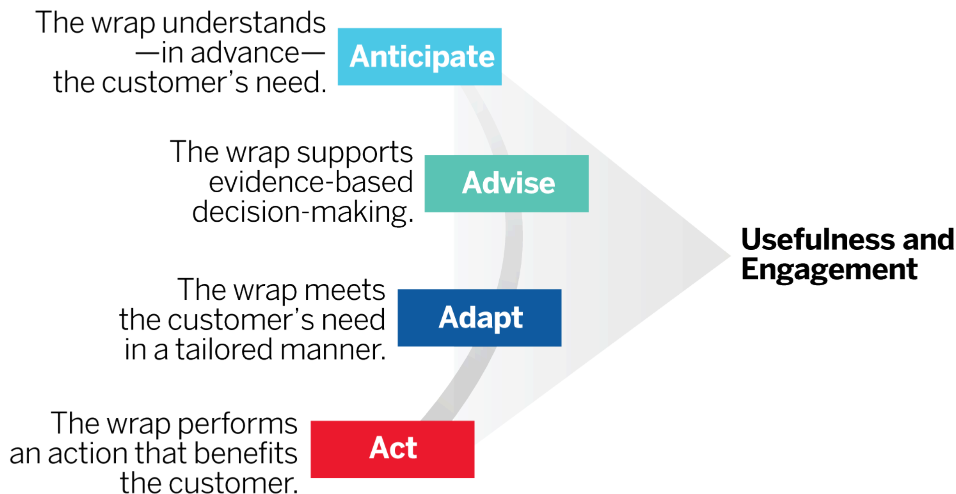
References

1.The 2018 MIT CISR Data Monetization Survey was administered to executives familiar with the company's enterprise-level data activities and outcomes. The executives were asked to estimate the percentage that each data monetization activity (improving, wrapping, and selling) contributes to the company's total returns from data — to total 100%. The average break-out across the 315 responses for data wrapping was 26%.

The Research

The researchers have explored data wrapping as a distinct data monetization phenomenon since 2013, drawing on dozens of executive and project team interviews, hundreds of publicly available use cases, in-depth case studies of BBVA, Cochlear, and PepsiCo, and a global survey of 511 product managers responsible for generating revenues from products.

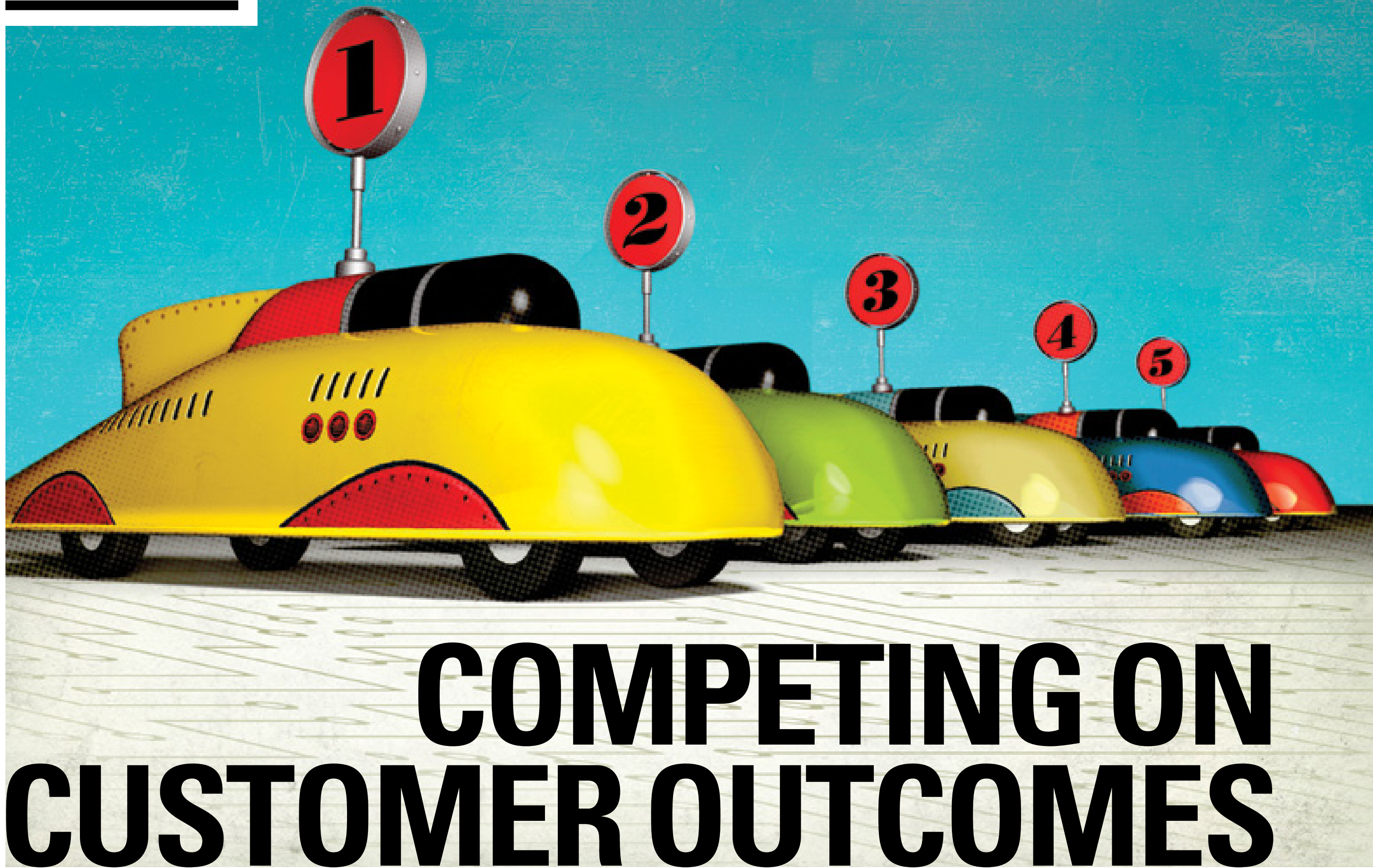
Four Design Characteristics for Data Wrapping



Questions to Answer When Evaluating Data Wrapping Opportunities

- What data analytics could help our customers better acquire, use, or create value with the product?
- Do we have the data, platform, and expertise to create the data analytics — and deploy at scale?
- How much money will our customer make or save (or what compelling problem will they solve) when they act upon the feature or experience?
- Given the value we create for the customer, what can we expect in return in the form of customer retention, acquisition, wallet share, or from the increased willingness to pay?
- What techniques and metrics can we use to monitor and measure the expected impact — for both the customer and the firm?
- How easy will it be for our competitors to follow suit?

