



Customer Relationship Success

Latest thinking and practical advice on the way forward

Centre for Corporate Change, Australian Graduate School of Management



University of Wollongong



Fairfax Business Research

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Research Partners

About The Centre for Corporate Change, Australian Graduate School of Management

www.ccc.agsm.edu.au

The strategic purpose of the CCC is to challenge the leadership status quo in Australia by providing a forum for radical new thinking based upon substantive experience and world-class research. The CCC stands for the merger of experienced corporate leadership with academic intellectual rigour, recognising that one is not antithetical to the other.

The CCC's operational goal is to foster and disseminate world-class thinking in the area of strategic change, which requires a multi-disciplinary approach to problem solving that, whilst broad in scope, also has the intellectual depth in the application of disciplinary know-how. Hence, the CCC's operational imperative is to bring together disciplinary excellence to the requirements of studying multifunctional organizational change no matter where on the globe that expertise resides.

About The Decision Systems Laboratory, University of Wollongong

www.uow.edu.au

The DSL is an interdisciplinary group of academics, post-doctoral researchers and research students drawn from the School of Information Technology and Computer Science, and the School of Economics and Information System at the University of

Wollongong. Who share an interest in exploring the technological issues underlying the design, implementation and testing of complex information systems.

About SAP

www.sap.com

Founded in 1972, SAP is the recognized leader in providing collaborative business solutions for all types of industries and for every major market. With 12 million users, 79,800 installations, and 1,500 partners, SAP is the world's largest inter-enterprise software company, and the world's third-largest independent software supplier overall. SAP employs over 28,900 people in more than 50 countries. Today SAP employs nearly 30,000 people in more than 50 countries. SAP professionals are dedicated to providing high-level customer support and services.

About Fairfax Business Research

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Executive Summary

What makes companies such as National Australia Bank in Australia, Otto Versand in Germany, Tesco in the United Kingdom and Capital One in the U.S so much better at managing customer relationships than their competitors? This question was the basis of a large survey of senior managers in medium to large Australian companies. The findings demonstrate that relationship leaders out perform their rivals by proactively identifying new market developments and seeking to meet latent or unarticulated needs of their customers.

To punch above your weight in today's competitive environment, companies need databases and softwares to gain a deep understanding of customer needs and behaviours. Yet, technology alone is insufficient for success. What sets relationship leaders apart from the rest is an ability to create the deeply-seeded organisational change required to support the open sharing of customer information.

Eight lessons follow from our study:

- Lesson 1: CRM programs are deployed for different reasons. The most optimal combination was 50% customer intimacy, 30% operational excellence, 10% data analytics and 10% tactical response
- Lesson 2: Sophisticated IT infrastructures are necessary but not sufficient for customer relationship success
- Lesson 3: The ability to ask penetrating questions, glean useful insights, and act decisively comes from skills that are not evenly distributed between organisations
- Lesson 4: CRM systems are a combination of activities that require managers to align and orchestrate the disparate parts of the organisation
- Lesson 5: The depth of relationship a customer wants with a supplier, can in itself, be an effective way of segmenting markets around fundamental customer needs
- Lesson 6: In the rush to fix the technology and business alignment issues, managers tend to overlook what is feasible and focus instead on what is desirable
- Lesson 7: Being response to customer needs is no longer sufficient. Positioning for success requires a proactive approach that is capable of identifying latent customer needs and competitive strategies
- Lesson 8: Different stages of relationship development represent different revenue and cost profiles. This implies that different customers must be managed in different ways

1. Introduction

There is a consistency and predictability to the quality of behaviour in the very best organisations.

— Margaret J. Wheatley, *Leadership and the New Science: Learning about Organisation from an Orderly Universe* (1994)

In most markets one sees leaders who outperform their rivals through their close and connected relationship to their customers. A number of these “relationship leaders” come to mind: National Australia Bank in Australia, Otto Versand in Germany, Tesco in the UK, Capital One and Harrah’s Entertainment in the U.S. For organisations such as these, customer relationship management (CRM) is more than a tool but part of a deeply embedded strategic disposition that enables them to outperform their rivals in what are otherwise fiercely competitive markets.

For those wanting to learn from these role models a number of questions come to mind. Why are they so successful? What market conditions exist that make investment in these programs worthwhile? What deeply embedded capabilities and customer-oriented cultures do they possess? How much time and effort have they invested in CRM? Is the answer to simply invest in the latest CRM software to leapfrog the competition?

The optimism generated from concentration on “relationship winners” is in stark contrast to the nay saying of many business commentators. For example, research and advisory firm, the Gartner Group, claimed that close to 50% of all CRM projects failed to meet expectations. Additionally, an InfoWorld survey found that close to 30% of chief technology officers said that CRM was one of the most “over hyped” technologies they had seen. These commentaries highlight the frustration many executives experience as software glitches, poorly trained staff and disparate legacy systems continue to hinder effective deployment of CRM programs. Far from improving profits and cementing relationships, some companies find themselves in the worst case scenario where their CRM systems wind up alienating long-term customers and employees. Yet despite these issues, the tide of CRM growth and development continues to swell and rise—the \$426 million spent on such systems in 2003 is expected to increase to over \$560 million by 2008 (*The Australian*, 29 June 2004).

So what, if anything, is wrong with CRM? Given the huge investment required to develop a CRM system it is hardly the case that such expenditures are made without a robust business case. Nor can the “relationship failures” simply be laid at the doorstep of an “over hyped” technology. Indeed, most post-mortems of CRM failure trace the problems back to factors other than software and technology. Nor are over optimistic “big bang” approaches to implementation solely to blame. Project teams today are astutely aware that the larger and more radical an IT project is, the more likely it is to fail.

In our mind, the problem rests fair and square with flawed managerial decision making. Put bluntly, senior managers underestimate the CRM implementation challenges and operational managers are not tactically allocating CRM programs in ways that are responsible and appropriate for the environments in which they operate.

In what follows we attempt to provide managers with much needed perspective. We integrate current thinking and best practice with new insights derived from a study conducted by the Centre for Corporate Change at the Australian Graduate School of Management. The report is not intended to be exhaustive but to provide a snapshot of the capabilities required and problems encountered when deploying CRM. Most importantly, it draws together complementary strands of thought, experience and data in a summary fashion, to present a picture of how decision making can be improved. It is hoped that this document will provide a springboard for more informed debate within organisations, whether they are delivering a new CRM program, terminating a floundering program or tweaking a well functioning program.

1.1 Customer Relationship Management: A Definition

From a technical perspective CRM is grounded on the interrelationship between high-quality customer data enabled by information technology (IT). However, from a strategic perspective its aims and scope are considerably broader. According to the Gartner Group, CRM is defined as a business strategy whose outcomes optimise profitability, revenue and customer satisfaction (*the why?*) by organising around customer segments, fostering customer-satisfying behaviours and implementing customer-centric processes (*the how?*). Although this is a reasonably complete definition it lacks the operational detail that most managers value. For example, there are environmental pressures that determine what the market will allow and whether it makes sense to invest in CRM programs. Organisations possess many resources and capabilities, but only a few will lead to positions of sustained advantage and these need to be spelt out in detail. Lastly, organising around the customer is costly and may not be feasible for everyone. Therefore, we seek a definition of CRM that is deeper and more inclusive of the drivers and impediments to CRM success. These aspects are all illustrated in the exhibit below and explored in detail throughout this report.

CUSTOMER RELATIONSHIP MANAGEMENT: A DEFINITION

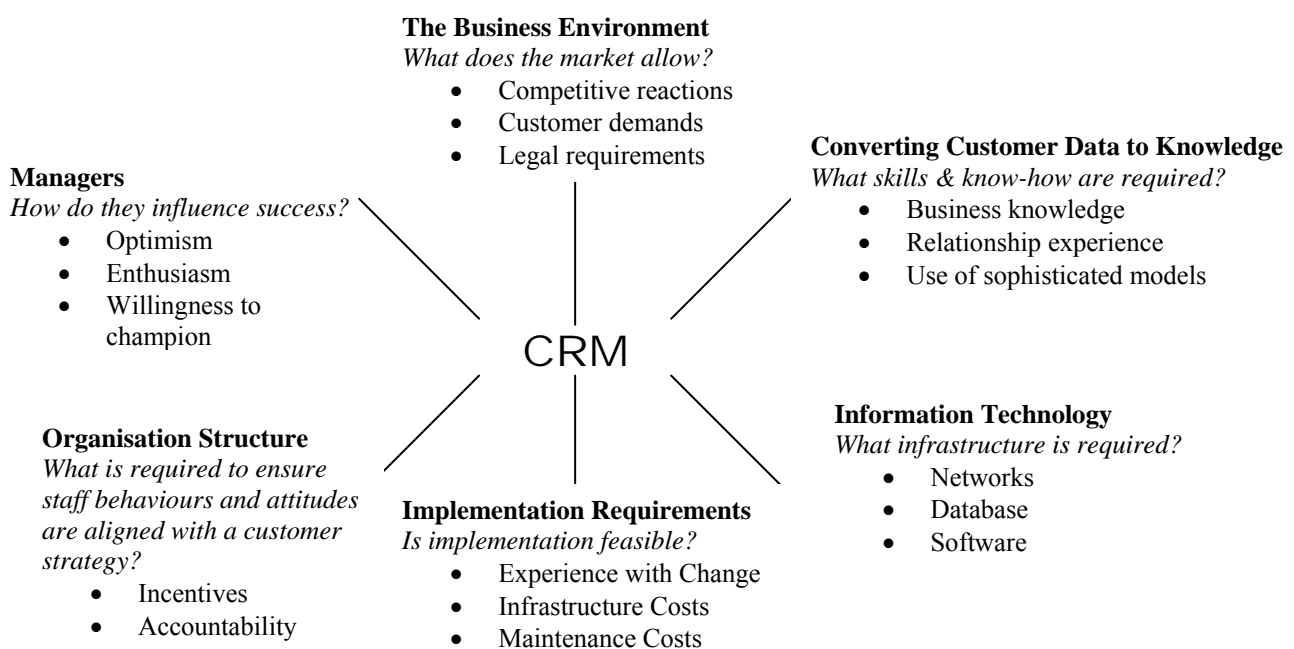


Exhibit 1 – CRM Operational Components

1.2 What was Done?

This report was prepared under the auspices of the AGSM's Centre for Corporate Change (CCC), with financial support from the CCC, Fairfax Business Research and SAP. It is one of the most detailed analyses of the way Australian companies are gaining competitive advantage from investment in CRM programs. The research entailed extensive fieldwork that included over 50 interviews of senior managers and executives in Australian companies. Additionally, the detailed survey data collected required the assistance of more than 400 Australian companies.

The targeted industries are characterised primarily by large consumer markets that cover a diverse range of customer contact points. They comprise a mixture of mature and emerging CRM programs, and the companies involved in the study are characterised by strong market pressures to differentiate themselves from their competition.

The results presented in this report are unlike any other research in five ways. Specifically we:

- Measure the business unit rather than the firm. What one unit such as Corporate and Institutional Banking, does at NAB to compete for customer relationships is very different from the actions of another unit such as Business Financial Services.
- Compare each business unit to their direct competitors. This is important because although a business can be ranked highly on certain capabilities they must be superior to their rivals in order to generate competitive advantages.
- Target a wide cross section of people in these organisations charged with developing and implementing CRM programs to ensure that responses are not subject to bias associated with the perceptions of a particular functional area.
- Provide insight into the range and depth of customer-relating capabilities being developed by companies within six broad industry sectors—financial services, insurance, airlines, utilities, telecommunications, hotels and large retailers, and
- Gain a clearer understanding of the nature and evolution of CRM programs by separating organisational capabilities from environmental pressures and examine how managers react to new strategic demands and their own organisational impediments.

1.3 Who Was Studied?

The targets of this study are senior managers in general management, marketing, finance and information technology. The industries represented included Finance (40% of those involved), Insurance (9%), Telecommunications (12%), Airline (7%), Hotels/Tourism (6%), Utilities (6%), Retail (10%) and Other (9%).

