F. BUTTLE: CUSTOMER RELATIONSHIP MANAGEMENT

Chapter objectives

By the end of the chapter, you will understand:

1 three major and different perspectives on CRM
2 several general misunderstandings about CRM
3 why companies and customers are motivated to establish and maintain relationships with each other, or not
4 the importance of trust and commitment within a relationship
5 how customer satisfaction, customer loyalty and business performance are connected
6 the five constituencies having an interest in CRM
7 how to define CRM.

Introduction

Customer relationship management, or CRM, means different things to different people. Even the meaning of the three-letter abbreviation CRM is contested. Most people use CRM to refer to customer relationship management. Others use CRM to mean customer relationship marketing.[1] Another group, in the belief that not all customers want a relationship with a supplier, omit the word relationship, preferring the term customer management.[2] Still others opt for the expression relationship marketing.[3,4] Whatever it is called, CRM is clearly a business practice focused on customers.

The term CRM has only been in use for a few years. One view, held by some of the information technology (IT) companies, is that the term CRM

Level of CRM	Dominant characteristic
Strategic	A top–down perspective on CRM which views CRM as a core customer-centric business strategy that aims at winning and keeping profitable customers
Operational	A perspective on CRM which focuses on major automation projects such as service automation, sales force automation or marketing automation
Analytical	A bottom–up perspective on CRM which focuses on the intelligent mining of customer data for strategic or tactical purposes

Figure 1.1
Levels of CRM

is used to describe software applications that automate the marketing, selling and service functions of businesses. Although the market for CRM software is now populated with many players it began back in 1993, when Tom Siebel founded Siebel Systems Inc. Use of the term CRM can be traced back to that period.

Because of its relatively short history there is still debate about the meaning of CRM. Some of the confusion arises because the term is used in a number of different ways.

We can think about CRM at three levels: strategic, operational and analytical, as summarized in Fig. 1.1 and described below.

Strategic CRM

Strategic CRM is focused on the development of a customer-centric business culture. This culture is dedicated to winning and keeping customers by creating and delivering value better than competitors. The culture is reflected in leadership behaviours, the design of formal systems of the company, and the myths and stories that are created within the firm. In a customer-centric culture you would expect resources to be allocated where they would best enhance customer value, reward systems to promote employee behaviours that enhance customer satisfaction, and customer information to be collected, shared and applied across the business. You would also expect to find the heroes of the business to be those who deliver outstanding value or service to customers. Many businesses claim to be customer-centric, customer-led, customer-focused or customer-oriented, but few are. Indeed, there can be very few companies of any size that do not claim to be on a mission to satisfy customer requirements profitably.

Customer-centricity competes with other business logics. Kotler identifies three other major business orientations: product, production and selling.[5]

Product-oriented businesses believe that customers choose products with the best quality, performance, design or features. These are often highly innovative and entrepreneurial firms. Many new business start-ups are product-oriented. In these firms it is common for the customer's voice to be missing when important marketing decisions are made. Little or no customer research is conducted. Management makes assumptions about what customers want. The outcome is that products are overspecified or overengineered for the requirements of the market, and therefore too costly for the majority of customers. That said, marketers have identified a subset of relatively price-insensitive customers whom they dub 'innovators', who are likely to respond positively to company claims about product excellence. Unfortunately, this is a relatively small segment, no more than 2.5 per cent of the potential market.[6]

Production-oriented businesses believe that customers choose low-price products. Consequently, they strive to keep operating costs low, and develop low-cost routes to market. This may well be appropriate in

developing economies or in subsistence segments of developed economies, but the majority of customers have other requirements. Drivers of BMWs would not be attracted to the brand if they knew that the company only sourced inputs such as braking systems from the lowest cost supplier. Henry Ford did not face this problem in the early stages of development of the automobile market. It was enough to tell customers they could have any car they wanted as long as it was black. But then came competition, and customer expectations changed.

Sales-oriented businesses make the assumption that if they invest enough in advertising, selling, public relations (PR) and sales promotion, customers will be persuaded to buy. Very often, a sales orientation follows a production orientation. The company produces low-cost products and then has to promote them heavily to shift inventory.

A **customer or market-oriented** company shares a set of beliefs about putting the customer first. It collects, disseminates and uses customer and competitive information to develop better value propositions for customers. A customer-centric firm is a learning firm that constantly adapts to customer requirements and competitive conditions. There is evidence that customer-centricity correlates strongly with business performance.[7]

Many managers would argue that customer-centricity must be right for all companies. However, at different stages of market or economic development, other orientations may have stronger appeal.

Operational CRM

Operational CRM is focused on the automation of the customer-facing parts of businesses. Various CRM software applications enable the marketing, selling and service functions to be automated. The major applications within operational CRM appear in Fig. 1.2.

- Marketing automation
  - market segmentation
  - campaign management
  - event-based marketing
- Sales force automation
  - opportunity management, including lead management
  - contact management
  - proposal generation
  - product configuration
- Service automation
  - contact and call-centre operations
  - web-based service
  - field service

Figure 1.2 Forms of operational CRM

Marketing automation

Marketing automation (MA) applies technology to marketing processes. Several capabilities are offered by MA software: customer segmentation, campaign management and event-based marketing. Software enables users to explore their customer data in order to develop targeted communications and offers. Segmentation, in some cases, is possible at the level of the individual customer. Unique offers may be made to a single customer at an appropriate point in time.

Marketing automation enables companies to develop, budget and execute communication campaigns. It automates the multiperson workflow that delivers the communication output. Typically, a print-based communication campaign will involve a number of people such as marketing manager, market analyst, copywriters, artists, printers, salespeople and media buyers. Their contributions to the campaign can be co-ordinated with the help of the software. MA can also audit and analyse campaign performance, and direct leads from advertising campaigns to the most appropriate sales channel.

In multichannel environments, campaign management is particularly challenging. Some fashion retailers, for example, have city stores, an e-tail website, home shopping, catalogue stores and perhaps even a TV shopping channel. Some customers may be unique to a single channel, but most will be multichannel prospects, if not already customers of several channels. Integration of communication strategies and evaluation of performance require a substantial amount of information collection and distribution, and of people management across these channels.

Event-based marketing is also known as trigger-based marketing. Typically, sales or service actions are initiated by a company in response to some action by the customer. The customer action triggers the company response. If a business customer emails in a request for information, this might initiate a sales process that commences with a courtesy call to thank the customer for the request. When a credit-card user calls a contact centre to enquire about the current rate of interest, this might be taken as an indication that the customer is comparing alternatives, and might switch to a different provider. This event may trigger an offer designed to retain the customer. Companies can trawl their transactional histories, and sales and service records, to identify exploitable connections between events and outcomes. For example, it might be discovered that many customers who buy flights to exotic destinations also buy high value health insurance. A company that has learned about this connection can target health insurance products to the traveller.

Sales-force automation

Sales-force automation (SFA) was the original form of CRM. It applies technology to the management of a company's selling activities. The selling process can be decomposed into a number of stages such as lead generation, lead qualification, needs identification, development of specifications, proposal generation, proposal presentation, handling objections and closing the sale. Sales-force automation software can be configured so that is modelled on the selling process of any industry or organization.

Sales-force automation software enables companies automatically to record leads and track opportunities as they progress through the sales pipeline towards closure. Intelligent applications of SFA are based on comprehensive customer data made available in a timely fashion to salespeople through various media such as desktops, laptop and handheld computers, personal digital assistants (PDAs) and cell-phones. Sales-force automation software has several capabilities, including opportunity management, contact management, proposal generation and product configuration.

Opportunity management lets users identify and progress opportunities to sell from lead status through to closure and beyond, into after-sales support. Opportunity management software usually contains lead management and sales forecasting applications. Lead management applications enable users to qualify leads and direct them, perhaps automatically, to the appropriate salesperson. Sales forecasting applications generally use transactional histories and salesperson estimates to produce estimates of future sales.

Contact management lets users manage their communications programme with customers. Customer databases are developed in which contact histories are recorded. Contact management applications often have features such as automatic customer dialling, the salesperson's personal calendar and e-mail functionality. For example, it is usually possible to build e-mail templates in Microsoft Outlook that can be customized with individual customers' details before delivery. Templates can be built that thank a client for an order, or to present a quotation. Sales-force automation is grounded on the right customer information being made available to the right sales team members and/or customers at the right point of time. In multiperson decision-making units, it is important to identify which people need what information. Companies should try to get the right information to the right person (see Case 1.1).

Case 1.1

Sales-force automation at Roche

Roche is one of the world's leading research-based healthcare organizations, active in the discovery, development and manufacture of pharmaceuticals and diagnostic systems. The organization has traditionally been product-centric and quite poor in the area of customer management. Roche's customers are medical practitioners prescribing products to patients. Customer information was previously collected through several mutually exclusive sources, ranging from personal visits to handwritten correspondence, and not integrated into a database or central filing system, giving incomplete views of the customer. Roche identified the need to adopt a more customer-centric approach to understand their customers better, to improve services offered to them and to increase sales effectiveness.