COMPETITION



COMPETING ON CUSTOMER OUTCOMES

RICHARD BORGE/THEISPOT.COM

Three revenue models can help companies capitalize on customer satisfaction.

BY MARCO BERTINI AND ODED KOENIGSBERG

In his 1969 book *The Marketing Mode*, Harvard Business School professor Theodore Levitt immortalized a gentleman named Leo McGivena, who reportedly said: "Last year 1 million quarter-inch drill bits were sold — not because people wanted quarter-inch drill bits but because they wanted quarter-inch holes."[1] A half-century later, this insight is as compelling as it ever was — customers still want to buy meaningful outcomes (a particular sensation, a tangible benefit, or some combination of the two), not products and services. What's changing is companies' ability to become more accountable for those outcomes by helping customers navigate three critical checkpoints: *accessing* the solution, *consuming* (that is, experiencing or using) it, and getting it to *perform* as expected or above expectation.

Even so, most companies do not stake their success on these checkpoints. Instead, they sell quarter-inch drills and promise customers that the quarter-inch holes they desire will follow. Indeed, a revenue model focused on transferring the ownership of a product or service to the buyer may appear prudent because revenue accrues up front, and any risk associated with access, consumption, and performance is passed on to customers. But in reality it places an unnecessary burden on customers and ultimately shrinks the opportunity in the market. This contraction occurs when, for instance, customers are priced out or forgo a purchase because it is inconvenient, when they perceive ownership as too risky and decide not to buy, and when they resolve to pay less to account for the possibility that they will not make sufficient use of their purchase or that it will not perform as advertised.

Technological advances are enabling companies to rewrite the rules of commerce. Mobile communication, cloud computing, the internet of things, advanced analytics, and microtransactions offer sharper, more timely information that can illuminate when and how customers access and consume their products and services, and whether and how well those products and services perform. We call this information *impact data* — it enables companies to track and understand what happens to their solutions beyond the moment of purchase.

The way we see it, impact data — and the technologies that deliver and analyze it — is transforming corporate accountability for customer outcomes from a fashionable marketing slogan into a strategic imperative. Some organizations dismiss this imperative, hoping that it is another passing trend. Others (often intentionally) make their prices more ambiguous and thus less comparable across competitors, which impedes sound purchasing decisions on the customer side. These will not be winning plays in the long run. Instead, companies should start to embrace accountability for outcomes and change their revenue models accordingly before they are forced to do so by more enlightened competitors and disruptive startups.

In this article, we'll describe three types of revenue models that can help companies win customers and drive growth in today's increasingly transparent markets. The framework draws on insights from our respective academic areas of behavioral economics and operations, our research, and our ongoing interactions with companies. We'll also provide guidance on developing and implementing the right revenue model for your company, unlocking the untapped market potential of your solutions, and capturing the lion's share of the resulting value.

From Promises to Proof

With three revenue models, companies can progressively deliver access, consumption, and performance. One step removed from standard ownership (or transactional) models are what we call *access models*. These include subscriptions and memberships; they anchor payments to periods of time rather than physical goods or services. Next up are consumption models, which include unbundling, metering, and sharing; they not only facilitate access but also enable customers to pay only when they use a product or experience a service. Finally, *performance models* address all three needs — access, consumption, and performance — together by enabling customers to pay on the basis of the outcomes they achieve. In the past, pay-by-outcome agreements have been used in settings where performance is easy to quantify and monitor. In recent years, however, we have seen them taking hold in more complex arenas, such as health care, education, insurance, and even live entertainment.

Facilitating access. Access inefficiencies can be traced to physical and financial hurdles. Physical hurdles include conditions like stockouts and inconveniences, such as when a purchase requires too much time or effort to consummate. Subscription services, such as HP Instant Ink and the Dollar Shave Club, are designed to lower or remove these hurdles by eliminating much of the pain associated with buying printer ink and razors, respectively, such as running out of them and running out *for* them.

Less obvious physical hurdles are the unwanted accumulation of expensive or idle assets and the disposal of assets, as well. Disposal is not always easy, especially when products contain toxic materials or are relatively large. Signify, formerly Philips Lighting, addresses this challenge by offering "light as a service" to corporate clients such as Schiphol Airport in Amsterdam and steel and mining giant ArcelorMittal. Under these contracts, Signify retains ownership of all fixtures and installations while the client pays for the light it uses. Similarly, Ikea is testing ways to shift the standard ownership model for flat-pack furniture toward a rental model to meet customers' needs for affordability and sustainability.

Financial hurdles to access arise when customers lack the capital to purchase a product outright, such as a fleet vehicle or household furniture. Mobility subscriptions — such as Care by Volvo, which includes a car payment, insurance coverage, comprehensive maintenance, and additional digital services in one monthly fee — are increasingly popular because they ease this constraint. Another financial hurdle can arise when customers want an assortment of items that are collectively expensive, such as a music or film library or a stylish wardrobe. Spotify and Netflix are household brands in this space. In fashion, successful upstart Rent the Runway offers three monthly plans for designer

clothing and accessories that let members decide how many items they rent at one time.

The common denominator across these and other access models is that revenue accrues as a function of time. At first glance, these are familiar, long-established renting and leasing models, but a host of recent technological advances pertaining to monitoring, prediction, logistics, and payment have extended their applicability across most sectors of the economy. Today, companies can lower the barriers to entry in a market by transforming almost any product into a service with enhanced convenience. Indeed, XaaS (everything as a service) has become the mainstream revenue model in the software and tech industries, rendering the licensed software CD obsolete.

Consume and pay. Consumption inefficiencies take many frustrating forms. They occur when an asset — say, a car, apartment, or medical device — either sits idle for a large portion of its useful life or is not acquired in the first place because customers cannot justify owning it. Automobiles, for example, sit idle about 95% of the time — a disturbingly low level of utilization for such an expensive product. Consumption inefficiencies also result when customers must purchase a predetermined package size that is too small or large given their needs. Finally, they occur when some barrier, such as a related risk or the price of a complementary good, prevents customers from using a product or service they already own. Companies have three options for tackling these problems: unbundling, metering, and sharing.

In the past, physical constraints made it economical to bundle offerings together (songs on a compact disc, articles in a newspaper, and so on). But digital technologies changed the economics: Now, companies can digitalize certain offerings and deliver them to match customers' actual consumption patterns. The recent experiences and struggles of traditional media companies with digital transformation can be traced in large part to this push toward unbundling.