A BROAD SECTION OF AUSTRALIAN INDUSTRY

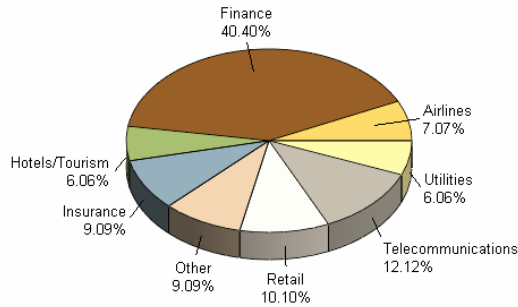


Exhibit 2 – Breakdown of survey respondents by industry

The median firm studied had approximately 300 employees, with the smallest firm having 50 employees and the largest 12,000. The managers involved worked in five areas: (1) corporate or general management, (2) financial/operations management, (3) marketing and sales, (4) technology management, and (5) customer support. All were very senior managers as attested by their titles. The wide distribution of respondents by job title provides rigour to the study as it ensures that selection bias in the results is kept to a minimum.

VERY SENIOR MANAGERS

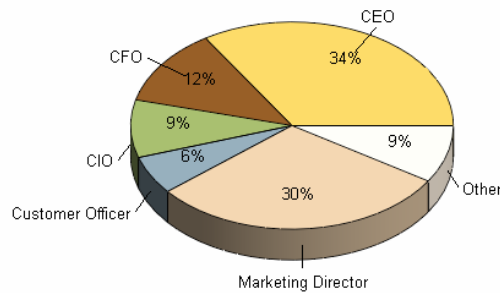


Exhibit 3 – Survey respondents by job title

1.4 Degree of CRM Adoption

We see in the companies studied a maturing of CRM experience and activity. Only 19 per cent of the respondents have no CRM programs in place, while 53 per cent have CRM operations in exploratory or pilot stages of development. In 28 per cent of cases, CRM programs have been deployed for advanced usage. This means that the CRM program has been successfully integrated into the core systems of the business. Not surprisingly, 75 per cent of firms believe that they will have in place mature/fully integrated CRM programs in the next 2-3 years. Furthermore, this study indicates that we did not just look at those companies that intend to implement advanced CRM programs. Several insurance and utility companies in our sample have no plans to deploy advanced CRM programs at all.

CRM SYSTEMS ARE MATURING

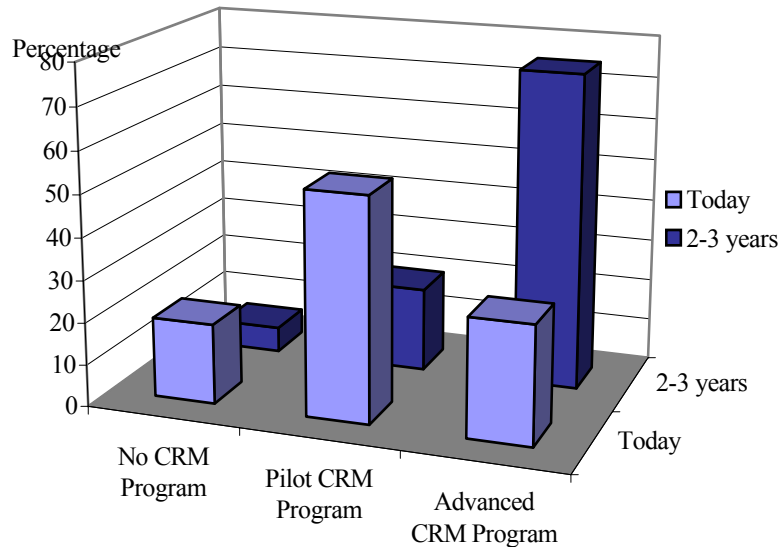


Exhibit 4 – State of CRM program today and in 2-3 years time

1.5 Report Outline

A primary aim of this report is to show how relationship leaders are using CRM programs to outperform their rivals. However, we also note that what has been shown to work for leading CRM implementers may present a desirable model for other firms but is rarely sufficient to account for the unique customer demands, organisational capabilities and environmental constraints that face your company. There are many reasons why this is the case such as historically developed capabilities, customer bases, managerial beliefs and regulatory environments etc. In this report we seek to explain both the drivers and impediments to customer relationship success.

The remainder of the report is structured as follows:

- Chapter 2 – we build the platform for this study by reviewing the work that purports to show that customer relationship management makes a difference. We then plot the way strategic orientations vary between respondents in our study.
- Chapter 3 – we explore the firm specific capabilities required to achieve an advantage. We break a customer-relating capability into its constituent parts and then show how the combination of these individual capabilities can lead to positional advantage.
- Chapter 4 – we illustrate the effect of personalisation and competitive, market and technological pressures on CRM success. These market pressures help us to understand the extent to which economic value can be created and managed through a more tailored customer relationship system.
- Chapter 5 – the ability of the organisation to weather the implementation problems inherent in instituting a long-term strategic change program is critical to CRM success. We illustrate the difficulty that many companies experience implementing CRM programs that alter the balance of power within their company and require both economic and behavioural changes amongst its employees and managers.
- Chapter 6 – we examine the performance implications of positioning for competitive advantage. Several measures of positional advantage are used to examine performance relative to competitors.

- Chapter 7 – we conclude with a section that wraps up the key findings in this report.

1.6 Acknowledgements

This project would not have come to fruition without the support of the project partners. Project champions deserving of special mention are Quentin Long, Matthew Bushby + SAP Contact. We also wish to thank Natasha Dubauskas and Noel Parkhill for assistance in executing the survey. Fran Prior provided diligent secretarial assistance and Pauline Olive aided us in her capacity as the business manager of the Centre for Corporate Change.

2. Does it Pay to be Customer Focussed?

“Would you tell me, please, which way I ought to go from here?” asked Alice.

“That depends a good deal on where you want to get to,” said the Cat.

“I don’t care where,” said Alice.

“Then it doesn’t matter which way you go,” said the Cat.

— Lewis Carroll,
Alice’s Adventures in Wonderland

For years, managers and marketers have emphasised strategies designed to increase the size of their customer base, encourage brand switching and boost purchase frequency. However, one of the most significant trends in recent years has been the shift in focus from engaging in single transactions to establishing long-term relationships with customers. Consultants and company directors echo this line of thinking:

First, you do everything you can to keep the clients you already have and defend your market share; only then can you think about looking for new customers.

Why the shift in strategic focus?

Markets in developed countries like Australia are often mature or at best growing slowly. This implies that there are fewer new customers over which companies compete. Competition is frequently intense and strategies based on customer acquisition are increasingly difficult to meet. It has been estimated that the cost of attracting new customers can be up to five times as much as the cost of serving existing ones efficiently to ensure that they stay with you. Current thought in marketing theory and practice points out that competing through superior service and customer relationships can be more profitable. Hence, allocating resources to customer service initiatives can be particularly effective when the cost of generating a new customer can substantially exceed the cost of retaining a present customer.

In one of the pioneering studies in this area, Bain & Company showed that something as small as a reduction in customer defections by 5% could lead to an astounding 60% increase in financial services profits over a 5-year period. The implication of these studies is that companies should allocate resources to build more cooperative and long-lasting relationships with their customers.

2.2 Service Profit Chain

The service profit chain has proven to be one of the most popular ways to illustrate the link between customer-focused behaviour and profitability. The logic is quite simple. When organisations turn their attention towards the customer, they create value for those customers that can, with some likelihood, drive customer satisfaction with the product and purchasing experience. In turn, the increased customer satisfaction will enhance loyalty. Finally, higher customer loyalty will drive increased firm profitability (see Exhibit 5).

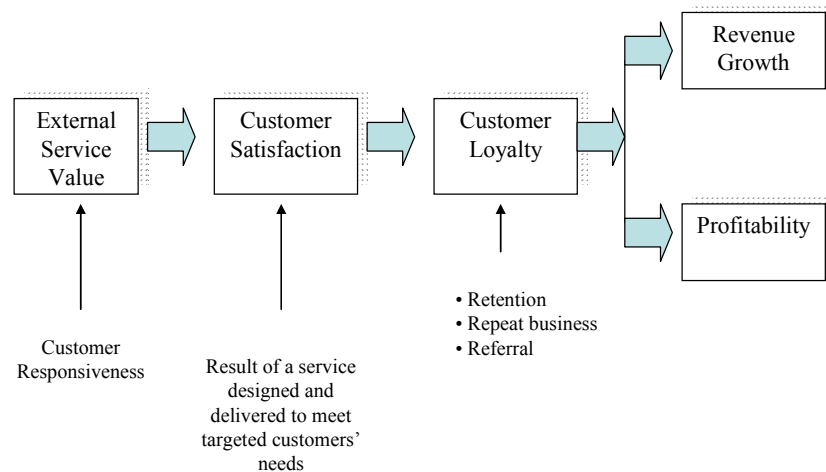


Exhibit 5 – Service Profit Chain (Heskett et al. 1994 Harvard Business Review)

A classic example of the implementation of the service value chain is the revitalisation of Sears, Roebuck and Company—the large, established American catalog retailer and department store that fell on hard times in the 1980s as the consumer retail market changed on a number of dimensions. More than 100 top-level Sears executives spent three years rebuilding the company around its customers. They developed a holistic business model for the company—the employee-customer-profit model—and an accompanying management system that tracked activities from management behaviour through employee attitudes to customer satisfaction and financial performance. Using statistical testing they established that a five percentage point improvement in employee attitude drove a 1.3 percentage point increase in customer satisfaction that, in turn, drove a 0.5 percentage point increase in sales turnover. Although this might appear small, one has to keep in mind that Sears sales in 2003 were US\$41.1 billion.

We live and breathe the service-profit chain, understanding our customers is fundamental to our success—satisfied customers make satisfied clients, make happy shareholders

AC Nielsen (<http://www.acnielsen.com.au>)

The service profit chain has been used in a host of industries, providing further evidence of a relationship between customer satisfaction, loyalty and company performance.

- **Banking.** Customer satisfaction in retail banking has been found to be 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 (Carr 1999).
- **Telecommunications.** A 10 per cent increase in a customer satisfaction index led to a 2 per cent increase in customer retention and a 3 per cent increase in revenues. In addition, customer satisfaction was a leading indicator of customer retention, revenue and revenue growth (Ittner and Larcker 1998).
- **Airlines.** As one might expect, the main drivers of dissatisfaction in the airline industry are high load factors (crowding), mishandled baggage and poor punctuality. The study concluded that as dissatisfaction rose, operating

revenue fell and consequently operating expenses rose and operating income fell (Behn and Riley 1999).

However, these studies do not claim to establish a cause-effect relationship. They simply find evidence of a strong correlation between customer satisfaction, loyalty and performance. Overall, these results indicate that the strongest indicator of success is loyalty. But what is loyalty and do all customer s really want to be loyal? As individuals we exhibit loyal behaviour to the things that really matter to us:

- To our spouse or partner
- To our rugby league, soccer or rugby union team
- To our political party

But do we really want to be loyal to a bank, airline, hotel or retail store?

2.3 The Service Profit Chain Under Attack

Contrary to the popular view that long-life customers are more profitable, others such as AGSM Professor Grahame Dowling, caution that loyal customers can often be less profitable. One reason for this is that they expect a reward for their loyalty; such as a price discount or extra free service. In the case of fast moving consumer goods, service, retail and lifestyle markets, there is no logical reason why customers should stay loyal to a single brand. There are many good reasons for this:

- Different brands are used during different usage occasions (e.g., French Champagne for celebrations, Chenin Blanc or Riesling with fish)
- Brands are complementary not substitutes (e.g., *The Sydney Morning Herald* for daily news and *The Australian Financial Review* for in-depth company analysis)
- It is necessary to combine various brands in order to create a complete product (e.g., with clothing, cosmetics, cooking, travel) and customers are unwilling to have such choice constrained by the supplier
- Consumers are variety seekers (e.g., Italian, French, Mexican, Chinese and Indian restaurants) and are unlikely to want to remain with the same supplier forever.
- The desire for novelty (let's experiment and try something new).

Additionally, the levers that managers need to pull to drive customer satisfaction can be quite different from what determines dissatisfaction. We see evidence of this on customer retention when a one-point increase in customer satisfaction (say from '2' to '3' on a five-point scale for measuring 'satisfaction') does not compare equally with a one-point downward shift (say from '4' to '3' on the same five-point scale). Diminishing returns may also set in if customer expectations are already met. Further investment aimed at increasing customer satisfaction from high to very high levels may not have the same impact on performance as investments aimed at moving customer satisfaction from low levels to parity.