Roche implemented a sales-force automation system where all data and interactions with customers are stored in a central database which can be accessed throughout the organization. This has resulted in Roche being able to create customer profiles, segment customers, and communicate with existing and potential customers. Since its implementation Roche has been more successful in identifying, winning and retaining customers.

Proposal generation applications allow the salesperson to automate the production of proposals for customers. The salesperson enters details such as product codes, volumes, customer name and delivery requirements, and the software automatically generates a priced quotation that takes into account the customer's relational status. Casual customers can generally expect to pay more than strategically significant customers.

Product configuration software allows salespeople automatically to design and price customized solutions to customer problems. Configurators are useful when the product is particularly complex, such as IT solutions. Configurators are based on an 'if . . . then' rules structure. The general case of this rule is 'If X is chosen, then Y is required or prohibited or legitimated or unaffected.' For example, if the customer chooses a particular feature (say, a particular hard drive for a computer), then this rules out certain other choices or related features that are technologically incompatible or too costly or complex to manufacture.

The technology side of SFA is normally accompanied by an effort to improve and standardize the selling process. This involves the implementation of a sales methodology. Sales methodologies allow sales team members and management to adopt a standardized view of the sales cycle, and a common language for discussion of sales issues. Many methodologies have been developed over the years, including SPIN (Fig. 1.3),[8] Target Account Selling (TAS),[9] RADAR[10] and Strategic Selling.[11]

Some companies face particularly complex selling tasks. This is especially true of mission-critical multimillion dollar sales such as the sales of defence systems to national governments. Here, a team of people from the supply side will sell to a team from the government/customer side over a long period, possibly several years. There will be a large number of contact episodes to understand, develop and deliver to very demanding customer specifications. It is clearly essential to track carefully the status of the opportunity and manage contacts in the most effective and efficient way. Even where the selling context is significantly less complex, SFA still holds out the promise of better contact and opportunity management.

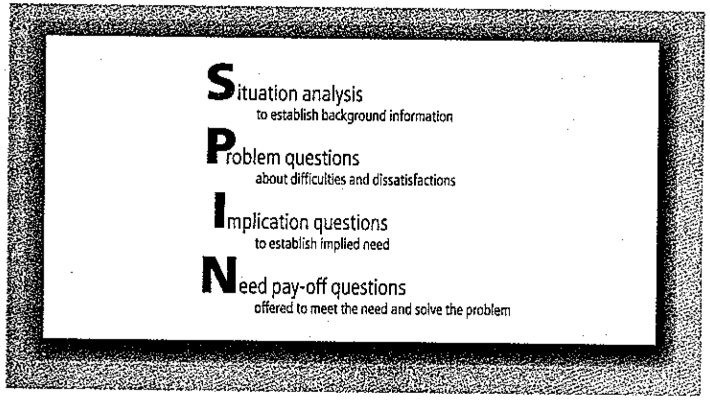

Figure 1.3 SPIN selling methodology (Source: Neil Rackham, Huthwaite Corporation)

Service automation

Service automation allows companies to automate their service operations, whether delivered through a call centre, a contact centre, the web or face-to-face in the field.[i] Software enables companies to manage and co-ordinate their service-related in-bound and out-bound communications across all channels. Software vendors claim that this enables companies to become more efficient and effective, by reducing service costs, improving service quality, lifting productivity and increasing customer satisfaction.

Service automation differs significantly depending on the product being serviced. Consumer products are normally serviced through retail outlets, the web or a call centre as the point of first contact. These contact channels are often supported by online scripting tools to help to diagnose a problem on first contact. Several technologies are common in service automation. Call-routing software can be used to direct inbound calls to the most appropriate handler. Technologies such as interactive voice response (IVR) enable customers to interact with company computers. Customers can input to an IVR system after listening to menu instructions either by telephone keypad (key 1 for option A, key 2 for option B) or by voice. If first contact problem resolution is not possible, the service process may then involve authorizing a return of goods, and a repair cycle involving a third party service provider. Examples of such a process include mobile phones and cameras.

Service automation for large capital equipment is quite different. This normally involves diagnostic and corrective action to be taken in the field, at the location of the equipment. Examples of this type of service include industrial air-conditioning and refrigeration. In these cases, service automation may involve providing the service technician with diagnostics, repair manuals, inventory management and job information on a laptop. This information is then synchronized at regular intervals to update the central CRM system.

Many companies use a combination of direct and indirect channels especially for sales and service functions. When indirect channels are employed, operational CRM supports this function through partner relationship management (PRM). This technology allows partners to communicate with the supplier through a portal, to manage leads, sales orders, product information and incentives.

Analytical CRM

Analytical CRM is concerned with exploiting customer data to enhance both customer and company value.

Analytical CRM builds on the foundation of customer information. Customer data may be found in enterprise-wide repositories: sales data

[i] Contact centres differ from call centres in that they handle not only phone calls, but also communications in other media such as mail, fax, e-mail and SMS.

(purchase history), financial data (payment history, credit score), marketing data (campaign response, loyalty scheme data), service data. To these internal data can be added data from external sources: geodemographic and lifestyle data from business intelligence organizations, for example. With the application of data mining tools, the company can then interrogate these data. Intelligent interrogation provides answers to questions such as: Who are our most valuable customers? Which customers have the highest propensity to switch to competitors? Which customers would be most likely to respond to a particular offer?

Analytical CRM has become an essential part of effective CRM implementation. Operational CRM struggles to reach full effectiveness without analytical information on the value of customers. Customer value drives many operational CRM decisions, such as:

- Which customers shall we target with this offer?
- What is the relative priority of customers waiting on the line, and what level of service should be offered?
- Where should I focus my sales effort?

From the customer's point of view, analytical CRM can deliver better, more timely, even personally customized, solutions to the customer's problems, thereby enhancing customer satisfaction. From the company's point of view, analytical CRM offers the prospect of more powerful cross-selling and up-selling programmes, and more effective customer retention and customer acquisition programmes. Retailer Wal-Mart uses analytical CRM. It collects data from its 1200 stores to identify which segments are shopping, what they are buying and which promotions are most effective. It constantly tries to improve average basket value through effective analytical CRM.

Case 1.2 shows how a UK based business-to-business (B2B) catalogue operation found that analytical CRM improved its performance on a

Case 1.2

Analytical CRM at UK Business Direct

	CRM	Traditional
Number of catalogues mailed	1000	5000
Mailing cost	£3000	£15 000
New customers obtained 1998	65	45
Conversion rate new customers	6.5%	0.09%
Initial sales per new customer	£180	£120
Total new initial sales revenues	£11 700	£5400
Acquisition cost per customer	£46.15	£333.33
Average customer sales 1998–2001	£7500	£2200
2 year gross margin (40%)	£3000	£880
1998 customers still active in 2001	80%	35%

number of metrics such as cost of customer acquisition, initial sales per customer, average customer value and customer retention, in comparison to what it normally achieved without the analytical insight provided by CRM.

Misunderstandings about CRM

This confusion about CRM has given rise to a number of misunderstandings that are challenged below.

Misunderstanding 1: CRM is database marketing

Database marketing is concerned with the development and exploitation of customer data for marketing purposes. Companies collect data from a number of sources. These data are verified, cleaned, integrated and stored on computers, often in data warehouses or data-marts. They are then used for marketing purposes such as market segmentation, targeting, offer development and customer communication.

Historically, most companies were located close to the markets they served and knew their customers intimately. Very often there would be face-to-face, even day-to-day, interaction with customers in which their knowledge of customer requirements and preferences grew. However, as companies have grown larger, they have become more remote from the customers they serve. The remoteness is not only geographical; it may also be cultural. Even some of the most widely admired American companies have not always understood the markets they served. Disney's development of a theme park near to the French capital, Paris, was not an initial success because they failed to deliver to the value expectations of European customers. For example, Disney failed to offer visitors alcohol onsite. Europeans, however, are accustomed to enjoying a glass or two of wine with their food.

Whereas most large and medium-sized companies do indeed build and exploit customer databases, CRM is much wider in scope than database marketing. A lot of what we have described earlier as analytical CRM has the appearance of database marketing. However, the issues described under strategic or operational CRM do not figure in database marketing.

Misunderstanding 2: CRM is a marketing process

At first pass, this would appear to be true, particularly for those who take CRM to mean customer relationship marketing. Indeed, CRM applications can be used for many marketing activities: market segmentation, customer acquisition, customer retention, customer development (cross-selling and up-selling), campaign management, and opportunity management, for example.

At a strategic level, however, CRM can be used as a core technology to support a company's mission to become more customer-centric. The customer data supporting a CRM strategy can be shared more widely throughout the enterprise than the marketing function alone. Operations management can use the customer data to produce customized products and services. People management (human resources) can use customer preference data to help to recruit and train staff for the front-line jobs that interface with customers. Research and development management can use customer data to focus new product development.

Customer data can not only be used to integrate various internal departments, but can also be shared across the extended enterprise with outside suppliers and partners. For example, Tesco, the international supermarket operation, has a number of collaborative new product development relationships with key suppliers. Tesco also partners with a major bank to offer financial services to Tesco customers. Both activities require the sharing of information about Tesco customers with supplier and partner.