In metering models, a company supplies the product but charges customers only for using it. The German company Winterhalter, which specializes in commercial dishwashing machines, racks, detergents, water treatment supplies, and services, adopted such a model with a program it calls Pay Per Wash. Instead of selling or leasing its products, the company charges customers for completed wash cycles. Similarly, Thermo Fisher Scientific's next-generation genetic analysis systems feature "pay per lane" DNA sequencing. The platform is the first to enable laboratories to run just one, a few, or all sequences and pay only for the reagents used in the sequences they choose.

In sharing revenue models, sellers either manage or join a platform to distribute a product or service across many interested users. These collaborative-consumption ventures are growing at an impressive rate because they not only reduce waste for customers but also improve the utilization of assets — and, therefore, the return on investment — of asset owners. Uber and Airbnb are obvious examples of this. So is logistics startup Flexe, which matches retailers with warehouses that have excess space, and SpotHero, which helps drivers find open parking spots in crowded cities by pooling the spare capacity of its participating partners.

Perhaps the biggest impact of sharing models, however, is felt in less-developed and rural economies, where information technology enables the sharing of critical assets, such as farming equipment, on a much larger scale than was previously possible. One example is Hello Tractor, whose platform enables farmers in Nigeria to access farm machinery on a pay-per-use basis while providing the security that the owners of the machinery demand through remote tracking. Similarly, Trringo, a tractor and farm equipment rental service in India, strives to make these scarce resources easily accessible and affordable to farmers across the country. These examples underscore the inherent relationship between initiatives that tackle consumption waste and those that tackle access waste. While access to farm equipment does not guarantee consumption, there is no consumption without access.

Each of these models aids customers by removing barriers to the use of solutions and activating dormant or underutilized capacity. But consumption models do not guarantee outcomes: They may or may not produce the performance customers seek from a product or service.

Performance, guaranteed. Value delivered is the ultimate outcome. In B2B markets, delivery of value implies that a particular solution improves the profitability of the customer, but agreeing to a contract

THE QUALITY PARADOX

Why don't companies immediately leap at the opportunity to monetize outcomes when, after all, this is what customers truly seek? We often find it's because they are blinded by the quality of their offerings, making it almost unimaginable to make money from anything other than the "stuff" they bring to market.

We call this phenomenon the *quality paradox*, and it has at least two triggers. First, businesses that invest continuously and heavily in research and development are susceptible to worshipping what they make. Such devotion reinforces attitudes and behaviors that are inherently inward looking. The more rooted a company's culture is in its proprietary technologies, engineering expertise, or process savvy, for example, the more vulnerable it is to being accountable to its offerings instead of its customers.

Second, innovation is expensive, and heavy investments in developing high-quality products and services tend to make company leaders more conservative in any decision that involves revenue. This leads directly to the traditional ownership model as a default, because that is often the simplest and safest way to cover costs and measure return on investment — even though it most likely won't maximize ROI.

based on profit impact can be a challenging task. For example, it is often hard to isolate the influence of a single contributing factor when a complex mix of factors are in play. In B2C markets, value combines impressions or sensations with tangible benefits, and research technology has not yet progressed to the point where a company can identify and measure the changes in brain activity that signal the overall satisfaction individuals derive from everyday products and services at scale. Even if this could be achieved, social norms might render collecting and using such intimate impressions impossible. In both contexts, the practical alternative is to settle on a proxy that represents value accurately, can be quantified by the company, and, in turn, can be verified by the customer. Let's consider three examples.

Instead of selling explosives, Australian multinational Orica adopted a revenue model based on the quality of the blasts it delivers to customers. Its rock-on-ground contracts are possible because the size of the broken rock that results from a blast has a significant impact on the operating cost of a mine (greater fragmentation makes it cheaper to handle and dispose of unwanted debris) and therefore a mine's profitability. These contracts have become a defining characteristic of Orica, both internally, in terms of innovation and product development, and externally, in terms of its ongoing relationships with customers and positioning in the market.

In health care, Roche, a Swiss pharmaceutical multinational, is developing personal reimbursement models, a clear break from the tradition of charging for a pill or treatment — the legacy ownership model in the industry. Under this new model, Roche acknowledges that the effects of medications can vary by indication (that is, the patient's specific condition), combination with other medications, and response, and customers are charged in light of that reality.

Lastly, Teatreneu, a popular comedy theater in Barcelona, Spain, brought a performance-based revenue model to live entertainment by charging patrons according to how much they enjoyed it. Customers entered the theater free of charge in its pay-per-laugh system, and a facial recognition system mounted on the seat back in front of them registered each time they laughed during a performance. Each laugh was priced at 30 euro cents, with a maximum charge of 24 euros per show, or 80 laughs, so that "no one would need to cry because they laughed more than they could afford."[2]

Performance models represent the cutting edge of outcome accountability. Such models charge directly and as precisely as possible for the value or utility that customers derive from a purchase. There is no need for intermediate measures — outcomes are monetized, and access, consumption, and performance inefficiencies can be minimized.

Walking the Outcomes Walk

The existential question for company leaders who are uneasy about the new technologies and disruptive competition that may be threatening their livelihood is, *What are we asking customers to pay for?* The hard truth about how a company can successfully earn revenue lies in how leaders answer this question, not in the promises being made in advertising, online, or on sales calls. Evolving your revenue model requires a different mindset and new competencies. In particular, there are five critical questions to answer:

1. What do we mean by outcome? The starting point is clearly defining *outcome* in the organization. To be suitable as the basis for a revenue model, an outcome must be:

- **Meaningful to customers.** This may seem obvious, but many companies still lapse into navel gazing — focusing on product or service features in which they have an inherent interest or technological advantage, even when these characteristics are irrelevant or matter little to customers. (See "The Quality Paradox.")
- **Measurable.** The organization and its customers must agree on the parameter(s) that best reflect outcomes, and when and how these will be captured.
- **Independent.** Neither the company nor its customers, nor third parties, can tamper with the measurement of the outcome to their benefit.

Beyond this, leaders have to consider the number of outcomes they want the organization to deliver and the degree of control they have over each outcome, as these factors can force trade-offs between complexity and financial returns. The right number of outcomes relates to the heterogeneity of customer

needs and wants in your market. This determines whether you can serve the market with a single outcome or should champion multiple outcomes. Clearly, the company that delivers multiple outcomes is likely to require greater coordination and face greater challenges along many dimensions, from product development and operations to marketing and communications, but in return it often serves — and monetizes — more customers.