What this means for a manager is that customer orientation does not always lead to greater customer satisfaction, nor does customer satisfaction always increase performance. Hence the equation "market orientation = performance" is far too

simplistic and does not hold in most circumstances. Therefore, the impact of CRM programs on firm performance may be either positive or negative, depending upon the measure used, the industry analysed and the type of IT system considered. What we can take from this is that more relationship building is not necessarily better, but rather building the *right* type of relationship is the key to performance success.

2.4 CRM Strategic Orientation

We know that CRM means different things to different organisations. In some cases it is designed to support cooperation and create a customer-centric business culture. This orientation treats customers as true partners and reflects a genuine willingness to cater to individual service requirements. Others are more focussed on the implementation of best practice to capture cost savings through business process automation. Some focused proactively on the generation of customer intelligence to enhance customer and company value. Lastly, some engage in CRM for purely tactical reasons to block the impact of loyalty and other relationship-based programs initiated by competitors. Each of these four strategic orientations is summarised in Exhibit 6.

Strategic Orientation	Dominant Characteristic
Customer as Partner	A top-down perspective that views CRM as a core customer centric business strategy. This orientation treats customers as true partners and reflects a genuine willingness to cater to individual service requirements.
Operational Efficiency	This perspective on CRM is focused on the implementation of best practice to capture cost efficiencies through major automation projects such as service, sales force and marketing automation.
Analytic Mining	A bottom-up perspective on CRM concentrating on the intelligent mining of customer data for strategic and tactical purposes.
Tactical Response	A tactical perspective that seeks to deny an advantage to competitors by imitating competitive initiatives such as loyalty programs to retain existing customers.

Exhibit 6 – Four Levels of Strategic Orientation

The results of our study show that in 96 per cent of cases, CRM programs incorporate elements of all four strategic orientations. Managers were asked to allocate the degree to which they were pursuing each of these four strategic orientations. Two orientations in particular display statistically significant variation. First, the median allocation to a ‘customer as partner’ orientation was 40 per cent. One third of companies in our sample allocated ‘21-40’ per cent and another 28 per cent allocated ‘40-60’ percent to this strategic orientation. The other significant area in which CRM is deployed is operational efficiency. The median allocation was 30 per cent, with 43 per cent of companies allocating ‘1-20’ per cent and 33 per cent allocating ‘21-40’ per cent to operational excellence in an effort to reduce costs. Although the remaining orientations were not statistically significant they were still important. In the case of analytic mining the median orientation is 10 per cent, with 73 per cent allocating between 1-20 per cent of their CRM strategy towards data intelligence and other

analytic activities. In the case of tactical response programs, such as loyalty schemes, 82 per cent of respondents have allocated less than 20 per cent to this orientation.

These findings imply that customer relationship and operational excellence strategies are primary strategic orientations in our sample. Data analytic and tactical response orientations appear to represent secondary strategic postures.

BREAKDOWN BY STRATEGIC ORIENTATION

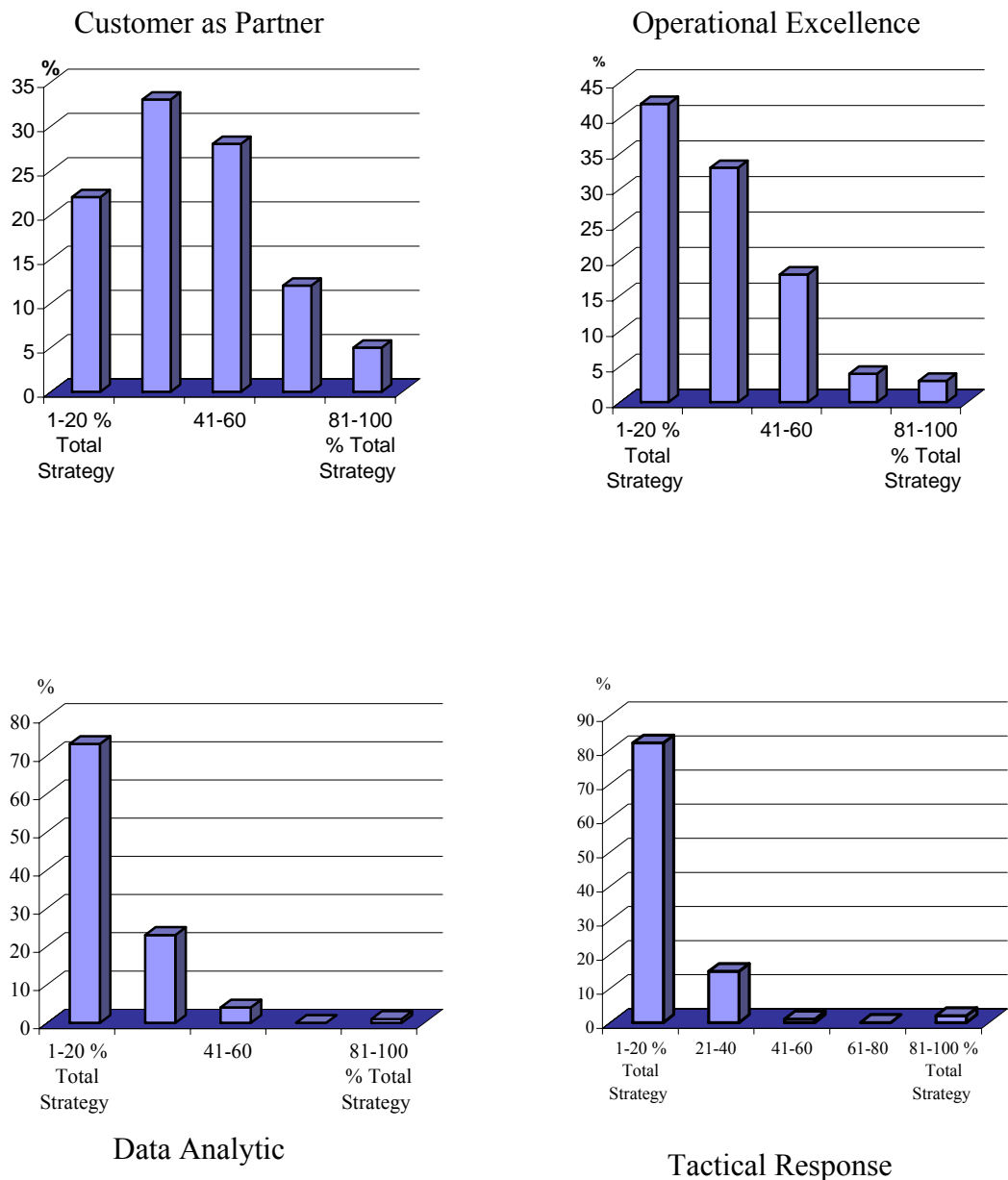


Exhibit 7 – Relevant strategic orientation that best describes your organisation’s CRM emphasis

It is interesting to note that in most cases (96 per cent) organisations employed a balanced approach that included elements of all four strategic orientations. Why might this be the case? First, it is likely that the organisations operate in a mix of mature and growth markets. For example, only 25 per cent of the companies surveyed indicated that they repeatedly deal with same customer base. Second, these

mixed markets are associated with differential risks and returns. For example, 54 per cent of companies indicated that less than 21 per cent of their customers account for more than 80 per cent of profits and/or lifetime value—an amazing validation of the 80:20 rule! Hence the goal of any organisation’s marketing strategy is not as clear as many would like. The reality for many companies is that they must work with customers that are at different relationship stages and these stages are dynamically changing.

What we see in the data is that a balanced approach makes sense. The starting point is to deploy a customer as partner orientation to change the way managers think about their customers and their business. Closely complementary to this is the development of systems for the collection of customer data that reduce costs through operational excellence. If used well, data analytics will also change the way customers think about your company. But what is the most optimal allocation?

To illustrate how companies perform when CRM programs are deployed for different reasons, we looked at the best, average and worst performing segments in our data. The different orientations are best illustrated on a two-by-two matrix (see exhibit 8) where the arrows indicate the mean score for each of the four categories.

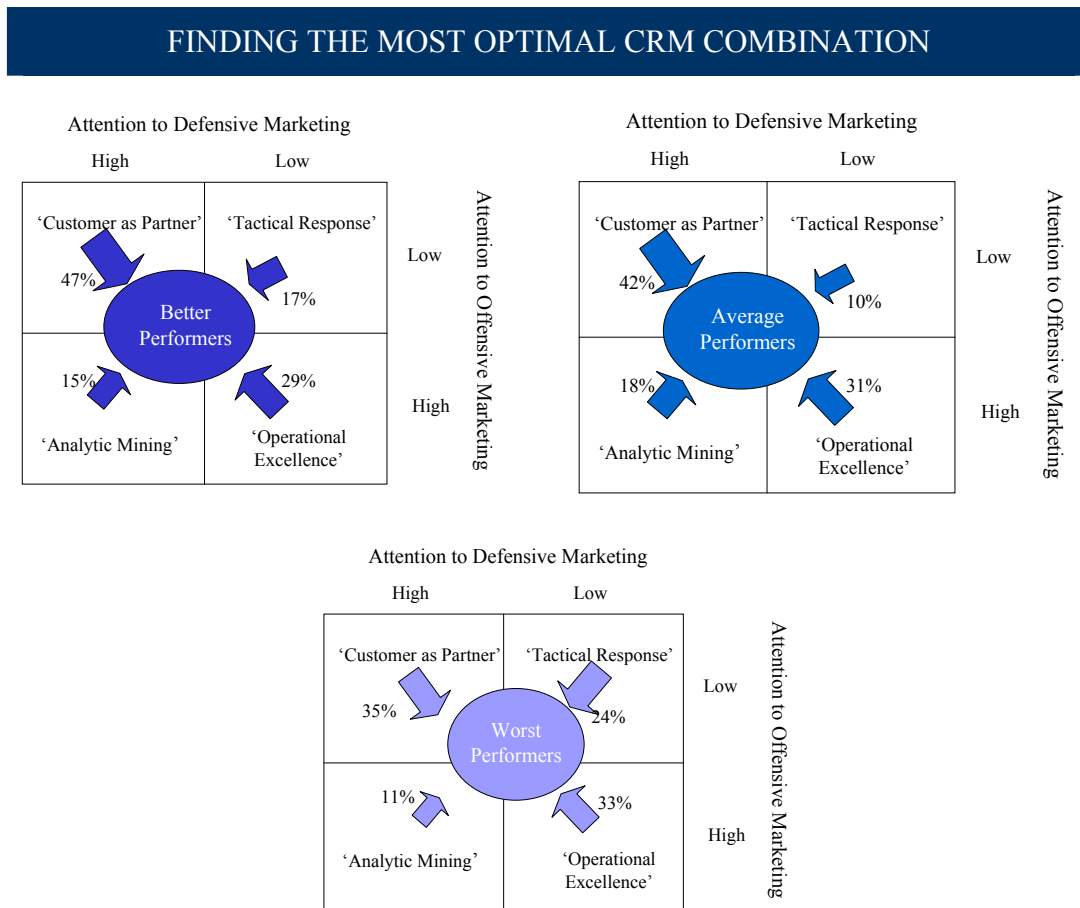


Exhibit 8 – Mean Allocation of CRM Activity

Median scores are also useful for descriptive purposes and are more effective at capturing the symmetry that characterises our data. If we look at the organisations that are performing better or far better than the competition, the ‘best’ combination is: customer as partner (50 per cent), operational excellence (30 per cent), data analytics (10 per cent) and tactical response (10 per cent). The companies that are average

performers in their industry tend to place less emphasis on deploying CRM to become customer focussed and more on data analytic activities. The median distribution for this segment is: customer as partner (40 per cent), operational excellence (30 per cent), analytic mining (15 per cent) and tactical response (10 per cent). Finally, the group of companies that performed worse or much worse than the competition are less sure about exactly what they should be doing with their marketing programs. They use CRM to achieve efficiency through operational excellence and to defend their current market position. These companies allocated the highest scores to operational excellence (35 per cent) and tactical response (15 per cent) orientations. Consequently they scored lowest on customer as partner (35 per cent) and analytic mining (10 per cent).

Lesson1

CRM programs are strategically deployed for different reasons. The most optimal combination was 50 per cent customer intimacy, 30 per cent operational excellence, 10 per cent data analytics and 12.5 per cent tactical response.