Clearly, there is more to CRM than a marketing process.

Misunderstanding 3: CRM is an IT issue

Many of the early CRM implementations were seen as IT initiatives. Most CRM implementations require the creation of high-quality customer databases and the deployment of IT solutions. However, this should not be misread. Customer relationship management is generally aimed at creating better value for customers and company. This aim is simply made possible by IT. To say that CRM is about IT is like saying that gardening is about the spade or that art is about the paintbrush. Since IT is an enabler of business objectives, it is therefore at most a part of the CRM effort.

Not all CRM initiatives involve IT investments. The focus of CRM is on better management of customer relationships. This may involve behavioural changes in store employees, education of call-centre staff, and a focus on empathy and reliability from salespeople.

Misunderstanding 4: CRM is about loyalty schemes

Loyalty schemes are commonplace in many industries, such as car hire, airlines, food retail, hotels. Customers accumulate credits, such as air-miles, from purchases. These are then redeemed at some future point. Most loyalty schemes require new members to complete an application form when they join the programme. This demographic information is typically used together with purchasing data to help companies to become more effective at their marketing communication and offer development. Whereas some CRM implementations are linked to loyalty schemes not all are.

Loyalty schemes may play two roles in CRM implementations. First, they generate data for the customer database that can be used to guide customer acquisition, retention and development activities. Secondly, loyalty schemes may serve as an exit barrier. Customers who have accumulated credits in a scheme may be loathe to exit the relationship. The credits accumulated reflect the value of the investment that the customer has made in the scheme, and therefore in the relationship.

Loyalty schemes are discussed in more detail in Chapter 9.

Misunderstanding 5: CRM can be implemented by any company

Strategic CRM can, indeed, be implemented in any company. Every organization can be driven by a desire to be more customer-centric. Chief executives can establish a vision, mission and set of values that bring the customer to the heart of the business, and CRM technology may play a role in that transformation. Some attempts are certainly more successful than others. The banking industry has implemented CRM very widely, yet there are significant differences between the customer satisfaction ratings and customer retention rates across the industry.

Any company can also try to implement operational CRM supported by CRM technology. Any company with a sales force can automate its selling, lead management and contact management processes. The same is true for marketing and service processes. The CRM technology can be used to support marketing campaigns across the customer base. It also can be used to support query handling, problem resolution and complaints management. However, operational CRM can be much better focused if supported by analytical CRM. For example, the selling approach may differ between different customer groups. Customers with higher potential value may be offered face-to-face selling; lower value customers may experience telesales.

Analytical CRM is based on customer data. Data are needed to identify which customers are likely to generate most value in the future, and to divide the customer base into segments having different requirements. Different offers are then communicated to each customer group to optimize company and customer value over the long term. If these data are missing then analytical CRM cannot be implemented. Neither will support be made available for operational CRM implementations.

What is a relationship?

The 'R' in CRM stands for 'relationship'. But what do we really mean by the expression relationship? What is a relationship between a customer and supplier?

Thinking in terms of a dyadic relationship, that is a relationship between two parties, we can define a relationship as follows:

A relationship is composed of a series of episodes between dyadic parties over time.

Each episode in turn is composed of a series of interactions. Episodes are time bound (they have a beginning and an end) and nameable. Episodes such as making a purchase, enquiring about a product, putting together a quotation, making a sales call, dealing with a complaint and playing a round of golf make up a relationship. Business relationships are made up of task and social episodes. Task episodes are focused on the business side of the relationship, whereas social episodes are not. Within each episode, each participant will act towards, and interact with, the other. The content of each episode is a range of communicative behaviours including speech, deeds (actions) and body language. The parties within the dyad may have very different ideas about whether they are in a relationship. Buyers may think they are being tough and transactional. Sellers may feel that they have built a relationship.

Relationships are dynamic

Relationships change over time. They evolve. Dwyer identified five general phases through which relationships can evolve:[12]

1 Awareness
2 Exploration
3 Expansion
4 Commitment
5 Dissolution.

Awareness is when each party comes to the attention of the other as a possible exchange partner. Exploration is the period of investigation and testing during which the parties explore each others' capabilities and performance. Some trial purchasing takes place. If the trail is unsuccessful the relationship can be terminated with few costs. The exploration phase is thought to comprise five subprocesses: attraction, communication and bargaining, development and exercise of power, development of norms, and development of expectations. Expansion is the phase in which there is increasing interdependence. More transactions take place and trust begins to develop. The commitment phase is characterized by increased adaptation and mutually understood roles and goals. Purchasing processes may become automated.

Not all relationships reach the commitment phase. Many are terminated before that stage. There may be a breach of trust that forces a partner to reconsider the relationship. Perhaps the requirements of the customer change. The supplier is no longer needed. Relationship termination can be bilateral or unilateral. Bilateral termination is when both parties agree to end the relationship. They will probably want to retrieve whatever assets they invested in the relationship. Unilateral termination is when one of the parties moves to end the relationship. Customers may exit relationships for many reasons, such as repeated service failures or changed product requirements. Suppliers may choose to exit relationships because of their failure to contribute profit. A prior option may be to reduce cost-to-serve.

This model of relationship development highlights two attributes of highly developed relationships: trust and commitment. Trust and commitment have been the subject of a considerable amount of research.[13–16]

Trust

Trust is focused. That is, although there may be a generalized sense of confidence and security, these feelings are directed. One party may trust the other's:

- **benevolence**: a belief that one party will act in the interests of the other
- **honesty**: a belief that the other party will be credible
- **competence**: a belief that the other party has the necessary expertise.

The development of trust is an investment in relationship building which has a long-term payoff. Trust emerges as parties share experiences, and interpret and assess each other's motives. As they learn more about each other, risk and doubt are reduced.

When trust exists between partners, both are motivated to make investments in the relationship. These investments, which serve as exit barriers, may be either tangible (e.g. property) or intangible (e.g. knowledge). Such investments may or may not be retrievable when the relationship dissolves.

If trust is absent, conflict and uncertainty rise, while co-operation falls.

It has been suggested that as relationships evolve over time so does the character of trust:[17]

- **Calculus-based trust** is present in early stages of the relationship and related to economic value. The outcomes of creating and sustaining the new relationship are weighed against those of dissolving it
- **Knowledge-based trust** relies on the individual parties' interactive history and knowledge of each other, allowing each to make predictions about the other
- **Identification-based trust** happens when mutual understanding is such that each can act as substitute for the other in interpersonal interaction. This is found in the later stages of relationship development.

Commitment

Commitment is an essential ingredient for successful, long-term, relationships. Morgan and Hunt define relationship commitment as:

> an exchange partner believing that an ongoing relationship with another is so important as to warrant maximum effort to maintaining it; that is, the committed party believes the relationship is worth working on to ensure that it endures indefinitely.[13]

Commitment arises from trust, shared values and the belief that partners will be difficult to replace. Commitment motivates partners to co-operate in order to preserve relationship investments. Commitment means that partners eschew short-term alternatives in favour of more stable, long-term benefits associated with current partners. Where customers have choice, they make commitments only to trustworthy partners, because commitment entails vulnerability, leaving them open to opportunism.

Evidence of commitment is found in the investments that one party makes in the other. One party makes investments in the budding relationship and if the other responds, the relationship evolves and the partners become increasingly committed to doing business with each other. Investments can include time, money and the demotion of current relationships. A partner's commitment to a relationship is directly influenced by the size of the investment in the relationship, since these represent termination costs. Highly committed relationships may have very high termination costs, since some of these relationship investments may be irretrievable. In addition, there may be significant costs incurred in switching to an alternative supplier, such as search costs, learning costs and psychic costs.

Why companies want relationships with customers

The fundamental reason for companies wanting to build relationships with customers is economic. Companies generate better results when they manage their customer base in order to identify, satisfy and retain their most profitable customers. This is a key objective of CRM strategies.

Improving customer retention rates has the effect of increasing the size of the customer base. Figure 1.4 compares two companies. Company A has a churn rate (customer defection rate) of 5 per cent per annum; company B's churn rate is 10 per cent. Put another way, their respective customer retention rates are 95 and 90 per cent. Starting from the same position and acquiring an identical number of new customers each year,

Year	Company A (5% churn)			Company B (10% churn)		
	Existing customers	New customers	Total customer base	Existing customers	New customers	Total customer base
1998	1000	100	1100	1000	100	1100
1999	1045	100	1145	990	100	1090
2000	1088	100	1188	981	100	1081
2001	1129	100	1229	973	100	1073
2002	1168	100	1268	966	100	1066

Figure 1.4 Effect of customer retention on customer volume

company A's customer base is 19 per cent larger than company B's after 4 years: 1268 customers compared with 1066 customers.