At the same time, outcomes tend to be less complex when their delivery depends only on the selling organization or when they can be broken down into a small set of clear, manageable steps. Conversely, outcomes tend to be more complex when they involve intermediaries and customers themselves or when the underlying process is unclear or difficult to control. Ultimately, complexity here is an issue of how many moving parts a company must track and coordinate to implement and maintain an outcomes-based model. For instance, the number of contributors is important because if a market evolves to the point where customers pay according to some measure of performance, then the team responsible for delivering that performance needs to share the resulting revenue.

2. What happens after our products and services reach customers? "How many miles does it have on it?" is one of the first questions a mechanic will ask when someone brings in a vehicle for service. It is also one of the most important questions a potential used-car buyer will ask. This single number sets expectations on wear and tear, repair needs, warranty costs, residual value, and more.

What mileage cannot do is tell us anything about the car's usage or performance with certainty. Once the vehicle leaves the dealer's lot, the rest is a black box of sorts. Odometers cannot tell us who sat in and used the car, the conditions under which any mile was driven, and how well the vehicle performed for each individual mile. Odometers also offer no insights into miles not driven because of a breakdown or other mechanical or technical issues with the car.

The missing link in understanding the value customers ultimately derive from their purchases is impact data. Over the past decades, customer-focused organizations have made important progress in understanding customers' needs and wants, as well as mapping their purchase processes and experiences. (See "Beyond Needs and Journeys.") However, prior to the widespread availability of information technologies, a company could not efficiently observe customers' post-purchase behavior directly, completely, and in real time.

This is no longer the case. Impact data enables companies to take customer focus full circle and define effective revenue models. Without impact data (in combination with traditional information on needs, wants, and journeys), companies would have no reliable means of identifying the access, consumption, and performance inefficiencies that can plague traditional revenue models based on ownership. Accordingly, they would have no reliable means to hold themselves truly accountable for the value they can offer customers.

One big consideration is the extent to which customers want to share their impact data. While collecting information on customers' needs, wants, and decision journeys is typically not invasive, collecting impact data is. It can reveal facts, patterns, tendencies, and behaviors that customers purposely keep to themselves. Any data-driven quest for a better revenue model may feel like theft to customers unless companies protect their privacy and foster trust. Protecting privacy involves putting the appropriate safeguards in place to keep data confidential.

BEYOND NEEDS AND JOURNEYS

Companies ultimately need three types of data to call themselves truly customer focused. The first type is data regarding customer needs and wants, which helps companies understand the kinds of solutions that customers will buy. This kind of data has been the lifeblood of R&D and marketing departments for decades.

The second type of data is relatively more recent and comprises information on the different steps that customers take when they seek out and select solutions to satisfy their needs and wants. The original representations of these decision-making journeys were linear, with customers following a rather predicable path from awareness and interest to an actual purchase. However, the decision journeys of today's customers are anything but linear, unfolding erratically across multiple physical and virtual touch points, with organizations trying to use this information to engineer richer experiences and forge stronger relationships with their target audiences.

The newest type of customer data is impact data, which closes the loop on any company's journey toward becoming a customer-focused business. It replaces anecdotes and guesswork, allowing organizations to pinpoint changes in the behavioral patterns of customers and draw more reliable conclusions about why they are happening. Impact data enables companies to improve their products and services to generate more value for themselves and their customers. Indeed, customers are increasingly demanding that companies use impact data to better serve their interests — and they are gravitating to sellers that profit only when customers are satisfied. Impact data allows customers to pay for precisely what they get, no more and no less.

Building trust involves reassuring customers that the company collects and uses impact data for purposes that are ultimately in their interests.

3. Are our products and services optimized for impact? A surprising but critical byproduct of answering the two questions above is that leaders suddenly have a sharp, unequivocal metric for assessing innovation. Innovation does not always serve the customer. Sometimes, even the most customer-obsessed companies take their eyes off the prize and look inward for inspiration — seeking the most cost-efficient solution, pushing features that internal factions desire, or making compromises that deliver an initially higher return on investment.

Answering this question allows leaders to review and adjust the current product and service portfolio. It enables them to better align their innovation efforts with the way customers derive value, and it motivates or pushes them to strip away internal distractions and focus on (re)designing for impact.

4. How do we engage customers who participate in the creation of value? Companies that adopt a performance-based revenue model are assuming the risk associated with the delivery of value to customers. Bearing this risk is not an issue if the company is confident that it can consistently create quality outcomes on its own. But what happens when customers are active participants in the creation of value? For example, a new drug may provide superior relief, but this depends on whether a patient complies with instructions on when and how to take the medication. Likewise, a well-designed course or educational platform may provide superior learning, but this outcome depends on whether a student puts in effort and follows the syllabus.

When customers participate in value creation, the ensuing risk may be excessive to the company, unless it can offer the right incentives to ensure they make the proper contribution. Perhaps the simplest way to motivate customers to behave is to reward them proportionally for acting in a manner that improves the underlying quality of the outcome. In other words, as the value pie expands in the exchange between the company and the customer, the customer should benefit from an increasingly larger slice.

Aside from financial rewards, companies have three options to mitigate the risk they have assumed from customers. First, they can enter into formal contracts so that both the company and its customers recognize their rights and obligations in a pay-for-performance exchange. Second, they can use elements of gamification — competition, a point system, or some other motivational mechanism — to nudge customers toward the behaviors that make the greatest contribution to outcome quality. This is particularly relevant for consumer markets and, for example, is a feature of many modern pay-as-you-drive auto insurance products. Finally, the company can extend its operations and take over the activities that are typically undertaken by customers. This option makes sense whenever customers lack sufficient know-how, skills, or resources to ensure a result on par with what the company could provide — something that we see frequently in industrial markets, where many leading suppliers have reinvented themselves as solution providers.

INNOVATION DOES NOT ALWAYS SERVE THE CUSTOMER. SOMETIMES, EVEN THE MOST CUSTOMER-OBSESSED COMPANIES TAKE THEIR EYES OFF THE PRIZE, SEEKING THE MOST COST-EFFICIENT SOLUTION, OR PUSHING FEATURES THAT INTERNAL FACTIONS DESIRE.

5. What is the transition plan? Changing the way your company makes money is not easy. The nature of your product (physical versus digital), the pace of technological change in your market, and beliefs about how long it will take your customers to change habits are likely to be important factors in deciding when to make a move. When the time comes, you will need to choose between the radical approach of launching the new model while switching off the old and easing into a new reality by operating multiple revenue models for some period of time. Neither approach is a walk in the park, and both depend on your ability to manage expectations inside and outside the company.