3. What Capabilities Are Required To Success?

Today, when people say “implement” CRM, they often think about technology; the reality is that you can only enable CRM with technology. There is a pattern in the marketplace where some big technology is introduced and everyone gets excited about tracking customer information with it. But CRM is more than that. You need three things: a means to track the information, the ability to evaluate customer performance with metrics, and the means to make change happen.

– Heidi Wisbach, manager CRM analytics, Cap Gemini Ernst and Young
Marketing News, 7 May, 2001

Many organisations are coming to the realisation that sustained competitive advantage is based largely on possession of the right resources and capabilities. Conceivably, an organisation can possess many resources and capabilities, but only a few of these have the potential to lead to positions of sustained advantage. It is rare that investment in simple customer relationship solutions such as network technology, CRM software, good intentions and skilled staff will produce superior outcomes. Instead, organisations require a deep-seeded commitment that underscores an investment in an overarching *customer-relating capability*.

But what is a customer-relating capability? We need to appreciate that broad generalisations will not suffice. Defining the necessary capability as possession of customer marketing skills for example, can be misleading if the value lies in a particular channel relationship as well as other ingredients such as technology, pricing or promotion that are merely average. Additionally, there needs to be some sense of how an organisation compares to others in their industry to appreciate the impact that each capability has on competitive advantage

To fully understand the scope of a customer-relating capability we break it down into three constituent parts:

- (1) *Information technology infrastructure* – the bedrock of a formal CRM system is data. If CRM is going to have a positive impact on performance, reliable data and information are prerequisites
- (2) *Skill converting market data into customer knowledge* – data and information alone are insufficient. Organisations must be capable of interpreting data correctly to ensure that the decisions that need to be made are in the right business context. Know-how must lead to new knowledge about customers that can be used to inform managerial and employee decision-making
- (3) *Supporting organisational structures* – simply gathering information and gaining new customer insight will have no impact on business performance unless actions can be taken appropriately and efficiently. The outputs of CRM systems have to be acted upon and this requires appropriate organisational structures, control systems and incentives

3.1 Customer Information Infrastructure

Over the last 15 years strong empirical evidence supported by managerial supposition has accumulated suggesting that information technologies, when effectively deployed, can contribute to superior performance. These advantages arise because the type of IT architecture required to support CRM is not effortless to deploy and requires skills

that are rare and cannot be duplicated easily. Hence, the companies that can develop this architecture reveal their superior internal capabilities.

A prime objective of many CRM systems is to gain a more complete picture of the customer by integrating data collection across all customer touch-points. The data in our study indicates that approximately one third (35 per cent) have achieved this goal while another third (37 per cent) are clearly struggling. These results confirm that delivery of a well-integrated picture of the customer is complex and difficult to achieve (see exhibit 9).

PROVIDING A FULL PICTURE OF THE CUSTOMER IS DIFFICULT

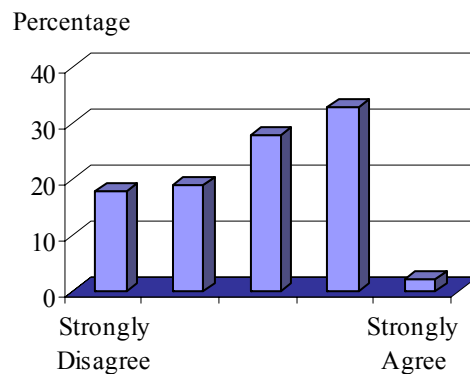


Exhibit 9 – CRM systems provide a full picture of customer histories, purchasing activity and problems

As anyone who has tried to deploy a CRM program will appreciate, the wrong technology base can turn integration initiatives into a massive technological and organisational nightmare. Integrating legacy systems and unfamiliar software requires custom integration that is costly, time consuming and risky. Therefore, the quality of a firm's IT infrastructure can act as a hedge against future uncertainty. It can facilitate the organisation's future ability to cost effectively respond to customer demands and provide the basis on which new service improvements can be developed and implemented.

We asked the managers in our study to indicate whether their information systems were extremely difficult, or very good at adapting and responding to unplanned customer needs. One third (33 per cent) indicate that they find it difficult to adopt their IT systems to changing customer needs. While another third (34 per cent) indicate that they are good at adapting their IT systems. The inflexibility of IT architecture also has implications for the ease with which CRM software can differentiate among customer segments (see Exhibit 10).

IMPACT OF IT FLEXIBILITY ON CUSTOMER DIFFERENTIATION

CRM allows us to differentiate among customers as to their lifetime value	To what extent is the following true of the information systems in your organisation			Total
	It is extremely difficult to adapt our IT & respond to unplanned customer needs	Average	We are very good at adapting our IT & responding to unplanned customer needs	
Strongly disagree	21%	19%	8%	29
Neither agree nor disagree	2%	5%	15%	22
Strongly agree	6%	7%	11%	24
Total	29	31	34	

Exhibit 10 - To what extent is the following true of the information systems in your organisation and CRM allows us to differentiate among customers as to their lifetime value

Consider for a moment the range of technologies that need to be interlinked. This list might include a combination of network infrastructure, front office applications such as sales force automation, call centres and telesales, campaign management and field service support, back end enterprise resource planning and other legacy systems. To simplify the wide-ranging scope of IT infrastructure we created an aggregate measure that combined measures of: IT flexibility, system integration, real time data provision, and the ability to differentiate among customers. When we compare this aggregate measure of “IT Infrastructure” with the competitive position in each industry the correlation is statistically significant. Twenty seven per cent of companies with high levels of IT infrastructure were also among the best performers in their industry. Likewise, 16 per cent of companies with poor IT infrastructure were also among the lowest performers in their industry.

IT INFRASTRUCTURE RELATIVE TO COMPETITORS

IT Infrastructure	Overall, how does your business compare to the three most profitable companies at managing customer relationships			Total
	Among the Lowest	Average	Among the Best	
Poor	16%	13%	11%	40
Average	6%	8%	8%	22
High	5%	6%	27%	38
Total	27	27	46	

Exhibit 11 – IT Infrastructure and competitive position

These results provide strong evidence of the growing importance of sophisticated IT architectures to support customer information flows. However, future performance and firm survival is not based on the sophistication of data collection , storage and delivery devices. Customer data needs to be interpreted correctly in the context of the business and new insights gained that inform the decision making process. Additionally, simply gathering information and gaining insight will have no impact on business performance unless the output of the CRM system are acted upon in the wider business.

Lesson 2

Sophisticated IT infrastructures are necessary but not sufficient condition for customer relationship success



3.2 Skills and Experience Converting Data to Knowledge

One of the primary reasons many organizations fail in implementing new forms of CRM technology is because they simply don't have the requisite skills and experience necessary to use the data effectively. For example, as new forms of data are made available human insight, skill and experience is required to transform static data into knowledge. This knowledge is then used to support decision making such as: whether a customer is more or less important, whether an idea for a new product is attractive or marginal, and so on.

Development of these skills requires deliberate investment in a cycle of learning through knowledge *articulation* and knowledge *codification*. Formalized documentation and procedures are a first step towards the articulation and codification of customer knowledge. Many organizations indicate that there are problems in this area with 37 per cent indicating that little formalized documentation and few procedures are in place. Among the better performers in this area are 28 per cent of organizations that they have in place extensive documentation and procedures that can be shared and used by others in the organisation (see Exhibit 12). No industry specific trends were visible in the data.

ITS NOT EASY TO DEVELOP THE FORMALISED DOCUMENTATION
REQUIRED

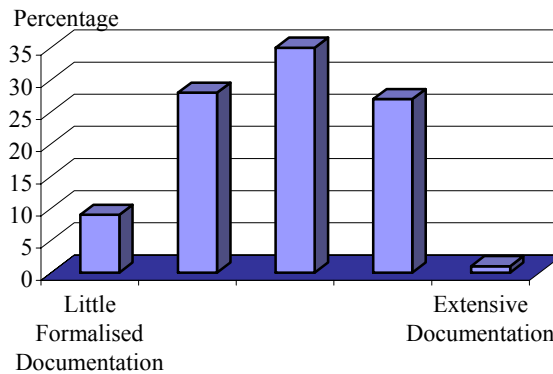


Exhibit 12 – To assist staff in extracting, manipulating, analysing and presenting data in your organisation we have in place little or extensive formalised documentation and few procedures

The complexity of modelling CRM data is significant. However, not all CRM applications address this problem adequately and customers do not always interact with organisations in ways that can be captured in hierarchies that support relational database logic. Because the world is not structured neatly, sophisticated models are required to handle the complex many-to-many relationships that arise from the data in these systems. Once again, our data indicates that the use of sophisticated models is highly variable (see Exhibit 13). Thirty two per cent strongly or very strongly agree that sophisticated models are used in their organisation, while 39 per cent strongly or very strong disagree. The most advanced models were found in selected retail and hotel chains. Perhaps surprisingly, most of the financial institutions are not using sophisticated modelling techniques.

SOPHISTICATED DATA MODELLING TELLS A TALE

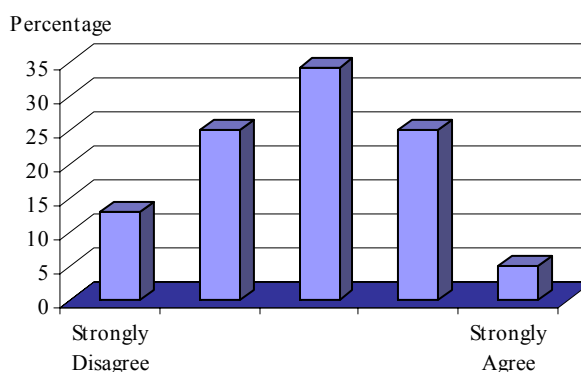


Exhibit 13 – Sophisticated Models Are Frequently Used to Analyse Data

Additional questions in our study identified several common traits among the better performing organisations (i.e. those with above average skills and experience):

- They have in place extensive documentation and procedures to assist staff extract, manipulate, analyse and present customer data

- They utilise sophisticated models to analyse data
- There is a common understanding between managers in customer service and IT units regarding how data can be used to improve customer service
- When extracting data from CRM systems and databases most of the staff involved have extensive knowledge of the business issues facing our firm

When we compare these measures with the competition, the correlation between skills and competitive position in each industry is statistically significant. Thirty five per cent of these companies with strong skills and experience are among the top performers in their industry; while on 5 per cent of companies with high skills are among the lowest performers in their industry (see Exhibit 14).

Lesson 3

Although market data is readily available from innumerable sources, the ability to ask penetrating questions, glean useful insights, and act decisively comes from a skill set that is not evenly distributed between organisations



SKILLS & KNOW-HOW RELATIVE TO COMPETITORS

Skills & Know How	Overall, how does your business compare to the three most profitable companies at managing customer relationships			Total
	Among the Lowest	Average	Among the Best	
Poor	11%	11%	11%	33
Average	3%	8%	8%	19
High	5%	8%	35%	48
	Total	19	27	54

Exhibit 14 – Skill & Know-How Compared to Competition

3.3 Supporting Organisation Structures

Competitive advantage lies not only in people and technology, but also in the architectural alignment that provides complementarity between firm incentives and controls, decision making processes, technologies, skills and routines. Different firms may possess the same basic physical technology and similar skills, but only one of these firms may possess organisational culture and social relations to fully exploit this technology. When we speak of supporting organisational structures we refer to the organisational heirarchy, incentives and controls, revealed competitive strategy and the ease with which technologies can be adjusted to meet new customer demands.

For example, managerial expectations are communicated to employees through various performance measures, incentives and other coordinating mechanisms that emphasise whether customers are viewed as valuable assets to be retained or anonymous transactional targets. These signals act as a litmus test to the effectiveness of firm behaviour both before, during and after each exchange. Our data indicates that 35 per cent of organsiations have in place considerable incentives schemes (pay raise, promotion etc.) based on customer satisfaction and retention. However, incentives are not well developed in a number of companies that responded to our survey; 44 per cent claim that they have no incentive schemes based on measures of product sales and profitability(see Exhibit 15).