Churn rates vary considerably. For example, after deregulation, about 25 per cent of UK utility customers changed suppliers within 24 months. The industry had been expecting 5–10 per cent churn. Most switched for better prices and to achieve a dual-fuel (gas and electricity) discount There is little merit in growing the customer base aimlessly. The goal must be to retain existing, and recruit new, customers who have future profit potential, or are important for other strategic purposes.[ii] Not all customers are of equal importance. Some customers may not be worth recruiting or retaining at all: those who have a high cost-to-serve, or are debtors, late payers or promiscuous in the sense that they switch frequently between suppliers.

Other things being equal, a larger customer base delivers better business performance. Similarly, as customer retention rates rise (or defection rates falls) so does the average tenure of a customer, as shown in Fig. 1.5. Tenure is the term used to describe the length of time a customer remains a customer. The impacts of small improvements in customer retention are hugely magnified at the higher levels of retention. For example, improving the customer retention rate from 75 to 80 per cent increases average customer tenure from 10 years to 12.5 years. Managing tenure by reducing defection rates can be critical. For example, it can take 13 years for utility customers to break even. In the UK, the average profit per household customer is £3 to £5, and the average customer acquisition cost is £40. A customer who defects after one year generates a loss of some £35.

Benefits from customer retention

Managing customer retention and tenure intelligently generates two key benefits.

First, the company's marketing costs are reduced. Fewer dollars need to be spent replacing lost customers. For example, it has been estimated that it costs an advertising agency at least 20 times as much to recruit a new client as to retain an existing client. In the UK, major agencies can spend up to £2 million on research, strategic analysis and creative work in pitching for one major client, with up to four creative teams working on different executions. An agency might incur these costs several times over as it pitches to several prospective clients to replace the lost client.[18] In addition to reducing the costs of customer recruitment, costs-to-serve existing customers also tend to fall over time. Ultimately, as in some B2B markets, the relationship may become fully automated. Some supply-chain relationships, for example, use electronic data interchange (EDI) that fully automates the ordering, inventory and invoicing processes, or develop portals that allow customers to manage their own purchasing arrangements.

Secondly, as tenure grows, suppliers better understand customer requirements. Customers also come to understand what a company can do

[ii] The idea of strategic significance is discussed in Chapter 4.

Customer retention rate (%)	Average customer tenure (years)
50	2
67	3
75	4
80	5
90	10
92	12.5
95	20
96	25
97	33.3
98	50
99	100

Figure 1.5
Retention rate and average customer tenure

for them. Consequently, suppliers become better placed to identify and satisfy customer requirements profitably, selling more product and service to the customer. Over time, as relationships deepen, trust and commitment between the parties are likely to grow. Under these circumstances, revenue and profit streams from customers become more secure. One study, for example, shows that the average online clothing customer spends 67 per cent more in months 31–36 of a relationship than in months 0–6. In the grocery market customers spend 23 per cent more over the same time differential. The same study also shows that the average clothing customer takes four purchases (12 months) to recover the costs of their acquisition; grocery customers take 18 months to break even.[19]

In sum, both the cost and revenue sides of the profit equation are impacted by customer retention.

Some companies use a model that has been variously known as a value ladder[20] or value staircase[21] to help them to understand where customers are positioned in terms of their tenure with the company. You may imagine a seven-stage customer journey from suspect status to advocate status, as follows.

1 **Suspect**: could the customer fit the target market profile?
2 **Prospect**: customer fits the profile and is being approached for the first time.
3 **First-time customer**: customer makes first purchase.
4 **Repeat customer**: customer makes additional purchases.
5 **Majority customer**: customer selects your company as supplier of choice.
6 **Loyal customer**: customer is resistant to switching suppliers; strong positive attitude to your company.
7 **Advocate**: customer generates additional referral dollars.

As in the Dwyer model cited earlier, not all customers progress uniformly along the path from 'never-a-customer' (suspect) to 'always-a-customer' (advocate). Some will have a long maturity phase (i.e. loyal customer); others will have a shorter life, perhaps never shifting from first-timer to repeat customer; others still might never convert from prospect to first-timer.

CRM software allows companies to trace where customers are on this journey and to allocate resources intelligently to advance suitable customers along the value path.

Costs and revenues vary from stage to stage. In the early stages, a company may invest significant sums in converting a prospect into a first-time customer. The investment in relationship building may not be recovered for some time. Reichheld and Sasser show that it takes a credit-card company almost two years to recover the costs of customer acquisition.[22]

This leads to the core CRM idea that a customer should be viewed not as a set of independent transactions but as a lifetime income stream. In the car industry, for instance, it is estimated that a General Motors retail customer is worth US$276 000 over a lifetime of purchasing cars (11 or more vehicles), parts and service. Fleet operators are worth considerably more.[23] When a GM customer switches to Ford, the revenue streams from that customer may be lost for ever. Case 1.3 illustrates the use of customer lifetime value in the telecommunications market.

Despite the financial benefits that accrue from a relationship there are sometimes clear disincentives for companies entering into relationships with their customers, particularly in the B2B context.

1 **Loss of control**. Relationships are bilateral arrangements, and therefore they involve giving up unilateral control over resources. Relationship partners have expectations of what activities should be performed and

Case 1.3

Optus estimates customer lifetime value in the mobile phone market

Like other telecommunications providers in the competitive mobile phone market, Optus was faced with a large percentage of their mobile phone customers switching to another carrier once their 12, 18 or 24 month contract had ended.

In an effort to reduce customer churn, Optus estimated the value of its various customer segments to ascertain which offered the highest lifetime value potential. Many factors were considered, such as the total spend on phone calls, SMS and information services over a contract period, the cost of servicing the customer and the probability of retaining the customer after the expiry of the initial contract.

The findings indicated that females aged between 20 and 25 had the highest value in the consumer market and tradesmen operating their own business had the highest value in the business market.

resources deployed both by themselves and the other party. It is not necessarily easy or cost-effective to exit a relationship. Sometimes, investments that are made in a relationship are not returned when a relationship breaks down.

2 **Resource commitment.** Relationships require the commitment of resources such as people, time and money. Companies have to decide whether it is better to allocate resources to customer management or to some other area of the business such as operations or people development.

3 **Opportunity costs.** If resources are committed to one customer, they cannot be used for another. Relationships carry with them high opportunity costs. If you commit resources to customer A, you may have to give up the possibility of a relationship with customer B, even if that seems to be a better proposition.

Customer satisfaction, loyalty and business performance

The rationale for CRM is that it improves business performance by enhancing customer satisfaction and driving up customer loyalty, as shown in Fig. 1.6. There is a compelling logic to the model, which has been dubbed the 'satisfaction–profit chain'.[24] Satisfaction increases because customer insight allows companies to understand their customers better, and create improved customer value propositions. As customer satisfaction rises, so does customer repurchase intention.[25] This in turn influences actual purchasing behaviour, which has a significant impact on business performance.

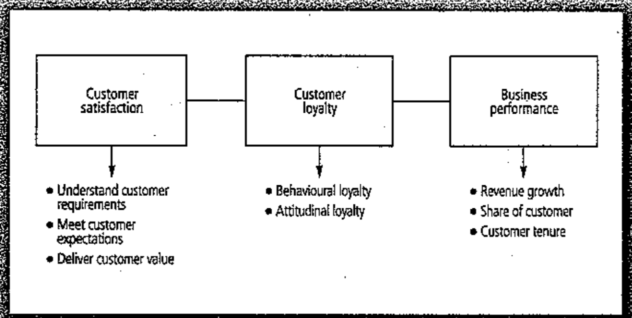

Figure 1.6 Customer satisfaction, loyalty and business performance

The variables and linkages between them will be examined. First, the major variables customer satisfaction, customer loyalty and business performance will be described.

Customer satisfaction has been the subject of considerable research, and has been defined and measured in many ways.[26] It may be defined as follows:

Customer satisfaction is the customer's fulfilment response to a consumption experience, or some part of it.

Customer satisfaction is a pleasurable fulfilment response. Dissatisfaction is an unpleasurable fulfilment response. The 'experience, of some part of it' component of the definition allows the satisfaction evaluation to be directed at any or all elements of the customer's experience. This can include product, service, process and any other components of the experience.

The most common way of operationalizing satisfaction is to compare the customer's perception of an experience, or some part of it, with their expectations. This is known as the expectations disconfirmation model of customer satisfaction. Basically, the model suggests that if customers perceive their expectations to be met, they are satisfied. If their expectations are underperformed, this is negative disconfirmation, and they will be dissatisfied. Positive disconfirmation occurs when perception exceeds expectation. The customer might be pleasantly surprised or even delighted. This model of customer satisfaction assumes that customers have expectations, and that they are able to judge performance. A customer satisfaction paradox has been identified by expectations disconfirmation researchers. At times, customers' expectations may be met but the customer is still not satisfied. This happens when the customer's expectations are low: 'I expected the plane to be late. It was. I'm unhappy!'

Many companies research requirements and expectations to find out what is important for customers, and then measure the customers' perception of their performance compared with the performance of competitors. The focus in CRM is on the elements of the value proposition that create value for customers. Companies have to do well at meeting these important value producers.

Customer loyalty has also been the subject of considerable research. There are two major approaches to defining and measuring loyalty, one based on behaviour, the other on attitude.