The first approach is risky, as you put all your eggs in one basket. And it is almost guaranteed to trigger short-term losses as transition costs quickly accrue and revenue is postponed from the point of purchase to some point in the future — periodically upon access, upon consumption, or upon

performance, depending on the model selected. For a public company, these effects can alienate investors unless they understand (and agree with) the strategy and recognize the temporary nature of the downturn.

The second approach appears safer but is by no means risk-free. When given a choice, existing customers are likely to switch to whichever revenue model makes them better off. Because this results in cannibalization, the short-term impact on sales to existing customers will be negative, which can create friction inside an organization that is caught off guard. Accordingly, it is important to set expectations and establish clear ground rules if the active revenue models are led by different teams, to avoid internal competition for the same customers. Prices must also be carefully calibrated to minimize cannibalization.

Irrespective of which of these approaches you take, the organization will soon need to ask itself what the business would look like if it dealt with customers on the basis of a changed revenue model. Imagining this scenario requires creativity and the proper perspective. What is the right benchmark when a company judges a future course of action? Although it is often the case in practice, the point of comparison (the control group, so to speak) should not be the status quo — as expressed by current performance in terms of the key financial and commercial indicators. This confers a false sense of security. Instead, the organization should draw a comparison between multiple futures, contrasting the likely consequence of the planned change in revenue model with the likely projected consequence of inaction (that is, the decision to maintain the existing revenue model). Moreover, the proper time horizon for this comparison should not be a short-term one, and any anticipated dip in sensitive metrics, such as number of customers, revenue, or profitability, should be viewed as an investment in a more sustainable future.

COMPANIES THAT EARN their living by selling products and services tend to presume that there is a direct and strong link between the amount of money customers spend on a specific offering and the achievement of the outcomes they desire. But this is often not the case, and the consequence of any disconnection is borne by the customer. Ownership in and of itself does not enable access, nor does it imply consumption. And it certainly does not guarantee performance.

When a company truly possesses a superior product or service, especially when it has the resources to innovate and maintain a technical advantage, it can do itself and its customers a disservice by stubbornly holding on to a revenue model based on ownership. This company is not properly pricing its competitive advantage. Indeed, claims of superior customer value are cheap talk unless companies back them up by not only delivering the solutions customers need and want but also adopting a revenue model that aligns its success with that of customers. This should be intuitive to companies — especially those that claim to put customers at the heart of their operations and have spent the past several decades sharpening their ability to gather meaningful insights about their motivations and decision journeys.

We urge you to act on this intuition. Not every company can or should rush to implement a performance-based revenue model, however. Performance models may be the final destination, but they are not necessarily the next destination.

Even so, companies should recognize that revenue models anchored in the mere ownership of a product or service are patently inferior. Making the transition to better alternatives anchored in time or use is within reach for most businesses — so they can start pursuing access and consumption models now.

Marco Bertini *is a professor of marketing at Esade - Ramon Llull University and cofounder of the school's Institute for Data-Driven Decisions.* ***Oded Koenigsberg*** *is a professor of marketing and the deputy dean at London Business School. They are the authors of* The Ends Game: How Smart Companies Stop Selling Products and Start Delivering Value *(MIT Press, 2020), from which this article is adapted. Comment on this article at https://sloanreview.mit.edu/x/62126.*

REFERENCES

1. T. Levitt, "The Marketing Mode: Pathways to Corporate Growth" (New York: McGraw-Hill, 1969).

2. Markedu, "Pay Per Laugh Teatreneu — Case Study Award Winning Campaign," Oct. 30, 2015, YouTube video, 1:27, www.youtube.com.

Reprint 62126.

Copyright © *Massachusetts Institute of Technology, 2020. All rights reserved.*

Why Pricing Decisions Need More Than Management Intuition

Daniel Deneffe and Herman Vantrappen

Understanding the value of economic thinking during and after the COVID-19 pandemic can help companies meet evolving customer needs.

The past year has wreaked havoc on many industries. Companies have faced a range of issues related to customer strategy: sharp drops in demand, excess capacity, heightened price sensitivity, and aggressive pricing decisions by competitors. One important takeaway from the unprecedented impact of this crisis is that executives need to question many of their long-held beliefs about the best way to deal with rapidly changing customer needs.

In this article, we describe six real-world customer strategy and pricing scenarios that many executives have faced in the past year. We discuss the prevalent, intuitive responses that many companies have made in response to each type of challenge and then examine when and why those intuitive responses may not be that sensible after all. Drawing on Daniel Kahneman's work on dual-process thinking, we contrast the effects of a *System 1* (fast and automatic) response with a *System* 2 (slow and effortful) response and suggest more thoughtful ways to approach the six scenarios.

What binds the six System 2 responses together is the practical application of sound economic and strategic thinking. These insights should help executives make smarter decisions as the world moves on from the current crisis — and faces potential new ones.

Situation 1: "Going through a major recession? Give temporary discounts." COVID-19 has plunged the global economy into the worst recession since World War II. The significant global decline in GDP implies that people, on average, are getting poorer. An executive's intuitive, reactive response (System 1) may be to lower prices. Executives may issue these changes in the form of clearly communicated, temporary price discounts rather than cuts in list prices so the prices can return to nondiscounted levels when economic conditions improve.

This recommendation seems sensible on its face. But when we activate System 2 thinking and evaluate the recommendation in more depth, a different conclusion emerges. Economists distinguish between "normal" and "inferior" goods: Inferior goods are those for which demand increases as consumer incomes decline, whereas normal

goods are those for which demand decreases as consumer incomes decline. This means that the System 1 recommendation does not hold for inferior goods (for example, budget cars as opposed to premium vehicles). Companies should confine temporary discounts to their normal goods because demand for their inferior goods is going to increase regardless. Conversely, when GDP picks up again, they should not raise prices for the inferior goods. This takeaway is important for companies with numerous products within a given category (for example, a food company that offers both value-for-money and gourmet pastas).

Situation 2: "Uncertainty makes people reluctant to spend? Let's lower prices." We all know what uncertainty does to stock markets: Big jumps in uncertainty trigger sharp falls in stock prices. By analogy, an executive's intuitive, quick response to the pandemic-induced uncertainty may be to lower prices. For example, the uncertainty about future travel policies and restrictions may lead lodging businesses to cut prices on their rooms.