DIVERGENT INCENTIVES

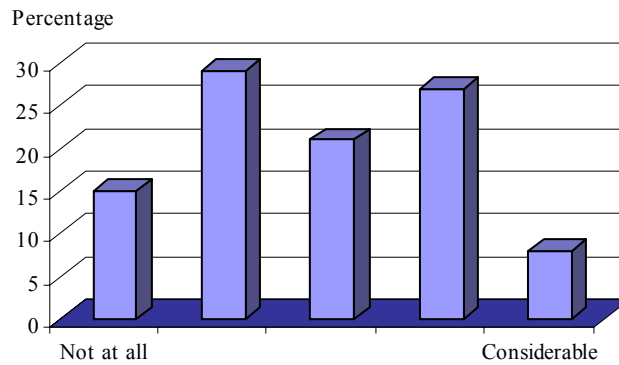


Exhibit 15 – To what extent are employee/management incentives used in your organisation to support customer relationship building

Control systems are used to tell organisations which resources and skills combine to ensure that information and knowledge flows are embedded, activated and given meaning. For example, are satisfaction levels as high as anticipated? Is this segment growing as fast as expected? And so on. Without the information from these systems, there is no basis for learning, correcting mistakes, and adjusting assumptions to better align what the firm is doing with what it should be doing. A key aim of an effective customer relationship control system is to ensure that accountability for the overall quality of the relationship is well defined and understood. As accountability becomes more widely dispersed across organisational stakeholders this task becomes increasingly difficult. The results indicate that 34 per cent agree or strongly agree that accountability for customer relationships is widely dispersed and 42 per cent of companies disagree or strongly disagree.

WIDESPREAD ACCOUNTABILITY

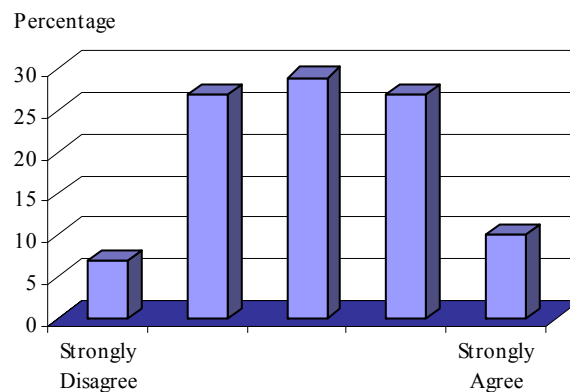


Exhibit 16 – Accountability for Customer Relationships

The ability to align organisational structures with marketing objectives is a key aspect of this capability. The implication is that whenever alignment is high, the company is more likely to be successful. Several questions in our survey were used to determine the extent to which an organisations strategy emphasises the importance of customer relationships. We created a scale to measure organisational architecture that included the importance of: (1) customer retention, (2) importance of customer knowledge to

future success, and (3) whether the firm takes a long term or short term view to customer relationships. Thirty-eight per cent of companies with highly aligned organisational architectures were also among the best performers in their industry (see Exhibit 17).


ORGANISATIONAL ARCHITECTURE RELATIVE TO COMPETITORS

Organisational Architecture	Overall, how does your business compare to the three most profitable companies at managing customer relationships			Total
	Among the Lowest	Average	Among the Best	
Poor	8%	2%	3%	13
Average	3%	11%	11%	25
High	5%	18%	38%	61
	Total	16	31	52

Exhibit 17 – Organisational Architecture Compared to Competition

The trend that emerges from each of the table exhibits in this chapter is that strong organisational capabilities are valuable. Those organisations with sophisticated IT infrastructure, strong skills and customer-focussed architectures were highly likely to be among the best performers. Being not so good on each of these capabilities means average or parity performance. The interpretation of this implies that strategic themes are required to prioritize, orchestrate and direct the collection of customer relationship resources.

Lesson 4
 CRM systems are a combination of activities that require managers to align and orchestrate the disparate parts of the organisation



3.4 CRM Program as a Combination of Capabilities

Whether weak or strong, CRM capabilities cannot be taken in isolation. The reason for this is that each dimension is nested within an intricate organisational system of interrelated and interdependent resources. Therefore it is important to conceptualise a CRM program as a combination of activities requiring managers to concentrate not on one or two capabilities independently but to optimise the overarching CRM program. Failure to do so may conceivably lead to worse customer response and satisfaction than the less sophisticated systems they are meant to replace.

In summary, we suggest that alone, each of the individual capabilities discussed in this chapter is necessary but not sufficient for CRM success. Only when combined, do they capture the true nature of interdependence contained in a customer-relating capability at an enterprise level (see Exhibit 18).

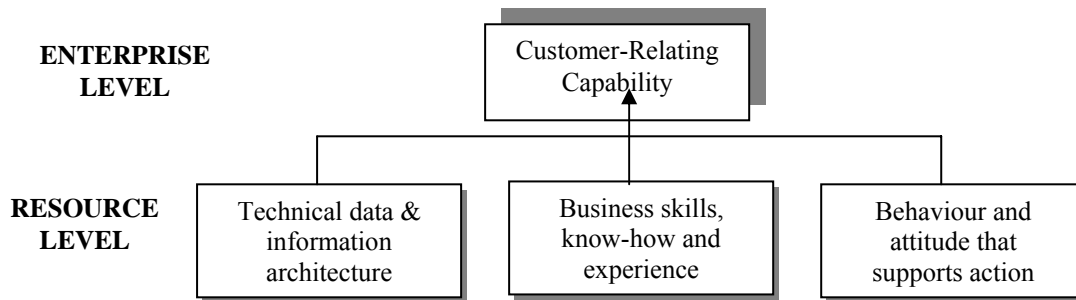


Exhibit 18 – Dimensions of a Customer-Relating Capability

Sometimes the valuable resource is an adroit combination of capabilities, none of which is superior alone, but when combined, makes a better package. Then competitive superiority is due to a weighted average effect—the business does rank first on any asset or capability but is better on average than any of the rivals. We saw evidence of this effect in Exhibits 11, 14 and 17, where a small percentage of companies scored lowly on individual capabilities, yet were still among the better performers in their industry. This weighted average effect is also influenced by:

- (1) The environmental turbulence and fickleness of customers in those markets where the company competes
- (2) The superior clarity and strategic focus that managers bring to the change initiative. This is important to provide the strategic thrust necessary to mobilise resources and create the type of organisational change required, and
- (3) The feasibility of implementing complex system integration and mutually reinforcing capabilities.

Each of these points is discussed in the chapters that follow.

4. Environmental Pressures Driving Investment in CRM

Over time researchers have increasingly come to see business strategies as systems of related choices. These choices are influenced by the multiplicity of connections or interactions that take place within an industry's performance landscape

— Daniel Levinthal, "Adaptation on Rugged Landscapes."
Management Science 43(7), 1997.

Customer relationship success is not simply a matter of investment in superior technology and data modelling capabilities. Success is also dependent upon the market and non-market conditions facing the organisation. These industry level factors determine the 'rules of engagement' that in turn, directly affect customer capabilities and problem solving, supplier capabilities and resource allocation. New opportunities for economic value may arise for many reasons such as customer co-production, customisation opportunities, reduction of links in the value chain, and so on. However, a necessary condition for successful customer relationship investment is that there must be some economic value added from the new arrangement. What prior research shows is that the first mistake made by firms is the assumption that this economic value exists when no such case exists.

4.1 Customer Willingness to Participate in a Relationship

The development of a meaningful exchange relationship depends directly on the ability and motivation of both the customer and the supplier to participate. For example, a company's success at moving a customer from an arm's length arrangement to a deeper level of commitment is contingent upon the customer's time, energy or motivation to form a relationship. Therefore, any understanding of exchange relationships requires that both sides be understood simultaneously.

Our study captured each manager's assessment of their customer base according to four different types of relationships. Each segment type captures a different stage of relationship development from total strangers on one end—that do not require personalisation—to true partners at the other end that are willing to contribute actively to the relationship. We calculated median scores for each segment type based on the number of customers and their revenue contribution. The mean proportion of customers that do not require personalisation is 34 with a mean revenue contribution for this segment of 16 per cent. The yet to be convinced group has a mean of 14 and revenue contribution of 11 per cent. The segment that accepts some personalisation has a mean of 20 and revenue contribution of 19 per cent. Alternatively, the mean proportion of customers that are true partners is 30. Although this segment is quite small it makes an impressive contribution of 57 per cent to company revenues. See Exhibit 17.

PROPORTION OF CUSTOMERS THAT REQUIRE PERSONALISATION

	Proportion of Customers (mean score)	Proportion of Revenue Contribution (mean score)
<i>Strangers</i> Customers that do NOT require personalisation	34	16
<i>Acquaintances</i> Customers that are yet to be convinced that entering a 'relationship' with your firm is beneficial to them	14	11
<i>Friends</i> Customers that accept some personalised contact but don't really want a relationship	20	19
<i>True Partners</i> Customers who believe they will benefit from a closer association with your organisation	30	57

Exhibit 19 – Provide your best estimate of the percentage distribution of customers and revenue for each segment

The data clearly shows that customer circumstances and preferences differ widely. These differences are independent of industry type or firm size. Most importantly, the data shows that revenue contribution increases markedly as customers move from:

- Strangers that do not require personalisation, to
- Acquaintances that have yet to be convinced that entering a 'relationship is beneficial, to
- Friends that accept some personalised contact, to
- True partners that believe they will benefit from a closer association with your organisation

This underscores the need to differentiate marketing programs on the basis of how value is created and to link value creation within each relationship segment to overall value creation for the company. In other words, organisations need to be selective about when and when not to grow a relationship. For example, insurance companies, utilities and casinos categorised many of their customers as strangers that do not want a relationship.

Lesson 5

The type of relationship a customer wants with a supplier can in itself be an effective way of segmenting markets around fundamental customer needs.



4.2 Competitive Pressures

Competitive pressures can arise because of the widespread adoption of CRM within sectors like banking, telecommunications and airlines—requiring later adopters to respond in kind. Alternatively, adoption of such systems can occur in related and complementary environments such as casinos, car rental agencies, hotels and tour operators. In these industries, CRM can potentially change the nature of inter-firm interaction requiring integration of systems and thinking.

Our results indicate that organisations face strong competitive pressures. In 45 per cent of cases managers agree or strongly agree that one frequently hears about new competitive products, models and other strategic initiatives. The implication is that whenever highly competitive pressures characterize your market, customers are more likely to switch because of an abundance of substitutes. CRM systems are also likely to be used heavily to manage organisational operations creating positional advantages that tend to be stronger and enduring. In the case where competitive pressures are low, executives may be led to believe that they can get away with minimal amounts of customer service. In these markets, CRM is unlikely to add value beyond traditional marketing activities.

When we look at the reasons why organisations have invested in CRM, it is clear that respondents believe that as competitive pressures increase, the incentives to match and neutralise another competitor’s relationship advantage increases. Additionally, many managers (59 per cent) strongly agree that the strategies of key competitors are extremely predictable. In 25 per cent of cases this predictability is correlated with a very strong belief that competitive initiatives are also driving CRM investment.

PREDICTABLE STRATEGIES BY COMPETITORS IS DRIVING CRM INVESTMENT

Investment driven by competitive initiatives	Strategies of key competitors in our industry are extremely predictable			Total
	Strongly Disagree	Unsure	Strongly Agree	
Very Weakly	5%	9%	12%	26
Some	8%	9%	22%	39
Very Strongly	2%	8%	25%	35
Total	15	26	59	

Exhibit 20 – Investment in CRM programs is driven by competitive initiatives and strategies of key competitors in our industry are extremely unpredictable

Banking and insurance companies faced stronger competitive pressures than most of the other sectors. Fifty per cent of banks and 40 per cent of insurance companies indicated that they were under strong to very strong competitive pressure to invest in customer relationships. Respondents from retail and airlines were surprisingly less concerned with competitive pressures. When compared to firm size, our data did not indicate any significant difference between small firms and large organisations.

4.3 Market Turbulence

A natural consequence of market growth—and the diffusion of innovation within a product life cycle—is that customer demand becomes more heterogeneous over time. In response to this heterogeneity, firms constantly innovate, putting forward alternative systems, services processes and products to create value for and to attract new customers. Turbulent, fast changing markets appear to dominate our study with 40 per cent of managers indicating that they agree or strongly agree that customer requirements are changing continually. Only 25 per cent disagree or strongly disagree that products and services are constantly changing in their markets.