Behavioural loyalty is measured by reference to customer purchasing behaviour where it is expressed in continued patronage and buying. There are two behavioural dimensions to loyalty. First, is the customer still active? Secondly, have we maintained our share of customer spending? In portfolio purchasing environments, where customers buy products and services from a number of more-or-less equal suppliers, the share of customer spending question is more important. Many direct marketing companies use RFM measures of behavioural loyalty. The most loyal are those who have high scores on the three variables: recency of purchases (R), frequency of purchases (F) and monetary value of purchases (M). The variables are measured as follows:

R = time elapsed since last purchase
F = number of purchases in a given period
M = monetary value of purchases in a given period

Attitudinal loyalty is measured by reference to components of attitude such as beliefs, feelings and purchasing intention. Those customers who have a stronger preference for, involvement in or commitment to a supplier are the more loyal in attitudinal terms.

Recently, researchers have combined both views into comprehensive models of customer loyalty. The best known is Dick and Basu's model, as shown in Fig. 1.7.[27]

These authors identify four forms of loyalty according to relative attitudinal strength and repeat purchase behaviour. The true loyals are those who have high levels of repeat buying and a strong relative attitude. High repeat purchase not associated with strong attitude may reflect inertia, high switching costs or indifference. Latent loyalty exists when a strong attitude is not accompanied by repeat buying. Perhaps this is a question of distribution and convenience.

From a practical point of view, the behavioural definition of loyalty is attractive because sales and profits derive from actions not attitudes. An attitudinal approach can help managers to understand what needs to be done to build high levels of commitment that are resistant to competitor actions. However, it is not clear from this model whether attitude precedes behaviour or behaviour precedes attitude. Researchers accept that causation may be circular rather unidirectional. In other words, each may precede and reinforce the other.

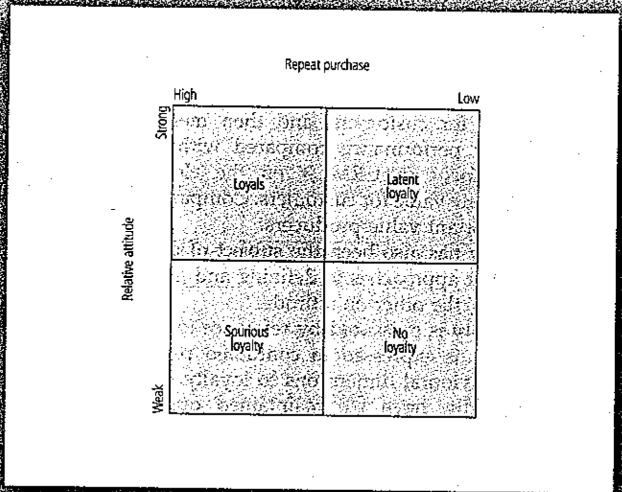

Figure 1.7 Two-dimensional model of customer loyalty (Source: Dick and Basu[27])

Business performance can be measured in many ways. The recent trend has been away from simple short-term financial measures such as return on investment (ROI) or earnings per share. Leading companies are moving towards a more rounded set of performance indicators, such as represented by the balanced scorecard.[28] This approach uses four sets of linked key performance indicators (KPI): financial, customer, internal, and learning and growth. The implied connection between these indicators is that people (learning and growth) do things (internal) for customers (customer) that have effects on business performance (financial). The KPIs that can be customized for each organization include:

- finance
  - return on investment
  - earnings per share
  - economic value added
- customer
  - customer satisfaction
  - customer retention
  - customer acquisition
  - customer loyalty
  - customer tenure
  - sales per customer
  - revenue growth
  - market share
  - share of customer: as indicated in Fig. 1.8, share of customer focuses on winning a greater share of targeted customers' or segments' spending, rather than share of a less well-specified market
- internal
  - quality conformance
  - manufacturing cost
  - cycle times
  - speed to market
  - inventory management
  - customer information system downtime
  - on time, in full, no error (OTIFNE) logistics performance
- learning and growth
  - employee satisfaction
  - employee retention
  - employees cross-trained
  - employee productivity.

The balanced scorecard is highly adaptable to CRM contexts. Companies need to ask the following questions. What customer outcomes drive our financial performance? What internal outcomes drive our customer performance? What learning and growth outcomes drive our internal performance? Figure 1.6 shows that the customer outcomes of satisfaction and loyalty drive business performance. Another business model that is supported by many CRM practitioners in the service sector links all four

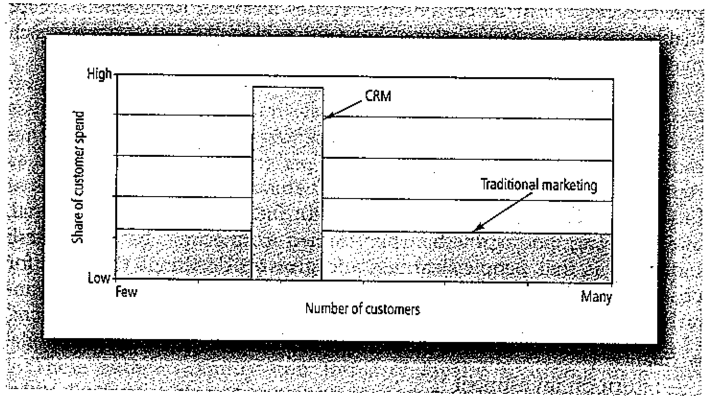

Figure 1.8
Share of market versus share of customer

classes of performance indicator. They believe that satisfied employees perform internal processes well to create value for customers who in turn become loyal and produce a strong profit performance for the company.[29]

What does the evidence show?

Research into the links between customer satisfaction, loyalty and business performance is now discussed. Analysis has been done on international data, national data, industry data and corporate data.

The European Customer Satisfaction Index is a tool that models the relationship between a number of relationship variables, including customer perceived value, customer satisfaction and customer loyalty at the international level. The model has not yet been extended to include business performance. However, researchers have found a strong relationship between value perceptions, satisfaction levels and loyalty.[30] At the national level, customer data from the Swedish Customer Satisfaction Barometer (SCSB) have been correlated with corporate profit performance. A lagged relationship was established, indicating that current customer satisfaction levels impact on tomorrow's profit performance.[31] The SCSB database matches customer-based measures with traditional financial measures of business performance, such as productivity and return on investment (ROI). SCSB researchers telephone-interview 35 000 individuals who have recently experienced a product or service and produce an annual assessment of their satisfaction levels across nine different industry sectors. The SCSB is one of several such national indices. There are others in Germany, Switzerland and the USA. A similar study, using data from the American Customer Satisfaction Index (ACSI) also found that customer satisfaction had a considerable effect on business performance, although there was variation across sectors.[32]

A number of studies in different industries and companies – including telecommunications, banking, airline and automobile distribution – support the relationship between customer satisfaction, loyalty and business performance.

- **Telecommunications**. One study of the telecoms industry found that a 10 per cent increase in a customer satisfaction index predicted a 2 per cent increase in customer retention (a behavioural measure of loyalty) and a 3 per cent interest in revenues (a business performance measure). The authors concluded that customer satisfaction was a lead indicator of customer retention, revenue and revenue growth.[33]
- **Banking**. Another study found that customer satisfaction in retail banking correlated highly with branch profitability. Highly satisfied customers had balances 20 per cent higher than satisfied customers and, as satisfaction levels went up over time, so did account balances. The reverse was also true: as satisfaction levels fell, so did account balances.[34]
- **Airlines**. A study in the airline industry examined the link between customer dissatisfaction, operating income, operating revenue and operating expense. The study identified the drivers of dissatisfaction as high load factors, mishandled baggage and poor punctuality. The study concluded that as dissatisfaction rose, operating revenue (an indicator of customer behaviour) fell, operating income fell and operating expenses rose.[35]
- **Car distribution**. A study of Volvo cars owners examined the links between customer satisfaction with three attributes – car purchase, workshop service and the vehicle itself – and loyalty and dealer business performance. The results indicated that a one scale-point increase in overall customer satisfaction was associated with a 4 per cent increase in dealer profitability at next car purchase.[36]

According to one review, there is 'growing evidence that the links in the satisfaction–profit chain are solid.'[24] However, the relationships can be both asymmetrical and non-linear. The asymmetric nature of the relationships is found by comparing the impact of an increase in one variable with an equivalent decrease. For example, a one scale-point shift up in customer satisfaction (say from 3 to 4 on a five-point scale) may not

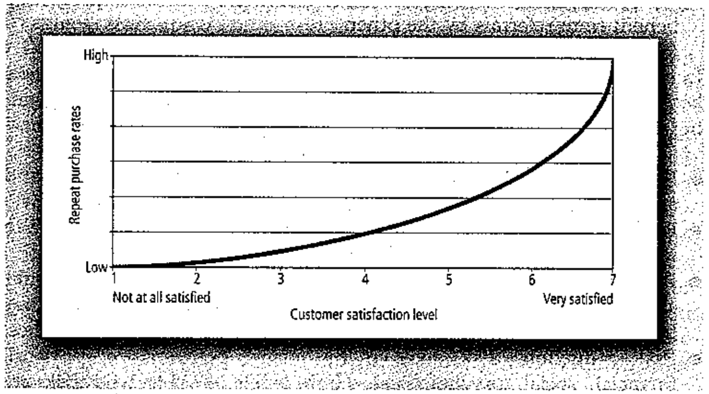

Figure 1.9
Increasing returns from investments in customer satisfaction

have a comparable impact on customer retention rates to a one-scale point downward shift (say from 3 to 2 on the same five-point scale). In addition, links can be non-linear. Non-linearity is sometimes reflected in diminishing returns, other times in increasing returns. For example, increasing returns may be obtained in customer retention as customers progress up the customer satisfaction scale, as shown in Fig. 1.9. Diminishing returns may set in if customer expectations are already largely met. Investments in increasing customer satisfaction at already high levels of performance do not have the same impact as investments at lower levels of performance.