However, a more thoughtful, System 2 approach starts with the realization that uncertainty positively affects demand for many services. In the case of hotel bookings, uncertainty about future travel restrictions makes customers hesitant to make bookings and reduces their willingness to pay for a hotel room. However, their willingness to pay for the option to cancel without penalty will increase, so their total willingness to pay for the bundle (i.e., room plus free cancellation) will be less affected. Consequently, a lodging company can minimize the downward effect on room prices, provided that it automatically includes free cancellation. To customers, it appears that the cancellation service is free, but in fact, it is the base hotel rate that has decreased while the cancellation option commands a higher premium. The takeaway is that the downward price effect from higher uncertainty can be mitigated by offering services that are valued more by customers when these factors are at play.

Situation 3: "Costs have gone up? Pass them on to customers." COVID-19 has led not only to dramatic changes in the demand for products and services but also to severe cost increases. In food retailing, for example, costs have increased due to various sanitation requirements. The cost impact may also be more indirect; take the case of the agricultural workforce, where shortages are resulting from travel restrictions. A company's System 1 response may be to pass on these cost increases to customers through higher prices, but once again this overlooks key considerations.

When it comes to the link between cost increases and price increases, economists point to the difference between fixed and marginal costs. An increase in fixed costs (for example, the installation of partition screens) will cut into the company's total profits. It should not, however, induce the company to raise the prices of its products, provided that the initial prices were set at the optimal levels: Starting from a very high price where no one buys and revenues are zero, the profit-maximizing price is reached when the marginal revenue of lowering price equals the marginal cost of doing so. Fixed costs do not enter the picture because they affect neither marginal revenue nor marginal cost. An increase in marginal cost, in contrast, affects that balance and should, if everything else remains constant, lead to higher prices.

Situation 4: "The business is losing money? Raise prices to recover losses." As a result of the crisis, numerous businesses are losing money for the first time in years. Leaders might be inclined to raise prices to recoup steep losses. Unfortunately, this approach may lead to a reduction in revenues that is larger than the costs savings from the reduced volumes, and thus a decline in profits.

A more thoughtful response would be to recognize that losses can be induced by various factors. It is therefore critical to analyze which external and internal factors are at the root of the loss and act accordingly based on the company's scenario:

- If the loss is due to a marginal-cost increase, raise prices.
- If it is due to a drop in demand and the company has excess capacity, decrease prices temporarily.
- If it is due to a fixed-cost increase, do nothing.

Situation 5: "Customers are spoiled by free services? Go for value pricing." In order to keep customers who are struggling during the crisis loyal, many B2B companies are offering

services such as free shipping or rush orders at no extra charge. The question of what to do with those freebies will pop up as soon as the economy picks up. Intuition might move executives to avoid changing tack as long as their competitors continue to offer the free services.

Unfortunately, doing nothing is costly in its own right. A System 1 response may be to go for value pricing, particularly since those free services were clearly communicated as being temporary: Assess the value that the customer attaches to a service, and price it in a way that the value is shared "fairly" between a company and its customer. Unfortunately, value pricing does not work for services that are not unique *and* that competitors continue to offer for free. In that case, value pricing does more harm than good, as the company will end up losing plenty of customers.

System 2 thinking suggests a better, negotiated approach, at least for B2B markets with repeat customers: Propose to customers before the year starts that they will obtain an end-of-year discount for the proportional reduction in the number of rush orders relative to the number in the past year. This leads to a pure win-win outcome. Customers will benefit from ordering regularly whenever they can and will place rush orders only when really needed. And since the company rewards customers only for *improving* their order behavior, not for placing the orders they make regularly anyway, it will gain more compared with a scheme that gives customers a discount for ordering regularly.

We should note that the scheme works only in markets where end-of-year service negotiations between customers of the same supplier are relatively nontransparent. That is the case in many B2B markets, in contrast to B2C markets, where price policies tend to be public.

Situation 6: "Some businesses have been lucky enough to benefit from COVID-19? We haven't, so we'll just have to sweat it out." There are plenty of companies that have benefited from offering or creating new products and services that meet the customer needs that have been particularly acute during the pandemic — such as home entertainment, food delivery services, and cleaning products, to name just a few categories. Other companies have been able to mitigate the impact in one line of business with gains elsewhere. An executive's intuitive System 1 response may be to shrug off these incidental success stories as exceptions that one cannot hope to emulate in one's own company.

The *dynamic capabilities* school of strategists teaches that a company's strategy should be primarily driven by its specific resources and competencies. Especially in periods of crisis, a company should find out how it can make small tweaks to its capabilities to meet new needs. Airlines, for example, have flexibly used their regular planes as quasi freighters. Office furniture companies have been creative in making their offerings eco-friendly and easy to install so as to meet the needs of the work-from-home segment. And in the hotel market, Red Roof started adapting its offerings through its Work Under Our Roof program: People who need a bit of quiet to get work done can rent out workspaces from 8 a.m. to 6 p.m. All of these examples demonstrate System 2 thinking that allows companies to not only address the current crisis but also look ahead to long-term competitive advantage.

The six situations described above have one thing in common: They illustrate how a thoughtful System 2 response based on sound economic and strategic logic can help executives make better management decisions about their offerings, prices, and cost management. Sadly, the COVID-19 pandemic has created highly visible opportunities to apply that logic and witness its impact quickly. But the underlying thinking should continue to prevail long after the world has conquered the virus.

About The Authors

Daniel Deneffe is a strategy consultant and a professor of economics and strategy at Hult International Business School. He also teaches "Business Strategy in the Real World" at Harvard University's Division of Continuing Education and can be reached at danieldeneffe@fas.harvard.edu. Herman Vantrappen is the managing director of Akordeon, a strategic advisory firm based in Brussels. He can be reached at herman.vantrappen@akordeon.com. They are the authors of *Fad-Free Strategy: Rigorous Methods to Help Executives Make Strategic Choices Confidently* (Routledge, 2020).

The Retail Profitability Paradox

Rodney R. Sides and Lupine Skelly

As consumers' power grows, companies are investing more to deliver value-adding experiences. How can retailers capture value in return?

When we think about the COVID-19 pandemic's impact on how people shop — and on how retailers cater to their needs — it's important to recognize that consumer preferences to "buy online, pick up in store" and to take advantage of other digitally enabled solutions are not simply short-term shifts. In fact, the current period is more likely a tipping point in the digitization of retail and in the shifting power dynamics between buyer and seller.

The traditional business-to-consumer retail model has unraveled in recent years, and COVID-19 has accelerated a push toward a new era of consumer-to-business relations. In this new model, consumers have become merchants in their own right, buying from a broad spectrum of retail channels, curating and promoting their own array of products via their social media accounts, reselling used goods through digital platforms, and setting the terms for how their purchases get to their doorsteps.

