Yale SCHOOL OF MANAGEMENT

Competitive Advantage through Customer Relationship Management Strategy

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Three ways to be a market-leader

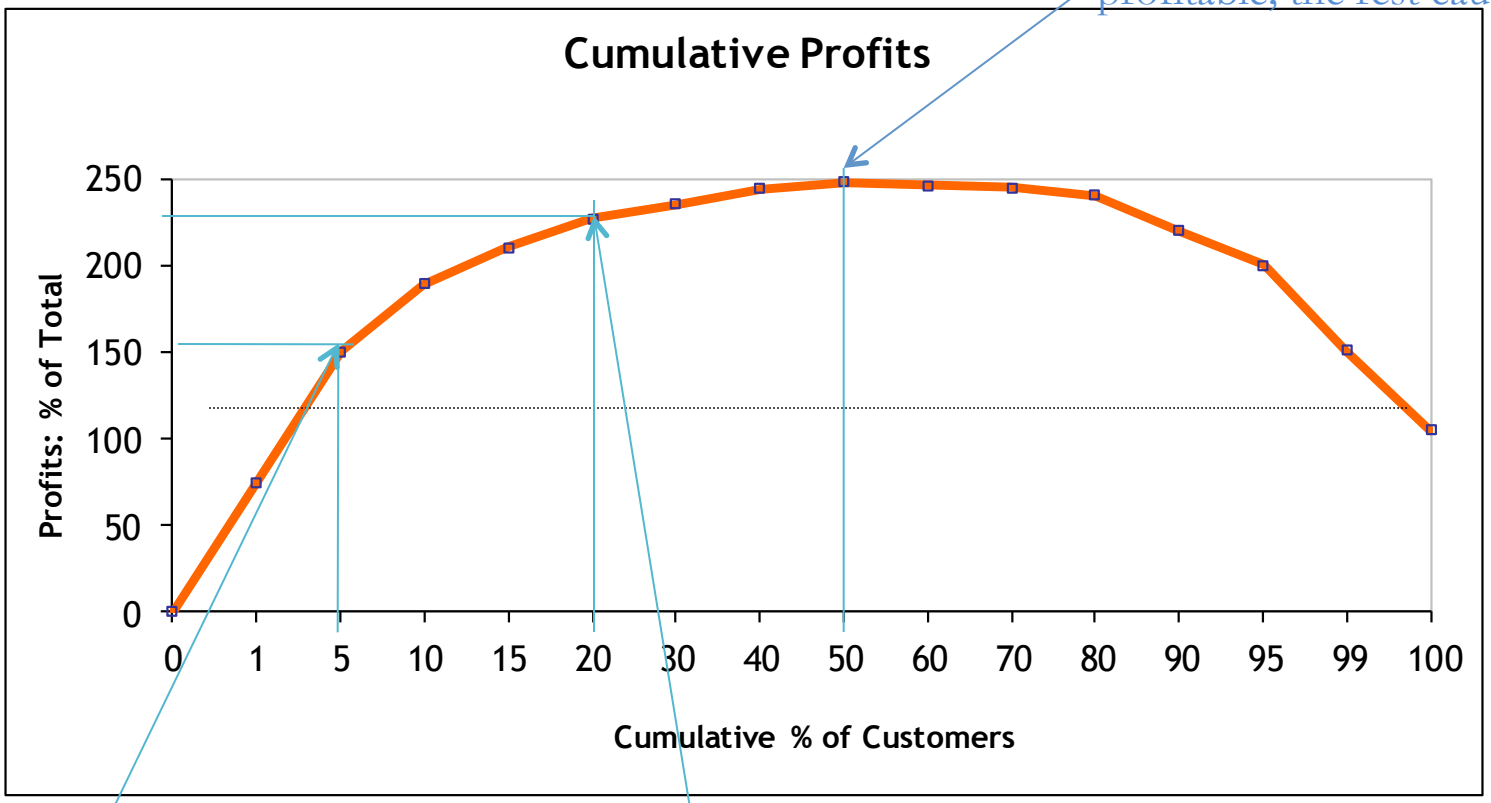
- Innovation of product
- Cost-leader
- **Relationship or customer intimacy**

The basic premise of CRM

"Customer relationship management (CRM) is a business strategy to identify, attract, convert and reward the most profitable customers to induce recurring exchanges with the business."