But, do customers want relationships with companies?

Although it is clear that companies want relationships with customers, it is far less clear that customers universally want relationships with their suppliers.

There are a number of circumstances when a B2B customer may want a long-term relationship with a supplier. These include when:

- the product or its applications are complex, for example, networking infrastructure
- the product is strategically important or mission-critical, for example, core raw materials supply for a manufacturer
- there are downstream service requirements, for example, for machine tools
- financial risk is high, for example, in buying large pieces of capital equipment
- reciprocity is expected. A financial audit practice may want a close relationship with a management consultancy, so that each party may benefit from referrals by the other.

In a B2C context, relationships may be sought when the customer seeks benefits over and above those directly derived from acquiring, consuming or using the product or service. For example:

- **Recognition.** A customer may feel more valued when recognized and addressed by name.
- **Personalization.** For example, over time, a hairdresser may come to understand a customer's particular preferences or expectations.
- **Power.** Some of the power asymmetry in relationships between banks and their customers may be reversed when customers feel that they have personal relationships with particular bank officers or branches.
- **Risk reduction.** Risk takes many forms: performance, physical, financial, social, psychological. High levels of perceived risk are uncomfortable for many customers. A relationship can reduce, or even perhaps eliminate perceived risk. For example, a customer may develop a relationship with a garage to reduce the perceived performance and physical risk attached to having a car serviced. The relationship provides the assurance that the job has been skilfully performed and that the car is safe to drive.
- **Status.** Customers may feel that their status is enhanced by a relationship with an organization, such as an elite health club.
- **Affiliation.** People's social needs can be met through commercially based, or non-commercially based, relationships. Many people are customers (members) of professional or community associations, for example.

Customer segments vary in their desire to have relationships with suppliers. In the banking industry, for example, large corporations have their own treasury departments and often obtain little value from a bank relationship; small private account holders have no need for the additional services that a relationship provides; small and medium-sized business and high net-worth individuals may have most to gain from a closer relationship.

CRM constituencies

Several constituencies, which together comprise the CRM ecosystem, have an interest in CRM:

- **Companies implementing CRM.** Many companies have implemented CRM strategies. The market for CRM software is thought to be mature in the largest CRM marketplace, the USA. Large companies in mature industries were the first to adopt CRM. They were followed by medium-sized companies. There is still potential for the CRM message to reach smaller companies, other worldwide markets and new business start-ups.
- **Customers and partners of those companies.** The customers and partners of companies that implement CRM are a particularly important constituency. If CRM does as is intended it will deliver improved customer experience. This, in turn, should result in a higher level of satisfaction, and the possibility of stronger commitment and loyalty to the supplier.
- **Vendors of CRM software.** Vendors of CRM software include companies such as Siebel, PeopleSoft, Pivotal, Oracle, SalesLogix and Salesforce.com. Some of these vendors offer CRM systems in which modules can be switched on or off according to customer needs. For example, Siebel offers a number of different service automation modules: call centre, web service and field service. Not all of these modules are relevant in all implementations. Other vendors offer specialized CRM applications, for example, for SFA only.

- **Vendors of CRM hardware and infrastructure.** Hardware and infrastructure vendors provide the technological foundations for CRM implementations. They supply technologies such as servers, computers, handheld devices, call-centre hardware and telephony systems.
- **Consultancies with a diverse range of capabilities such as strategy, business, application and technical consulting.** Consultants have benefited hugely from CRM implementations. They have helped companies implementing CRM in several ways: choosing between different vendors, developing implementation plans, and project management as the implementation is rolled out. Most CRM implementations are composed of a large number of smaller projects; for example, systems integration, data quality improvement, market segmentation, process engineering and culture change. The major consultancies such as Accenture, McKinsey, Bearing Point, Braxton and CGEY all offer CRM consultancy. Smaller companies sometimes offer specialized expertise. Peppers and Rogers provide strategy consulting. SAS and MicroStrategy focus on the statistical analysis of customer data. DunnHumby is known for its expertise in data mining for segmentation purposes.

As mentioned earlier, there is little consensus on what constitutes CRM. The CRM vendors and consultants may see the core of CRM as consisting of three major elements: a customer database, some data-mining capability, and a suite of front-end applications covering marketing, sales and customer service functions operating across all channels and touch-points. Companies implementing CRM may see it as something more rudimentary and fundamental, such as way of doing business that focuses on the customer. Within companies, different functional groups may have different perspectives: IT may see it as a systems implementation, whereas marketing may see it as a better way to run campaigns.

Why do companies implement CRM?

Companies are motivated to adopt CRM for both defensive and offensive reasons. Offensive motivations are associated with a desire to improve profitability by reducing cost, and increasing revenues through improved customer satisfaction and loyalty. Defensive motivations arise when leading competitors have adopted CRM successfully, and a company fears losing customers and revenue.

Companies thinking of adopting CRM face a significant problem. They need to know whether CRM pays. Investment in CRM may cost many millions of dollars. The typical investment of a Global 3500 company in CRM technology (software and services) is estimated at US$15 million to US$30 million annually. Over three years, the company will spend over

US$75 million.[37] In contrast, a small company can buy a CRM package off the shelf for US$1000 per seat (i.e. licensed user), costing it no more than US$10 000 a year.

Technology, however, is not the only cost of CRM. A CRM project can take between three and five years to implement fully. The technology costs tend to cluster at the front of the project. As project time moves on, people and process costs become larger. Front-office processes such as marketing and selling might need to be re-engineered. Back-office processes such as operations and finance might also be changed to suit the new focus on customers. People on the current payroll might need to be reskilled or retrenched. New talent with CRM-useful skills, such as customer analytics, may need to be recruited. The organization structure might need to be overhauled, perhaps by shifting it from a product-centric to a customer-centric structure. Technology will typically account for only one-fifth to one-third of total CRM project costs. Many companies now consider the total cost of ownership (TCO) – all people, IT and process costs – in computing returns on investment.

In early CRM implementations there was not much evidence to support CRM investment decisions. Early adopters bought CRM because they felt it made sense to understand and satisfy their customers better. Vendors and consultants sold CRM on the promise of greater customer retention and profitability. Today, vendors use evidence in selling to new customers: ROI models and case histories of successful implementations support the selling effort.

In recent years there has been much comment on the effectiveness of CRM. Gartner Research estimated that the failure rate is 65 per cent and that it may escalate to 80 per cent,[38] and that 'there is a growing view among organizations adopting CRM that their projects are not delivering the hoped-for value'.[39]

An Internet survey of some 2200 CRM clients, including many who had installed GoldMine, Onyx, Oracle, PeopleSoft, Pivotal, SalesLogix, SAP and Siebel products, concluded that customer satisfaction with the CRM product was 'very low indeed'.[40] The average customer satisfaction index score across all vendors was 63.1 out of 100, lower than reported in studies of other comparable IT sectors. The survey measured five attributes: ease of implementation, customer focus, price satisfaction, support and functionality. Ease of implementation scored lowest, at 55, whereas functionality scored highest, at 68, across all vendors. A key finding was that clients do not want 'out-of-the-box functionality', but adaptation to their own requirements.

While there has been client-side concern about CRM's performance, vendors and consultancies are, perhaps unexpectedly, more bullish. A report from Accenture claimed that a 10 per cent improvement in the top 21 CRM capabilities, including customer service and turning customer information into insight, could boost profits in a $1 billion business unit by $40–50 million. They found that between 28 and 60 per cent of the variance in companies' return on sales was due to CRM performance.[41] Fred Reichheld from Bain and Company has famously claimed that a 5 per cent improvement in customer retention, a key objective of many

CRM strategies, can enhance profit by between 45 and 95 per cent across a variety of industries.[42]

Although there is some evidence supporting CRM's delivery of a worthwhile ROI, other research suggests that up to 45 per cent of companies are unable to compute ROI from their CRM investments.[43] Only one-third of companies in a Cap Gemini Ernst and Young (CGEY) survey could provide any estimate of their expected return on CRM investments.[44]

Efforts to compute ROI from CRM investments are dogged by three questions:

1 What counts as an investment in CRM?
2 What counts as a return on that investment?
3 Over what period should the return be measured?