Consumers no longer rely on retailers the same way they did in the traditional model. Rather than trusting the same retailer for the best prices and the broadest selection, people are more likely to skip from source to source, powered by peer recommendations and price comparison shopping as they go.

Retailers have realized that their role in the customer journey has changed, and while their profit margins were already squeezed, many have invested heavily in expanding digital experiences and increasing convenience for consumers. They're developing more partnerships with third-party providers of data-driven services and experiences to create more value for their customers, but these strategies can lead to a profitability paradox in which they struggle to capture value in return. Retailers can no longer rely on alleviating margin pressure just by cutting costs.

In order to thrive in this new era, retail businesses need to reinvent both how to go to market and how to leverage their own customers along the way.

A Competitive Customer Experience Comes at a Price

Deloitte's April 2021 financial and strategic analysis of 100 retailers from 11 retail subsectors demonstrates how recent customer experience trends are compounding a margin crisis that was already playing out before the pandemic.

Median profitability declined 300 basis points from 2012 to 2019, while return on assets declined 340 basis points over the same period. That lost ground will be difficult to recover.

Price competition, coupled with demand for top-tier personalized customer experiences, increased customer acquisition costs by over 60% from 2013 to 2018. [1] To deliver the types of services that consumers are now accustomed to, such as the ability to shop from a multitude of platforms, retailers now need new expertise.

Enter the third-party vendors, who support the shopping journey with services such as fit-predicting tools and product viewing technology; payment plans and platforms to power retailers' websites; and third-party logistics, marketplace, and last-mile delivery solutions.

For example, "buy now, pay later" is becoming one of the fastest-growing payment options in the U.S. It's projected to grow at a combined annual growth rate of 13% over the next five years, with third-party providers collecting transaction fees from merchants of up to 50 cents plus up to 10% of the purchase price per transaction, according to Deloitte research. [2]

Retailers are exacerbating their own margin erosion while fueling logistics companies' success — essentially giving away personalized services and conveniences for free in order to compete. (See "The Profitability Paradox.") While 50% of consumers say they're willing to spend more on convenience, retailers can't suddenly start charging for services that have become a standard element of the customer experience. [3]

Margins Erode While Additional Cost Pressures Loom

The pandemic exacerbated long-running retail profitability issues — many of which have been plaguing the sector since the early 2000s. According to our analysis of 100 public retail companies' financial performance, median margins on earnings before interest, taxes, depreciation, and amortization (EBITDA) declined 300 basis points from 2012 to 2019, a period that reflects the high point of the Great Recession recovery up until just before the pandemic. Discretionary categories — especially department stores, and apparel and specialty retailers — experienced the greatest swings, partly because of increased competition from direct-to-consumer companies, subscription models, and even homegrown brands popping up on social media. Nondiscretionary categories, like grocery stores, operated at lower margins but also experienced less drastic swings.

Our analysis also revealed that all retail sectors are facing margin pressure from sales, general, and administrative expenses and that the median return on assets decreased 340 basis points on average, with all 11 subsectors in our analysis seeing declines. Rising variable costs of shipping, higher warehouse labor costs, and rising digital advertising costs — coupled with low conversion rates (especially for social media) — make retailers' road back to recapturing margins even more difficult. [4]

During the height of the pandemic, many retailers reached for the only levers they had left, cutting costs wherever possible. In Deloitte's 2021 retail outlook survey of 50 U.S. retail executives, 7 in 10 rated realigning cost structure as an investment priority. [5] However, given the focus on cost cutting for the past several years, there might be little left to cut going forward, and that strategy alone is not likely to return retailers to profitability.

Other concerning factors on the horizon might continue to threaten margins, including rising commodity costs and potential transitory inflation, increased labor costs, and continuing supply chain issues. Larger players might be able to scale accordingly to absorb these additional costs. For example, a large mattress retailer said it expects to pass along 80% of upcoming cost increases through higher pricing and efficiency gains. [6] However, it could be more difficult for smaller players and those operating at lower margins to push through.

Leaders Can Find Success by Embracing the Paradox

If nothing changes, and if margins continue to erode, we're

facing a retail future of online platforms, mass merchants, and a handful of companies with unique value propositions. What can retailers do to ensure their sustained success?

As part of our profitability analysis, we investigated how leaders (those above the median EBITDA margin) and laggards (those below the median) were strategizing for the future. We found that leading companies are pursuing two approaches: exploring new revenue streams and monetizing existing assets, and embracing a consumer-to-business mentality.

Explore new revenue streams and monetize existing assets. Twenty years ago, private-label credit cards were a boon for retailers, helping to create loyalty while driving additional revenue. Retail leaders today are looking for new ways to easily access new revenue streams, such as adding subscriptions and membership programs and expanding into value-adding services that align with their core offerings. For example, some athletic apparel retailers have launched fitness apps or expanded into selling wearable gadgets and hardware to generate additional income and foster more brand loyalty. [7] Other examples include lifestyle brands venturing into travel services, and big-box and grocery retailers exploring financial and health care services to meet the needs of their consumers in a more holistic way. This effectively creates a second-level membership based on the size and type of customer and employee base.

Other retailers are monetizing their existing assets, expanding into platforms and services, and getting creative with their "intangible assets." For example, companies may use their expertise in consumer data to offer advertising support as a service to other businesses. [8] Another example is in-store technology and experiences that can be developed and sold to other retailers. This can range from queue management, innovative signage, and computer vision (teaching computers to understand the content of images) to create more frictionless offerings.

We have also seen leaders explore areas such as logistics as a service where, by partnering with real estate investment trusts, companies can leverage physical locations for fulfillment and customer connection points. This strategy offers an opportunity for job creation while at the same time bringing the supply chain closer to the customer.

Embrace the consumer-to-business mentality. Innovative services and partnerships certainly can shore up retailers' profitability, but the shift to the consumer-to-business paradigm requires a more holistic retail reinvention. We've identified three initial steps for retailers to consider as they approach this new era of retailing.

1. Remove friction. Consumers have made it clear they want a different retail journey. Instead of relying on a favorite, trusted retailer to serve up the best options, modern consumers prefer to be their own merchants and rely on themselves or their peers to refine their selections. Retailers will need to find ways to remove friction across this new customer journey: from various purchasing formats (text, livestream, social media, web) down to the way items are fulfilled (drop shipments, "buy online, pick up in store" options, regular shipping). Consider the value of a platform with noncompeting or even competitive retailers joining together to give the consumer more ease of choice. This may blur the boundary between stores, but it can also save retailers significant expenses in reaching and fulfilling the needs of this new kind of consumer.