FICKLE CUSTOMERS CREATE MANY CHALLENGES

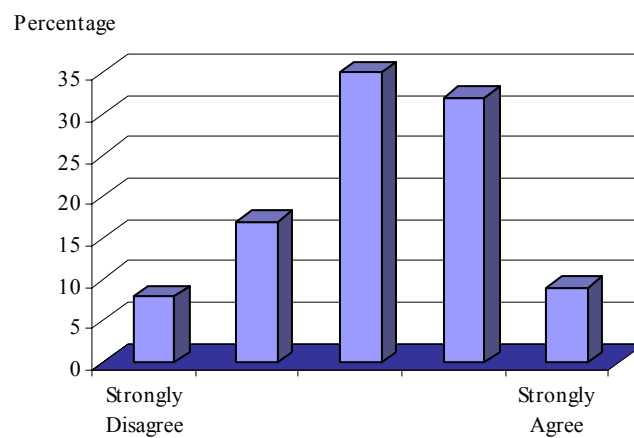


Exhibit 21 – Customer requirements for the products and/or services sold in our industry are changing continually

Returns to customer relationship building activities are likely when fast changing markets demand different assets and capabilities than those required in more stable environments. Advantages are short lived as competitive pressures quickly undermine the value derived from product differentiation. The ability to stay on top of customer trends and to respond quickly to changing markets is critical for superior performance in such environments.

This point is visible in our study as market pressures quite clearly provide the strongest drivers of CRM adoption. Seventy eight per cent of organisations consider themselves under considerable pressure to deliver high levels of customer service. These companies indicated that their decision to invest in CRM programs was a direct reflection of industry forces that demand high levels of customer service. See Exhibit 22.

MAIN DRIVER IS CUSTOMER SERVICE

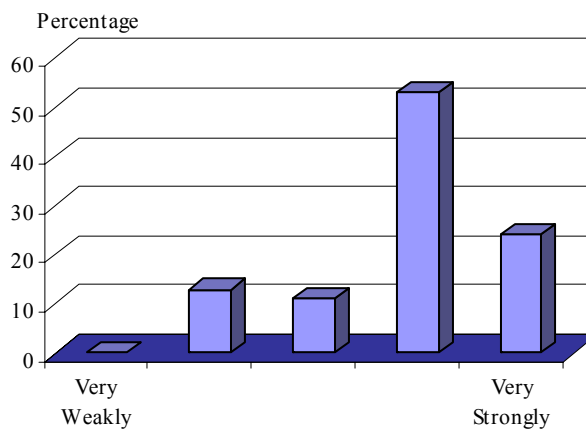


Exhibit 22 – Industry Pressures to Deliver High Levels of Customer Service

The 22 per cent of companies suggesting that market pressure is a weak to very weak reflection of their decision to invest in CRM appear to operate in stable environments. This suggests that organisations facing relatively stable environments prefer to exploit existing knowledge and capabilities rather than explore new possibilities. When the levels of customer service demanded by the market are low we also see more involvement by privacy activists and not surprisingly less demand for highly integrated products that span different business units.

4.4 Technological Pressures

Technological advances such as the Internet, relational databases and CRM software create enormous opportunities for firms and their customers. A sizable 83 per cent of managers strongly agreed that technological changes provide big opportunities to deliver new levels of service to customers in their industry. These same executives also have high hopes indicating that the Internet and related technologies will make it very easy to personalise/tailor their product or service offerings to customers (see Exhibit 23). Forty five per cent of managers strongly disagreed that advances in the use of database technologies by competitors was a key reason for investment in customer relationship programs. While, 40 per cent believed that advances in the Internet and networking technologies strongly reflected their decision to invest in CRM programs. This suggests that the drivers for new customer relationship programs are new opportunities for low cost interconnection between the customer and the various touch points in the firm.

NEW TECHNOLOGY = NEW OPPORTUNITIES

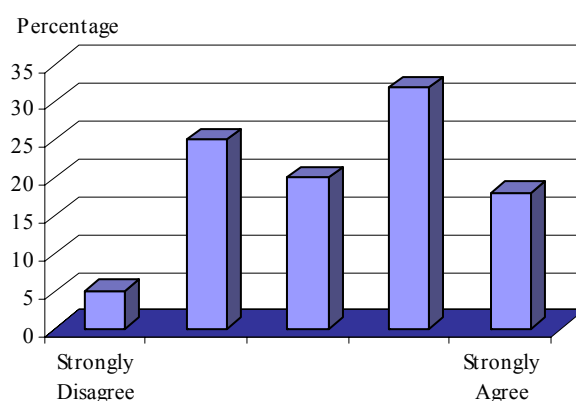


Exhibit 23 – The Internet and related technologies will make it very easy to personalise/tailor product or service offerings in their industry

Technological pressures have been felt most in banking, insurance, telecommunications and utility sectors. This point is also evidenced in shareholder pressure where 36 per cent of managers strongly agree that investment in CRM is a direct reflection of shareholder beliefs that technologically sophisticated companies are more favourable in comparison with technologically naïve organisations.

4.5 Customer Privacy

In markets where the customer has little information on the company and/or the company has insufficient information and understanding about the customer, transaction marketing is likely to dominate. This is because consumers will often use their power to hinder information exchange. This environment will encourage activists with a view that companies are not to be trusted. Under these circumstances individuals will be reluctant to become voluntary members of CRM programs, and will only want transactional exchanges. This will lead to higher costs and lower levels of communication between the customer and company, reducing the efficiency of CRM. These activists will use legal regulation to protect themselves and exploit the new data protection software and technology to their own advantage.

Some 50 per cent of companies strongly agreed with the statement that privacy activists are extremely active in their industry. A relatively small 24 per cent indicated that privacy activists are not very active in their industry.

CONCERNS WITH CONSUMER PRIVACY

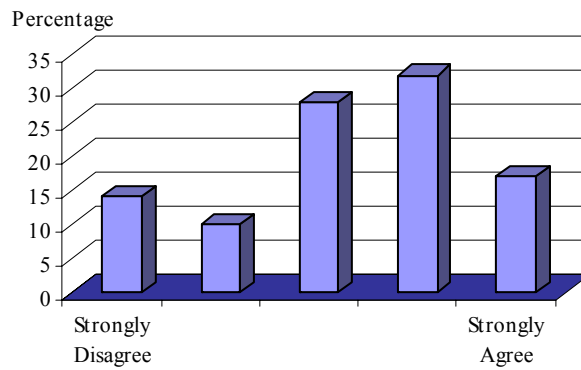


Exhibit 24 – Privacy activists are extremely active in our industry

In the banking sector 56 per cent of managers strongly agreed that privacy activists were extremely active. This compares with retail where a 55 per cent of managers strongly disagreed that privacy activists were extremely active in their industry.

Understanding the dynamic competitive environment is a necessary step to effectively allocate the right type of marketing program to the right type of customer. This chapter has shown that the type of relationship a customer wants with a supplier and the strength of competitive and market pressures facing the firm are strong indicators of CRM program success.

5. The Implementation of Complex Organisational Change

Change sticks when it becomes “the way we do things around here.” Until new behaviours are rooted in social norms and shared values, they are only temporary and a waste of time and energy.

– John Kotter, “Leading Change: Why Transformational Efforts Fail”
Harvard Business Review, 73(2), 1995

In order to execute a CRM strategy successfully, especially in uncertain environments such as CRM, firms need to manage change in people, systems and structures. This requires an appreciation of the forces that influence the process of strategy implementation. This is made all the more difficult by the fact that CRM is unlike other reengineering change programs that have preceded it. The complexity involved in a CRM program creates enormous challenges for staff expected to integrate disparate customer databases and qualitative and quantitative approach to managing customers. Additionally, the diversity in a CRM program creates accountability issues and complicates the challenge of persuading employees to embrace the behavioural change required. Consider for a moment the stakeholders affected by a CRM initiative. They include frontline sales and service providers, call centre representatives, business analysts, IT professionals and a broad array of managers located in diverse positions throughout the organisation (just to name a few). Any of these stakeholders can break a CRM program, but none individually can make it successful. When the responsibility for different aspects of a solution rests in different places, it’s often hard to muster the organisational resolve to pull in the right people, unplug the bottlenecks and make effective decisions.

Firms that lack experience working with these perennial organisational challenges all too frequently fail to appreciate the challenges they impose. In the rush to fix the technology and business alignment issues, managers tend to overlook what is feasible and focus instead on what is desirable. The impact of this has been played out in several abandoned IT projects such as: Westpac’s CS 90 project that lost A\$150m and the London Stock Exchange Taurus project that was dumped after an £80m investment (Drummond 1999).

Mistakes Are Going To Happen, And You Can Bank On It
02 May 1998, Australian Financial Review

TAURUS - JOBS HIT BY RIPPLE EFFECT.
18 March 1993, Computer Weekly

5.1 Direct System Costs of Implementation

CRM systems are typically quite expensive with some reports suggesting that the median price for a CRM project exceeds US\$1 million (Yu, 2001). Many organisations in our study were rightly spooked by these costs:

- 55 per cent indicated that the cost of network infrastructure and hardware is a large constraint
- 49 per cent indicated that the cost of CRM and sales force automation software is a large constraint

The impact of direct costs of implementation is clearly a significant factor but CRM programs also incur additional costs associated with call centre infrastructure and IT staff required to maintain these systems. We combine these costs into an overall measure that includes costs of hardware, software, infrastructure and maintenance (see Exhibit 25). Less than 10 per cent of respondents believed that when combined, these costs are a small deterrent to implementation. Forty per cent of companies see these costs as a large or very large factor inhibiting CRM deployment.

When we examine the impact of cost constraints on each industry sector the results are not surprising. Managers in the hotel and banking sectors were more likely to be concerned with the direct costs of IT. Sixty six per cent of hotels and casinos viewed direct costs as a large or very large constraint, while 58 per cent of those in banking expressed the same level of concern. Managers from the retail sector were less concerned with direct costs, with 66 per cent indicating that costs were a small constraint.

CRM PROGRAMS ARE NOT CHEAP

	The cost of hardware, software and network infrastructure		
	Strongly disagree	Unsure	Strongly Agree
Banking	8%	33%	58%
Insurance	0%	50%	50%
Telecommunications	25%	62%	12%
Airlines	40%	60%	0%
Hotels/Tourism	0%	33%	66%
Utilities	50%	0%	50%
Retail	66%	22%	12%
Other	0%	92%	8%

Exhibit 25 – In your business unit, to what extent does the following constrain your organisation’s ability to deploy CRM

5.2 Indirect Costs of Implementation

The full impact of cost constraints is a function of not only direct costs, but indirect costs as well. There are three areas where these indirect costs arise, the difficulty acquiring skilled workers, the time needed to effectively codify customer data and the impact that system failure may have on brand equity.

- (1) *Difficulty acquiring skilled staff* – the cost and availability of skilled staff to manage complex IT related projects has frequently been the cause of concern for many organisations. However, the companies surveyed here appear less concerned, with 60 per cent believing that the shortage in acquiring skilled managers to strategically manage internal CRM developments is a small constraint.
- (2) *Effort required to codify customer data* – the time needed to recode customer data is another matter. Relational databases are not designed to deal with unstructured data and 58 per cent of respondents believed that the time needed

to effectively code customer data is a big consideration. This is completely independent of industry or firm size.

- (3) *Risk of System Failure* – the importance of system failure on brand reputation and equity did not appear to create a barrier to adoption with 54 per cent claiming this is a small impediment to implementation.

“Nothing is ever smooth. The biggest problem we have in the bank is implementing, you know, just getting the people to develop the systems is basically a pain in the backside. It just takes so long and we have been trying to get a new net system going for this all financial services type offering. We have gone around in circles the last two months, we still haven’t got there and I think we are pretty frustrated by it all.”
Director, Financial Services

5.3 Beliefs Held by Managers

When new, infant technological opportunities such as CRM arise, even managers in competing firms in the same market or managers within the same firm can hold very different beliefs about the opportunities the technology will create and its likely impact on performance. For example, some managers may believe that CRM will *enhance* the effectiveness of the organisation or its legitimacy in the market and still others will believe it will have little or *no effect* on current performance. The hallmark of all ideas is that someone must see the opportunity the idea presents; CRM is no different

Characterising the beliefs of managers is a difficult exercise. However, we can talk about two extremes that highlight how beliefs influence outcomes. At one extreme is the tendency to cater to risk aversion. If complex reengineering programs such as CRM are to succeed they require managers who hold strong beliefs regarding the value of CRM. We see evidence of this commitment in our managers where 67 per cent strongly agree that CRM programs will create new value for their major customers. A smaller, although still significant 35 per cent strongly believe that CRM is a major breakthrough that will have a revolutionary strategic impact on your industry in the next two years (see Exhibit 26).