What counts as an investment in CRM?

Companies adopting the CRM way of doing business are likely to incur costs in a number of areas. Some of these may be capital costs; some may be expenses. They largely fall into three major categories: IT, people and process costs.

Information technology costs include investments in IT infrastructure and hardware, database development and software. The cost of hardware and software is falling. Software may be purchased outright or licensed. Several software components may be required for a large-scale CRM investment. This might include SFA, sales management automation, contact-centre automation, MA, e-commerce functionality and knowledge management.

People costs include recruitment, redeployment and training costs. The cost of IT professionals is dependent upon the supply of talent. During periods of talent shortage, IT people costs rise dramatically. Process costs may also be significant. Current working practices and workflow may need to re-engineered. Project management, change management and consultancy costs can add considerably to the final bill.

What counts as a return on investment?

At the level of strategic CRM, the executive team would want to know how much additional profit an investment in CRM would yield. For complex, long-term, multiphase projects this is an impossible question to answer. To compute the gain associated with a CRM initiative would require all other variables impacting the profit equation to be held constant, or an experimental design to be constructed. Large-scale implementations take up to five years to accomplish. During that time, the competitive environment may have changed dramatically, with new players entering, mergers and acquisitions, new products on the market, and customer expectations lifted.

Despite the expectation of shareholders that boards will measure performance against a set of hard financial indicators, senior management is also likely to employ some very soft indicators of CRM's impacts. One survey suggests that 'customer-centric visioning, in which executives develop an enterprise view of their strategy from the customer perspective' is the most valuable CRM outcome.[44] Clearly, this outcome is difficult to measure in hard numbers.

As noted earlier, every large-scale implementation is composed of a number of smaller projects. Each of these will have cost profiles and timescales. However, not all generate revenue streams. Investments in database development and market segmentation, for example, typically represent sunk costs without which it would be impossible to run CRM-driven marketing and sales campaigns. They are necessary costs that enable CRM to function.

With small-scale implementations the task of measuring return is easier. If only a single function is automated, it is possible to establish clear performance targets. For example, it may be possible to measure the number of proposals written before SFA with the number written afterwards, or the number of prospects converted into first-time customers, or the number of quintile two customers who are migrated to quintile one.[iii] Even so, without appropriate controls in place, management could not be sure that the cause of the change is the CRM investment.

As large projects are broken down into smaller units (the operational and analytical perspectives in Fig. 1.1) it becomes easier to set some very specific KPIs which measure CRM's impact on one or both sides of the profit equation: revenues or costs. Operational KPIs may include greater sales force productivity, reduced service costs, and increased share of customer spend. Analytical KPIs may include reduced customer acquisition costs, improved productivity from direct marketing campaigns, and higher rates of multiple product ownership. Banks, for example, can improve the chances of customers becoming more profitable by having them buying several products such as savings accounts, investment accounts and insurance policies. Customers who only have a current account (checking account) are notoriously unprofitable.

Many CRM implementations use even more indirect measures of the impact of CRM upon ROI. These measure neither cost nor revenue. Rather, they measure a driver of either or both; for example, customer satisfaction or customer retention. Anderson, Fornell and Lehmann are clear that high levels of customer satisfaction drive profitability.[31] Reichheld is equally clear that customer retention drives profitability.[42] Both are elements of the satisfaction–profit chain that was examined earlier.

[iii] Many companies divide their customer into quintiles. The top 20 per cent of customers (quintile one) generally represents a higher contribution to sales and/or profit than lower quintiles. CRM strategies may focus on migrating customers from lower quintiles into higher quintiles, i.e. making customers more valuable in terms of sales and/or profit.

Over what period should the return be measured?

For many companies CRM is a long-term investment that is expected to pay off over periods of up to five or more years. As the perspective on CRM shifts from strategic to operational to analytical, the time frame over which performance is measured becomes shorter. Whether an organization becomes more customer-centric following the adoption of CRM practices is a question that can only be answered over the long term. However, it is certainly possible to measure the costs and revenue impacts of CRM-enabled marketing campaigns over a matter of weeks, if not days.

Contexts of CRM

There is wide variety in the contexts in which CRM is practised and in the relationship issues that companies face in those contexts. Customer relationship management takes many forms and addresses many relationship issues. Four contexts will be considered: banks, automobile manufacturers, high-tech companies and consumer goods manufacturers.

- **Banks** and the telecommunication firms deal with individual consumers or customers. They want CRM for its analytical capability to help them to manage customer defection (churn) rates and to enhance cross-sell performance. Data-mining techniques can be used to identify which customers are likely to defect, what can be done to win them back, which customers are hot prospects for cross-sell offers, and how best to communicate those offers. Banks and telecommunication companies want to win a greater share of customer spend (share of wallet). In terms of operational CRM, they are both transferring service into contact centres in an effort to reduce costs.
- **Automobile manufacturers** deal with distributor/dealer networks. They have little contact with end-users. They want CRM for its ability to help them to develop better and more profitable relationships with their networks. Being physically disconnected from drivers, they have built websites that enable them to interact with these end-users. This has improved their knowledge of customer requirements. Ultimately, they hope that CRM will enable them to win a greater share of end-user spend across the car purchase, maintenance and replacement cycle.
- **High-tech companies** manufacture complex products that are generally sold by partner organizations. For example, small innovative software developers have traditionally partnered with companies such as IBM to obtain distribution and sales. However, companies such as Dell have innovated channels. They go direct-to-customer (DTC). These DTC companies may use CRM to collect customer information, segment their customer base, automate their sales processes with product configurator software and deliver their customer service online. They have also developed automated relationships with suppliers, so that they carry no or low levels of inventory, which are replenished frequently in rapid response to order patterns.
- **Consumer goods manufacturers** deal with the retail trade. They use CRM to help them to develop profitable relationships with retailers, and to understand costs-to-serve and customer profitability. Key account management practices are applied to strategically significant customers. Purchasing processes enabled by IT deliver higher levels of accuracy in stock replenishment. Manufacturers can run CRM-enabled marketing campaigns which are highly cost-effective.

The not-for-profit context

Most of this chapter has been concerned with CRM applications in the for-profit context. However, CRM can also be found in the not-for-profit context. Some of the basic skills of database development and exploitation, and customer lifecycle management, are equally relevant to not-for-profit organizations (see Case 1.4).

The Salvation Army uses CRM capability to solicit contributions, using event-based fundraising. The Army also knows the value of different donor segments, and works at retaining their high value donors and at migrating casual donors up the value ladder towards bequest status.

Universities have deployed CRM to manage their student and alumni relationships. Today's students are thought to represent considerable

Case 1.4

Not-for-profit operational CRM at the city of Lynchburg

The city council of Lynchburg, VA, USA, sought to improve the levels of information and services that it provided to its 69 000 citizens. The 'Citizens First Program' involved the design and implementation of an operational CRM strategy to open the lines of communication and to automate many services between the city council's 1100 employees, municipal departments and the citizens of Lynchburg. The project comprised the establishment of a website to provide citizens with 24/7 access to information concerning the city's services and facilities, and enabling citizens to make requests for information, enquiries and complaints. Supporting the website was CRM software and a linked call centre, providing personalized follow-up and ongoing support.

Since implementation in 1999, many benefits have been seen, namely:

- There has been a 50% reduction in the time taken to respond to citizens' enquiries.
- Citizens can track the progress of requests for service, enquiries, etc.
- The city council can measure and report on organizational performance.
- Levels of communication within the city council and between municipal departments have improved.

potential lifetime value to universities. For example, students who enjoy their experiences at a graduate school of business may return there for executive education. They may recommend the institution to their personal networks, or when they reach an appropriate level of seniority commission the school to consult or deliver customized training and development to their companies. Schools as eminent as Harvard Business School have been hugely successful at fundraising from their alumni networks.

Defining CRM

Against this background of three levels of CRM, misunderstandings about CRM, differing constituency viewpoints, and contexts of implementation, it is no easy matter to settle on a single definition of CRM. However, we can identify a number of core CRM attributes, and integrate them into a definition that underpins the rest of this book.

CRM is the core business strategy that integrates internal processes and functions, and external networks, to create and deliver value to targeted customers at a profit. It is grounded on high-quality customer data and enabled by IT.

This definition certainly has a for-profit context. If the not-for-profit community were to replace the words business, customers and profit with appropriate equivalents, then it would apply equally well in that context.

Summary

In this chapter you have learned that CRM has a variety of meanings. It can be considered at three levels: strategic, operational and analytical. There are many misunderstandings about CRM. For example, some people wrongly equate CRM with loyalty programmes, whereas others think of CRM as an IT issue. Different constituencies such as CRM consultancies, CRM software vendors, CRM hardware and infrastructure vendors, companies that are implementing CRM, and their customers in turn, may have very different perspectives on CRM. The implementation of CRM may cost many millions of dollars, and management is increasingly demanding evidence that CRM investments will produce a satisfactory return. Although CRM is generally thought of as a business practice it also has application in the not-for-profit context.