2. Redefine service. With consumers shifting their role in retail from last-mile delivery to chief merchant, the service experience needs to be redesigned. Product marketing is more critical than ever, and retailers have the chance to monetize their digital properties to help build product awareness at the new point of purchase while creating an alternative revenue stream, essentially shifting trade dollars from in-store marketing to digital platforms. Additionally, retailers have the opportunity to leverage the extended ecosystem outlined above to alleviate customer pain points. For example, consumers are offered multiple ways to receive products but often have limited options for returns. Working with partners, there is an opportunity to offer more options and create new service expectations in the marketplace. Many last-mile partners are already in the neighborhood, so home pickup of returns, even for a modest fee, may be a way to offset some last-mile costs.

3. Organize operations by customer segment. Many retail organizations are set up in silos, with each group owning a small piece of the customer experience — often without

a centralized function to coordinate customer touch points. In the consumer-to-business landscape, companies should consider a more cohesive approach governed by a designated customer management team, to establish accountability and the authority of the customer. Imagine creating segment teams that have full accountability for that customer. Across the customer journey — from products, to specific marketing campaigns and targeting, to in-store and unique digital experiences — retailers can meet consumers where they are to address their specific needs and provide a more intimate experience.

Asking what happens when the consumer is first in the value chain instead of last should drive the need to rethink the role of the store, the structure of the supply chain network, how marketing channels are prioritized, and what products are core to the assortment.

The future of retail is more complex and multidirectional. That future is hard to envision for those retailers facing declining margins that have yet to evolve their operating models to fit the needs of consumer-led retail. The pandemic has prompted a retail reckoning, and for those who are investing in the way forward, the promise of future profitability lies in embracing the customer-to-business mentality.

About The Authors

Rodney R. Sides is the global leader of Deloitte Insights, is vice chairman of Deloitte LLP, and leads the retail, wholesale, and distribution practice in the United States. Sides has more than 30 years of experience assisting retailers with their strategies to improve operational efficiency and increase profitability. His experience spans store operations, supply chain, procurement, back-office operations, and IT. Lupine Skelly is the research leader for the Retail, Wholesale, & Distribution sector within Deloitte Services LP's Consumer Industry Center. Skelly has more than 15 years of consumer market research experience uncovering actionable insights around emerging trends across the retail industry.

References

1. N. Disai, "How Is CAC Changing Over Time?" ProfitWell, Aug. 14, 2019, www.profitwell.com.

2. Primary interviews with direct providers, conducted by Deloitte analysts, April 2021.

3. "Global State of the Consumer Tracker," Deloitte, accessed April 2021, www2.deloitte.com.

4. K. Lobaugh, B. Stephens, C. Reynolds, et al., "The Future Is Coming ... but Still One Day at a Time," PDF file (Deloitte Insights, June 2020), www2.deloitte.com.

5. R.S. Sides and L. Skelly, "2021 Retail Industry Outlook," Deloitte, January 2021, www2.deloitte.com.

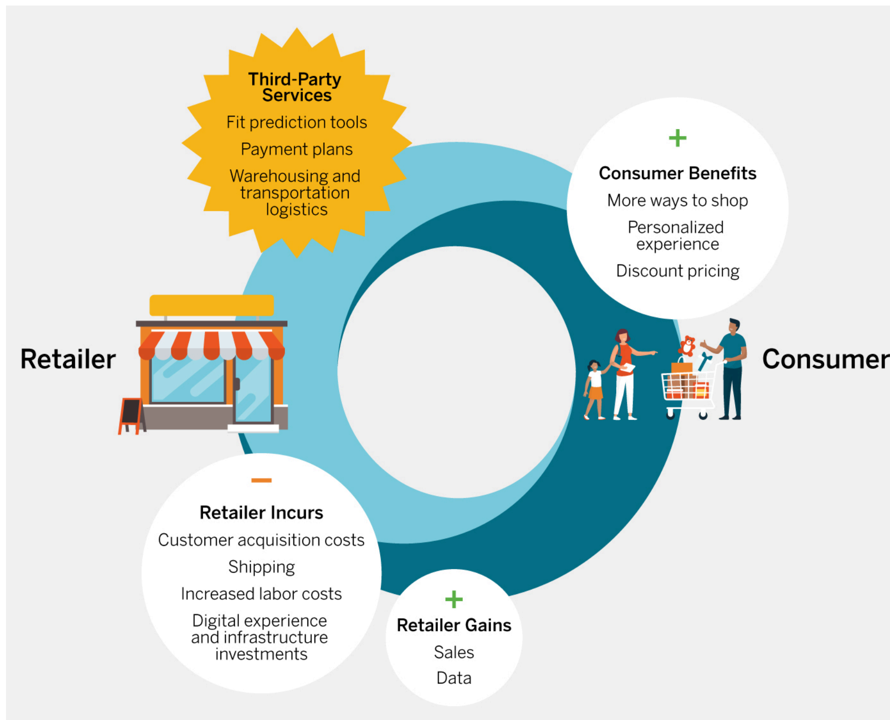
6. Sleep Number Corp. Q1 2021 Earnings Call, April 21, 2021.

7. D. Howland, "Lululemon Snaps Up At-Home Workout Platform Mirror for $500M," Retail Dive, June 30, 2020, www.retaildive.com.

8. A. Bruell, "Walmart Revamps Ad-Sales Business to Expand Its Reach," The Wall Street Journal, Jan. 28, 2021, www.wsj.com.

The Profitability Paradox

Consumers and third parties are capturing value from retailers. Success for retailers now depends on their ability to sell to — and through — their customers across a variety of channels in increasingly sophisticated and personalized ways.



Source: Deloitte Development LLC

MITSloan
Management Review

PDFs • Reprints • Permission to Copy • Back Issues

Articles published in *MIT Sloan Management Review* are copyrighted by the Massachusetts Institute of Technology unless otherwise specified.

MIT Sloan Management Review articles, permissions, and back issues can be purchased on our website, **shop.sloanreview.mit.edu**, or you may order through our Business Service Center (9 a.m. - 5 p.m. ET) at the phone number listed below.

Reproducing or distributing one or more *MIT Sloan Management Review* articles **requires written permission.**

To request permission, use our website **shop.sloanreview.mit.edu/store/faq**,
email **smr-help@mit.edu**, or call 617-253-7170.