WHAT DO MANAGERS BELIEVE?

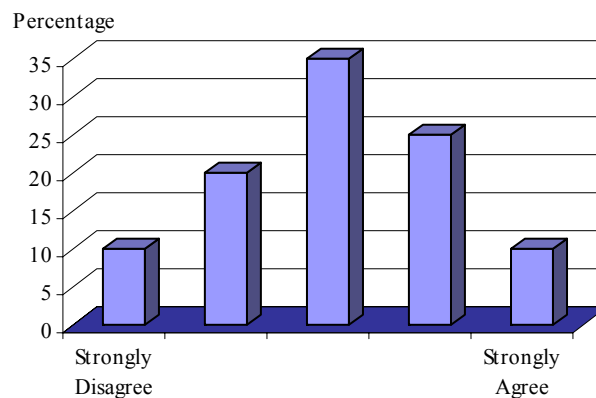


Exhibit 26 – CRM is a major breakthrough that will have a revolutionary strategic impact on your industry in the next two years

The variance in this data is strongly related to the impact that technological developments such as the Internet and e-business have had on the industries of the companies considered. Many managers are unwilling to “bet the firm” and espouse more modest ambitions with 31 per cent strongly disagreeing that CRM is a major breakthrough for their industry. This division was particularly visible in banking where 39 per cent strongly agreed with the statement and 34 per cent strongly disagreed. Such uncertainty leads to fragmented and contradictory signals and incentives. The investment ends up being insufficient for real success and the commitment to changing organisational processes, training and reward systems that CRM demands can be erratic.

Insurance Industry

A McKinsey study on the insurance industry found that more than one-third of the CRM modules developed during the past three years—in areas such as marketing campaign management, data analysis and opportunity management—remain dormant. It is speculated that this predicament arose because managers often hedge their bets, and are, therefore, unlikely to infuse the organisation with the necessary energy to modify the structures and metrics for evaluating frontline (customer facing) behaviour. Faced with little change in the incentives for performance, those interfacing with the customer understandably manage what they know, historically works and is rewarded, leading to the predictable result that these systems are used little or not at all.

At the other extreme is managerial overoptimism. Managers can, at times, succumb to over optimism when it comes to their company’s ability to manage change successfully. Although this overoptimism can be traced to many sources, one of the most powerful is the tendency by individuals to exaggerate their own talent; to believe that they are above average. Consider the results of a survey conducted by the U.S. College Board in the 1970s involving 1 million students that has recently been republished in a 2003 edition of the *Harvard Business Review*. When students were asked to rate themselves in comparison to their peers, 70 per cent of students said they were above average in leadership ability. For athletic prowess, 60 per cent saw themselves above the median, 6 per cent below. When assessing their ability to get along with others, 25 per cent considered themselves to be in the top 1 per cent.

In a similar manner, the respondents in this study display evidence of over optimism. Thirty four per cent of managers indicated that they were either more positive or far more positive than their competitors, while 42 per cent believed that they held similar beliefs to their competitors (see Exhibit 27).

DANGERS OF OVEROPTIMISM

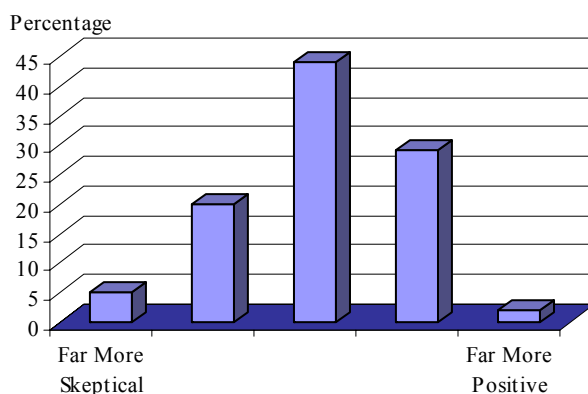


Exhibit 27 – Overoptimism Compared to Competitors

Although such optimism is not necessarily bad, particularly when radical change is required, the trick is to balance optimism with an ability to generate realistic assessments of whether this type of change is feasible.

“Probably the biggest impediment to e-intelligence so far has been serious doubts by the Managing Director in particular and other senior managers about the value of e-business. Some of them think this is really a flash in the pan, they spend a lot of money then find out it’s just a passing phase and then why did we bother to spend all that money and waste all that time with it.”
 Managing Director, Retail Sector

5.4 Cultural Change

In most cases, introducing CRM requires a major cultural change to the sales, service or marketing functions of companies. Integrating legacy systems with new customer relationship needs is a tricky activity. Surprisingly, many executives indicated that their organisations were highly proficient at integrating legacy systems. Fifty per cent strongly agreed that their companies were proficient in this area, and only 26 per cent strongly disagreed with the statement.

ABILITY TO INTEGRATE IS A PREREQUISITE FOR CRM

My organisation is well prepared to implement CRM	We are very proficient at integrating legacy systems with new customer needs			Total
	Strongly Disagree	Neither	Strong agree	
Strongly disagree	19%	11%	8%	38
Neither	20%	15%	1%	36
Strong agree	5%	8%	15%	28
Total	44	34	24	

Exhibit 28 – My organisation is well prepared to implement CRM and we are very proficient at integrating legacy systems with new customer/ partner relationship needs

Most executives know that new CRM applications change how people work. The greater the organisational and cultural change the less likely the company is to achieve their return on investment goals when CRM projects. Success in such a climate demands the need for executive support, user buy-in, ongoing communication with users and extensive training. There is a need to involve business users early and let them drive the functional requirements that include on-screen design and navigation. Getting the systems right so that the salespeople will be eager to use it appears to be a challenge for many of the companies studied. Only 26 per cent believed that they were well prepared for implementation challenge and 38 per cent strongly disagreed that they were prepared for CRM (see Exhibit 29).

HOW WELL PREPARED ARE YOU FOR CRM?

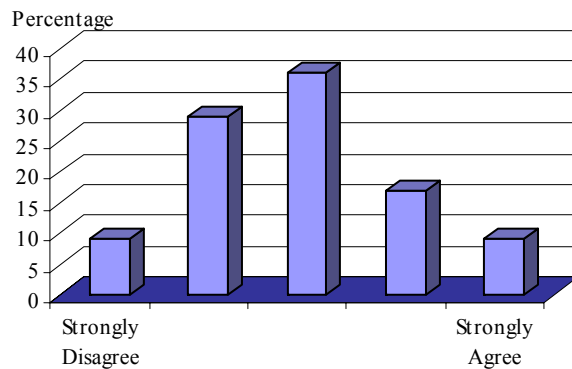


Exhibit 29 – My organisation is well prepared to implement a fully integrated CRM system

The main insight emerging from the discussion above is that before any new CRM programs can be developed it must first be ‘doable’. Doable means

“The end-users of CRM tend to be special animals. The big thing is that since marketing, sales and customer-service personnel work on commission time lost adjusting to a hard-to-use system is money lost”

Barton Goldenberg, president of ISM Inc., a CRM advisory firm in Bethesda Md

either that it is either not in conflict with the operational or strategic constraints or that sufficient strategic resources are in place to overcome the operational constraints.

Direct and indirect costs were found to be strong operational constraints and these no doubt combine to form inertial tendencies that restrict new initiatives in many organisations. Add to this the reality that old skills and knowledge embedded in organizational routines and procedures are not easily changed and we see many implementation difficulties arising for firms in their attempts to exploit CRM.

Lesson 6

In the rush to fix the technology and business alignment issues, managers tend to overlook what is feasible and focus instead on what is desirable.

6. Positioning for Competitive Success

The essence of competitive advantage is a positioning theme that sets a business apart from its rivals in ways that are meaningful to the target customer.

— George S. Day, *Market Driven Strategy: Processes For Creating Value*
The Free Press (1994)

As we have shown in previous chapters, CRM projects can easily cost several million dollars, not counting the time, human resources and organisational ‘angst’ involved in the process itself. Any proposal for funding an initiative to build customer relationships must clearly demonstrate how the initiative will affect key measures that are important to the company financially. Quantifying the right performance measures will not only increase the chances of getting a project approved but also pave the way to improve organisational performance. Determining the appropriate measurements to be used, however, is a particularly elusive task.

Traditional measures of success, such as quarterly product sales, cost of goods sold, the number of new customers acquired, and earnings before interest, taxes or depreciation are tried and true, but are also problematic for a variety of reasons. First, they don’t measure those factors that create future value such as customer responsiveness, quality service and speed of response. Second, they miss the importance of innovation and the ability to learn. Lastly, they don’t motivate long-term behaviour. Over the past two decades a great deal of attention has been devoted to the development of a more balanced set of measures. One approach suggested in the academic literature is to measure customer orientation on the basis of *reactive* and *proactive* measures.

6.1 Reactive Customer Orientation

As the title suggests a reactive orientation is focussed on the expressed needs of customers. The assumption is that the better the company is at reacting to these expressed needs the more likely it is to retain customers and outperform its competitors. Compared to their competition 61 per cent of companies investigated indicated that their company is among the most responsive at meeting individual needs (see Exhibit 30). Clearly these companies treat customer interaction very seriously as indicated by a number of other performance measures:

- 53 per cent believe they are the easiest for customers to do business with,
- 39 per cent believe they are the best at sharing customer experiences across the business,
- 77 per cent consider themselves among the most trusted of companies, and
- 47 per cent feel they are among the best at developing systems that allow customers to help themselves.

RESPONSIVE TO INDIVIDUAL CUSTOMER NEEDS

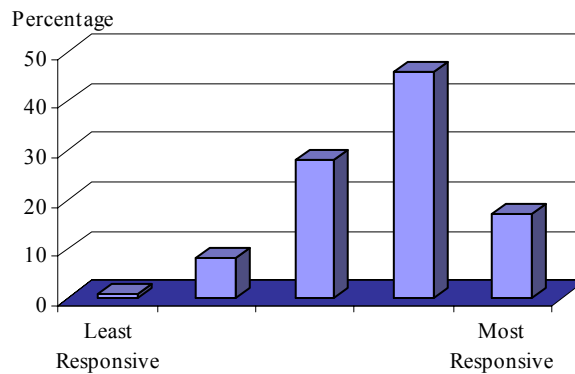


Exhibit 30 – Taking the perspective of your most profitable customer segment, how would they compare your business to your three nearest competitors?

6.2 Proactive Customer Orientation

Being reactive to the customer is one thing, but it is also important that companies are proactive in their desire to satisfy a customer’s latent needs. This approach is based on intelligence gathering and is therefore focused on acquiring information about customer behaviour in an attempt to identify latent customer needs and competitor capabilities and strategies. In our study, 40 per cent of companies believed that they are among the best at discovering unarticulated (latent) customer needs (see Exhibit 31). This proactive orientation was confirmed by a number of additional measures:

- 45 per cent considered themselves among the best at predicting new market developments,
- 47 per cent thought they were among the best at brainstorming how customers use new products and services,
- 48 per cent view themselves as among the best at working closely with lead users, and
- 52 per cent believed they were among the best at driving business objectives by customer satisfaction.

PROACTIVE ATTEMPTS TO DISCOVER LATENT CUSTOMER NEEDS

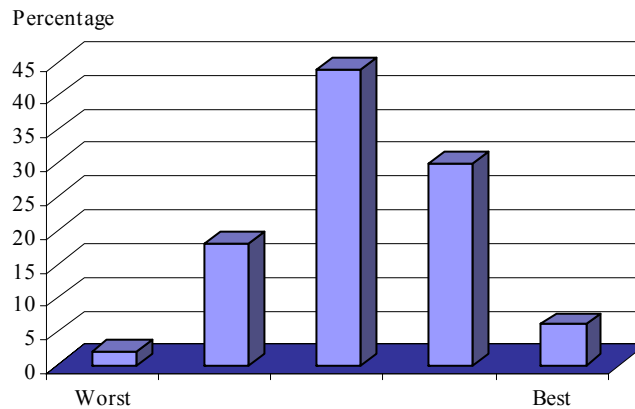


Exhibit 31 – Taking the perspective of your most profitable customer segment, how would they compare your business to your three nearest competitors?