Finally, we have produced a definition that underpins the rest of this book. We define CRM as the core business strategy that integrates internal processes and functions, and external networks, to create and deliver value to targeted customers at a profit. It is grounded on high-quality customer data and enabled by IT.

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Chapter objectives

By the end of the chapter, you will understand:

1 the five primary stages of the CRM value chain
2 the basic role of customer portfolio analysis, customer intimacy, network development, value proposition development and managing the customer lifecycle in CRM strategy development and implementation
3 the four supporting conditions of the CRM value chain
4 why culture and leadership, data and IT, people, and process are important contributors to CRM strategy development and implementation.

Introduction

Chapter 1 showed that there are many different views about customer relationship management (CRM). There are strategic, operational and analytical viewpoints. In addition, different constituencies such as CRM software vendors, hardware and infrastructure vendors, consultancies and companies implementing CRM, and their customers, may have different opinions about the function and content of CRM.

We integrated these viewpoints into the following definition of CRM:

> CRM is the core business strategy that integrates internal processes and functions, and external networks, to create and deliver value to targeted customers at a profit. It is grounded on high-quality customer data and enabled by information technology.

This chapter presents a model that takes this definition as its point of departure. The model provides a 'helicopter view', giving an overview of the CRM landscape.

The CRM value chain sets out a five-step process for developing and implementing CRM strategy (Fig. 2.1). Each of the five primary steps is performed with the deployment of a number of tools and processes. These are explored in more detail later in the book. The model also identifies a number of supporting conditions that facilitate successful implementation. We explore those conditions in this chapter.

The goal of CRM

Broadly speaking, the general aim of any CRM strategy is to develop more profitable relationships with customers. Some companies do this by taking cost out of the relationship; for example, by shifting customers to

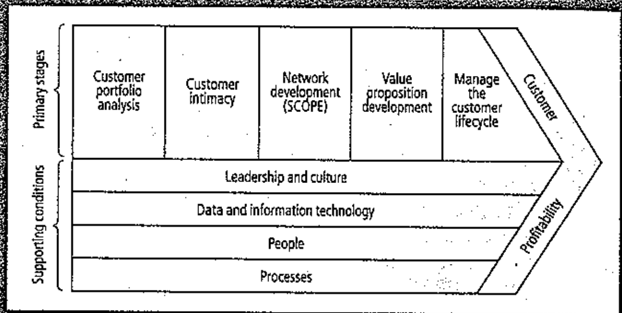

Figure 2.1 The CRM value chain

web-based self-service. Others do this by increasing the revenue earned from a customer relationship; for example, by selling customers additional products and services. Most companies use both of these approaches. This core CRM objective is noted in the arrowhead at the right end of the CRM value chain: customer profitability. In a not-for-profit context, you would work towards different CRM objectives, such as operational efficiency or increased client satisfaction.[1]

Measuring customer profitability implies that an organization must be able to trace revenues and costs to customers, either at a segment or at an individual level. Most business-to-business (B2B) companies can trace revenues to customers. Invoicing databases contain these data. Fewer B2B companies can trace costs to customers; for example, costs of customer acquisition and costs-to-serve. In business-to-consumer (B2C) CRM implementations, costs and revenues are more likely to be allocated at a segment level, since there are many more customers.

The primary stages of the CRM value chain

The model identifies five key steps in the development and implementation of a CRM strategy.

In brief, the five steps are as follows.

1 **Customer portfolio analysis**: this involves an analysis of the actual and potential customer base to identify which customers you want to serve in the future. Top of the list will be strategically significant customers, including those that will generate profit (value) in the future.

[1] These were the objectives of a CRM project for a non-government organization.

2 **Customer intimacy**: you will get to know the identity, profile, history, requirements, expectations and preferences of the customers that you have chosen to serve

3 **Network development**: you will identify, brief and manage relationships with your company's network members. These are the organizations and people that contribute to the creation and delivery of the value proposition(s) for the chosen customers. The network can include external members such as suppliers, partners and owners/investors, as well as one important internal party, employees.

4 **Value proposition development**: this involves identifying sources of value for customers and creating a proposition and experience that meet their requirements, expectations and preferences.

5 **Manage the customer lifecycle**: the customer lifecycle is the customer's journey from 'suspect' towards 'advocate status'. Managing the lifecycle requires attention to both process and structure:
- **process**: how will the company go about the important processes of customer acquisition, customer retention and customer development, and how will it measure the performance of its CRM strategy?
- **structure**: how will the company organize itself to manage customer relationships?

These five primary stages of the CRM value chain represent three main sequential phases of CRM strategy: analysis, resource development and implementation.

Customer portfolio analysis (CPA) and customer intimacy (CI) are primarily analytical activities. CPA involves using customer and market data to decide which customers to serve; CI involves getting to understand customers and their requirements. Network development and value proposition development are focused on building or acquiring resources to create and deliver value to customers. Managing the customer lifecycle is about implementing CRM by acquiring and retaining customers, and developing their value.

These steps are iterative and reflexive. They are iterative in the sense that the five-step process is repetitive and continuous. It is not a one-time process that leads to a strategy that is serviceable for ever. For example, in a dynamic environment in which competitors keep improving their value proposition it is important to review periodically which customers to serve, what to serve them and how to deliver the value.

The process is reflexive in the sense that there is backwards and forwards interdependence between the five stages. For example, analysis at stage 1 (customer portfolio analysis) leads to a decision about which customers the company will serve. This decision determines the composition of the value proposition (stage 4). If the company does not have the competencies to deliver, either alone or in partnership with other organizations, the proposition that customers want, then the company will need to review its target market decision.

At each step several tools and processes are used for analytical, planning, implementation or control purposes. These are detailed in Fig. 2.2.

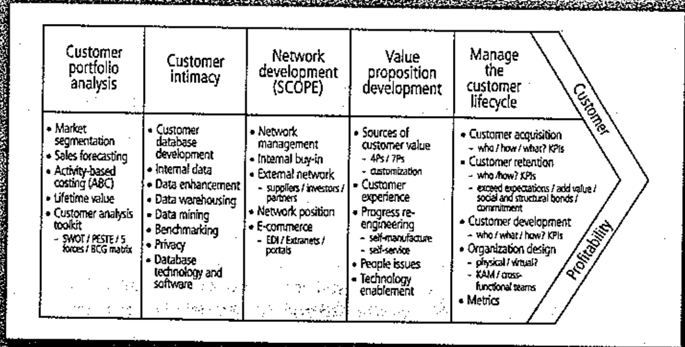

Figure 2.2 Tools and processes on the CRM value chain

The five steps, and the associated tools and processes, are described in more detail in future chapters. The sequence of the chapters follows the CRM value chain:

- Chapter 3: Information technology for customer relationship management
- Chapter 4: Customer portfolio analysis
- Chapter 5: Customer intimacy
- Chapter 6: Creating and managing networks
- Chapter 7: Creating value for customers
- Chapter 8: Managing the customer lifecycle: customer acquisition
- Chapter 9: Managing the customer lifecycle: customer retention and development
- Chapter 10: Organizing for customer relationship management.

The supporting conditions of the CRM value chain

This section will focus on the four conditions that support the development and implementation of the CRM strategy. These are

- leadership and culture
- data and information technology (IT)
- people
- processes.

These four conditions influence each of the five primary stages of the CRM value chain. If the conditions are not supportive of the CRM strategy then its implementation is less likely to succeed. Each of them is summarized in turn.

Leadership and culture

Both leadership and organizational culture can influence the outcomes of CRM strategies.

Leadership

Leadership is very important to the success of CRM implementations for a number of reasons.

Leadership decides whether CRM is focused on strategic, operational or analytical goals.

At the level of strategic CRM, leadership is needed to set out whether a customer (market) orientation, sales, product or production orientation will guide the company into the future. These different business orientations were discussed in Chapter 1. Companies that commit to CRM are more likely to have a marketing or sales orientation than a product or production orientation.

If marketing issues lie at the heart of the implementation, the broad CRM goals are likely to be expressed in terms of improved business performance through higher levels of customer satisfaction and retention. If sales goals underpin the CRM investment, the objectives are likely to be expressed in terms of improved sales effectiveness (e.g. higher sales per customer) or greater sales efficiency (e.g. reduced costs-to-serve).

The mission, vision and values of an organization will be derived from, or be reflected in, the adopted business orientation. Selfridges provides an illustration. This European upmarket fashion retailer has the following mission.

> *Our mission is to become Europe's best and most exciting department store chain by meeting customers' needs in a unique and theatrical way, whilst, at the same time maximising operational efficiency.*

This mission clearly identifies

- the strategic group within which the company operates: European department stores
- its business orientation: customer orientation, 'meeting customers' needs'
- the product: a 'unique and theatrical' shopping experience
- its values: differentiation, excellence, customer focus, operational efficiency.

These commitments form the basis of and rationale for Selfridges CRM programme. They define who the company will serve and how they will be served.

CRM can be expensive to implement

Operational and analytical CRM implementations can be expensive. Companies will be investing significantly in IT, process engineering and people development. Leadership needs to be committed to the project to