There is a strong argument to make that a reactive or proactive positional advantage will lead to improved return on investment, increased sales, etc. When we compared these two measures only proactive orientations were statistically related to performance. Reactive measures did not have a significant effect on performance.

Lesson 7

Being response to customer needs is no longer sufficient. Positioning for success requires a proactive approach that is capable of identifying latent customer needs and competitive strategies.



Despite these promising results, there is still room for caution regarding the accuracy of these findings. While 30 per cent of respondents indicated that they were extremely confident that their answers were correct, approximately 68 per cent indicated that they were only mildly confident, with a very small 1 per cent indicating that they were not confident at all. The reasons for this are that many companies do not measure these aspects of performance formally.

6.3 Additional Measures of Customer Orientation

Other popular marketing performance metrics seek to capture the duration of a customer’s relationship with the firm by measuring customer retention rate and annual rate of customer defections. In general, the companies in our study experiences quite low levels of customer defection. In 39 per cent of cases, defection rates were between 0-4 per cent, in 17 per cent of cases they were between 5-9 per cent and 19 per cent at 10-14 per cent. Most telecommunications companies reported defection rates of between 5 and 15 per cent. Only 3 per cent of companies experienced defection rate higher than 30 per cent. Not surprisingly these were largely hotel and retail companies that faced strong to very strong competitive pressures.

CUSTOMER DEFECTION RATES

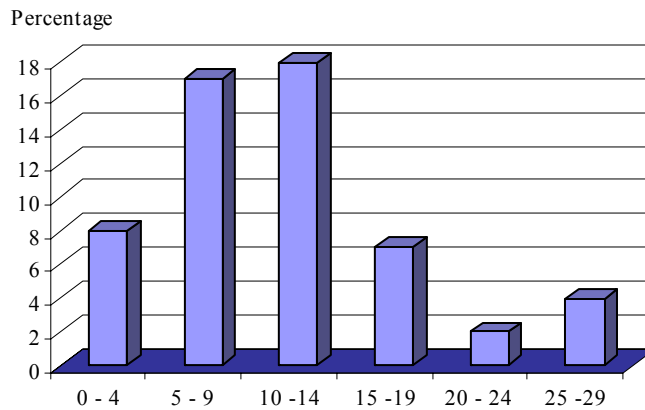


Exhibit 32 – What is the annual rate of customer defections to your competitors?

It is important to know not only the rate of defection but also how this rate has changed over the past three years. The data indicates that some Australian companies face considerable pressures with 5 per cent indicating that they have experienced a considerable increase in the rate of defections, 33 per cent report a modest increase and 35 per cent indicate no change at all (see Exhibit 33).

CHANGE IN CUSTOMER DEFECTION RATES

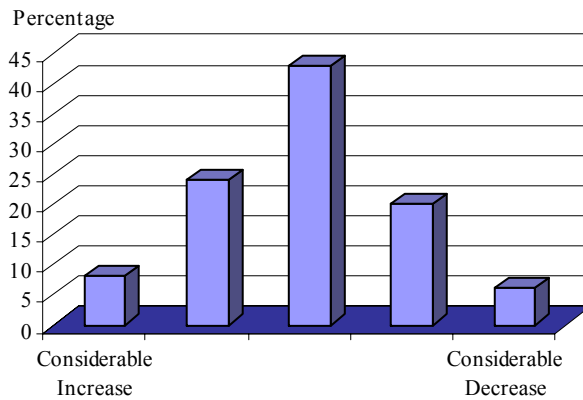


Exhibit 33 – How has this rate of defections changed in the past three years

What is important in this climate is not only the rate of defections, as companies in telecommunications, hotels and retail should expect that many of their customers would switch between competitors. Instead, what is relevant is the share of wallet or degree of a customer’s total product usage that is controlled by your company. Here we see that 8 per cent of companies report a considerable increase and 55 per cent report a modest increase.

SHARE OF WALLET

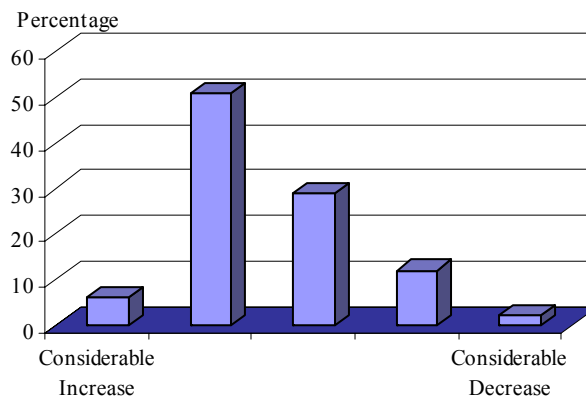


Exhibit 34 – With regards to your most valuable customers, state how your ‘share of wallet’ (degree of a customer’s total product usage that is controlled by your organisation) has changed in the past three years

What this study indicates is that it is the amount of money that a customer spends with a company that drives lifetime value to the company—regardless of how long they have been or are likely to be a customer of the company. For example, 50 percent of companies that reported a modest or considerable increase were either average or better than average performers in their industry. The implications for decision making are that managers should focus on revenue enhancement as opposed to customer retention. One way to cross check this is to look at those firms in our survey that have devoted a very large part of their strategic orientation to customer loyalty programs. Although these programs keep their customers ‘on the books’ for an extended period of time, there is no evidence to suggest that they are enhancing profitability relative to competitors. In fact our data indicates an even performance split for those companies with a heavy emphasis on loyalty programs.

Lesson 8

Different stages of relationship development represent different revenue and cost profiles. This implies that different customers are managed in different ways.



7. A Final Wrap

Our study reveals that CRM programs are becoming commonplace in medium to large sized Australian companies. Within the next two years three quarters of the companies in our survey believe that they will have in place advanced CRM programs. The results presented are very much ‘warts-and-all’ showing both the positive and negative aspects of organisational attempts to manage customer relationships. Without under-emphasising the complexity of the problem we can summarise our results succinctly as follows:

- While many CRM strategies are based on the theory of increasing customer retention through improved satisfaction, it is a myth that all customers have the time, motivation and energy to form information-intensive ‘personal’ relationships.
 - ❑ Segmenting markets around fundamental customer needs, can in itself, be an effective starting point for performance improvement
 - ❑ This is not easy as most organisations work with customers that are at different relationship stages and these stages are dynamically changing, and
 - ❑ To deal with this problem, the best organisations employ a **balanced approach** where they trade-off the benefits and costs associated with customer intimacy, operational excellence, data analytics and loyalty programs.
- To ensure CRM program success, organisations need to develop a high level customer-relating capability. The three constituent parts of a customer relating capability are:
 - ❑ A flexible IT infrastructure that provides a full picture of the customer histories, purchasing activity and problems
 - ❑ The skill to convert market data into knowledge of the customer (management of information collection, organisation and use)
 - ❑ Supporting organisational structures (the degree to which the behaviours and values of staff are aligned with the new customer orientation)
 - ALONE, each of these capabilities is insufficient for success. Therefore, managers should be wary of concentrating on one or two aspects independently in an effort to gain control over what can be a large-scale project.
- The **main constraints** limiting CRM programs are organisational first, financial second and technological third
 - ❑ Organisational constraints are not just political and cultural issues, but also the way CRM programs can disturb the delicately balanced chain of customer knowledge related activities. The implications of this are that managers need to sell CRM programs early and sell them often to ensure participation by the necessary stakeholders
 - ❑ Financial constraints loom large and a systematic analysis of how you do things now and the organisational transformation required to support relationship programs is required

- Technological constraints are not about what software solutions are available but revolve around the ability to get systems to talk to one another and integrating disparate and legacy systems in an organisationally friendly manner
- Firms operate CRM programs with **varying degrees of success** with many experiencing outstanding success stories and failures. Some examples of these include:

“Direct customer feedback has proven to be an excellent program that was not originally requested” (CFO – Financial Services)

“The implementation of a new frequent flyer proposition to market that is fully supported by our CRM system has strengthened our internal processes and improved our competitive position considerably” (Airline Sales Director)

“Success has been the use of a new data warehouse for developing customer retention strategies, failure has been the continual failure to use the CRM system by Account Managers” (CIO – Financial Services)

“We have experienced too many failures to list. Availability of skilled resources in Australia is a major problem” (CRM Director – Telecommunications)

“Failure is due to the use of the technology, not the technology per se”(CEO – Financial Services)

The final insight we offer is that CRM is about managing different types of customer relationships. In this study we looked at four different types of relationship: strangers, acquaintances, friends and true partners. As these relationships types evolve over time they create very different demands on CRM programs and subsequent company value and profitability (see Exhibit 35).

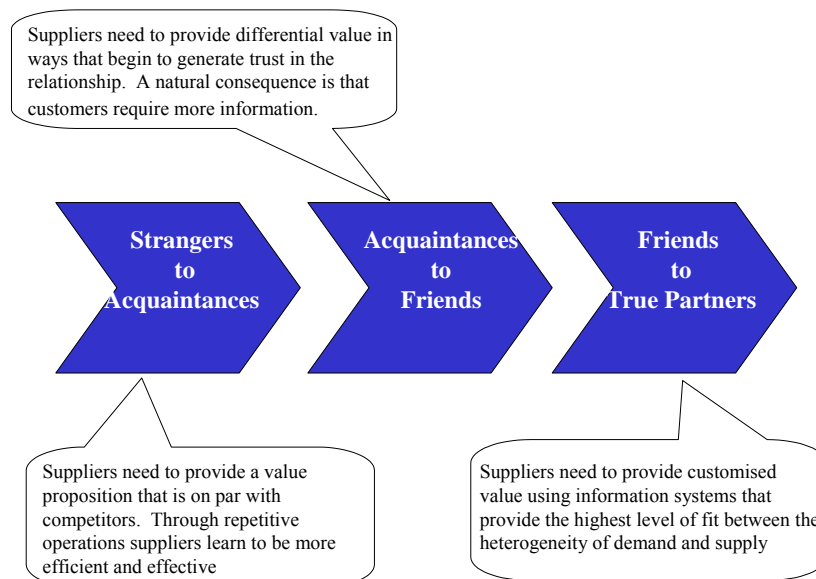


Exhibit 35 – Evolving Relationship Types

- **Strangers to acquaintances** – strangers are customers that have not yet entered the market or are customers of competing suppliers and hence do not require personalisation. As soon as there is a business transaction, a customer moves to a new level of awareness. At this point the supplier and customer become acquaintances. In many cases, these customers are still yet to be convinced that entering into a ‘relationship’ will be beneficial. In this case, suppliers need only provide a value proposition to a customer that is on par with competitors, or parity value. By listening to their customers and delivering on the basics, companies will gain experience and learn to improve production efficiencies. As you become better at providing the routine benefits that customers expect to get when they make a purchase you begin to gain a positional advantage over those with less experience and volume.
- **Acquaintances to friends** – by directing resources towards ensuring that all communication between your firm and your customers is relevant. You show customers that you remember them and that their business matters to you. As the customer relationship evolves from acquaintance to friend, suppliers are increasingly required to move from delivering value on par with the competition to creating differential value. This requires development of trust in the relationship through provision of diversified products and services. A natural consequence is that customers require more information, thereby placing greater demands on the company’s technology and the staff responsible for modelling customer data.
- **Friends to true partners** – ultimately trust breeds’ greater commitment that results in a shift from short-term exchanges to long-term relationships. Customised information and products are required for true partners. This implies that appropriate organisational structures are in place to ensure that you treat your best customers well. This implies that staff behaviours and values are tightly aligned with customer needs.

From a resource allocation perspective, organisations need to ensure that the delivery of parity value, differential value, and customised value is tightly aligned with customer motivation to remain as strangers, acquaintances, friends or true partners. Carte blanche approaches that seek to establish relationships with all your customers are unlikely to be profitable. In our study, the firms that were most comfortable with customer relationship programs were firms that knew what they wanted to get from their data systems and had a realistic appreciation for the organisational constraints that exist. In other words, these firms had a clear, unconstrained strategy aimed at identifying customer segments and extracting the most value from their economic interactions with different types of customers. It is in this area, as many organisations would agree, that considerable room for improvement exists. In our next report, we aim to provide companies with more detailed measurement instruments and classifications schemes that enable them to identify and sort different customers according to their value. For those wanting more detail on this a list of selected readings has been included. Should you wish to be involved in further research in this area, then please contact the authors of this report.

Further Readings For Those Who Want More

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