- CRM in a nutshell: from your customers base, identify Angels <u>and</u> Devils, and do something special for them

Whale curve: not all customers are profitable…



Only top 50% of customers are profitable; the rest cause losses

Top 5% of customers give 150% of profits

225% of profits from top 20% of customers

* Source: Shin et al. (Management Science 2013)

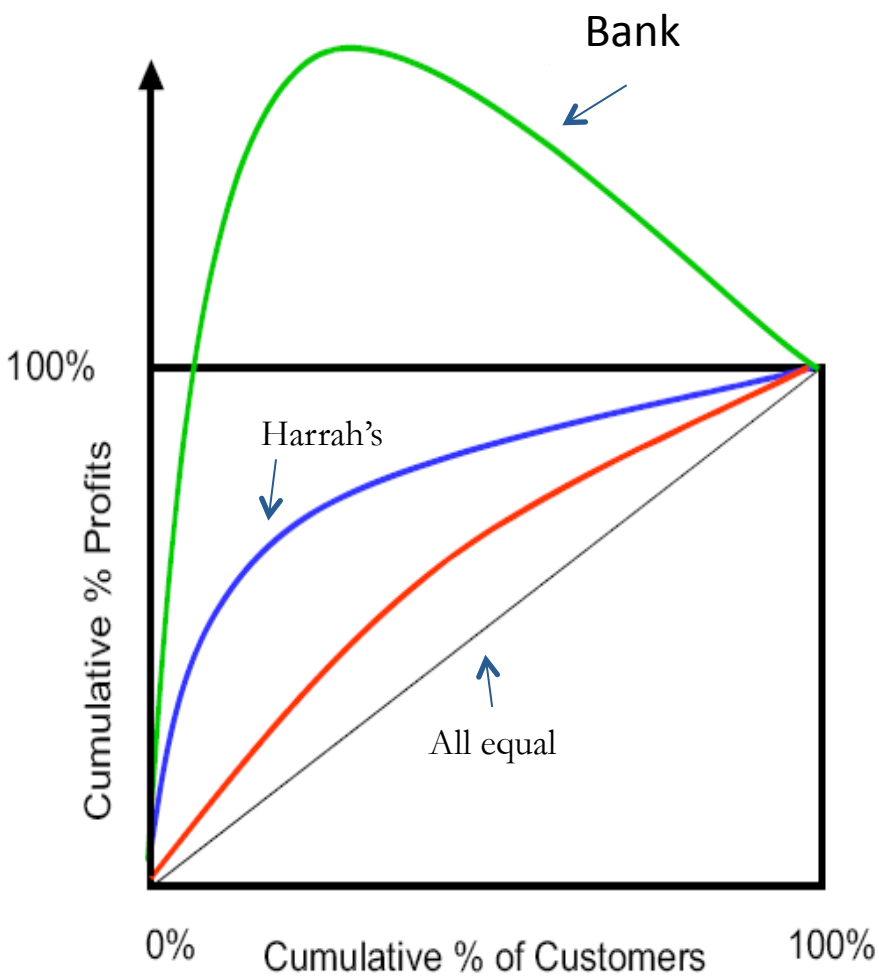
Customer costs may exceed revenue!

- B2B markets, top 20% generate 150-300% of total profits, while the middle 70% break even, and the bottom 10% reduce 50-200% of profits (Kaplan and Narayanan 2001)

- B2C markets, firms increasingly augment their core product or service with additional services as part of purchase package at a given price.
  - A bank customer (using a teller $1.34 vs. ATM $0.16: Gupta and Herman 2012)
  - A retailer customer (abusing liberal return policy: Strauss 2007)
  - A hotel guest (pool, spa, tennis courts)
  - A Google/Yahoo email customer
  - Netflix

Profit curves vary across industries…

Profitability Curve



* Source: Shin and Sudhir (SMR 2015)

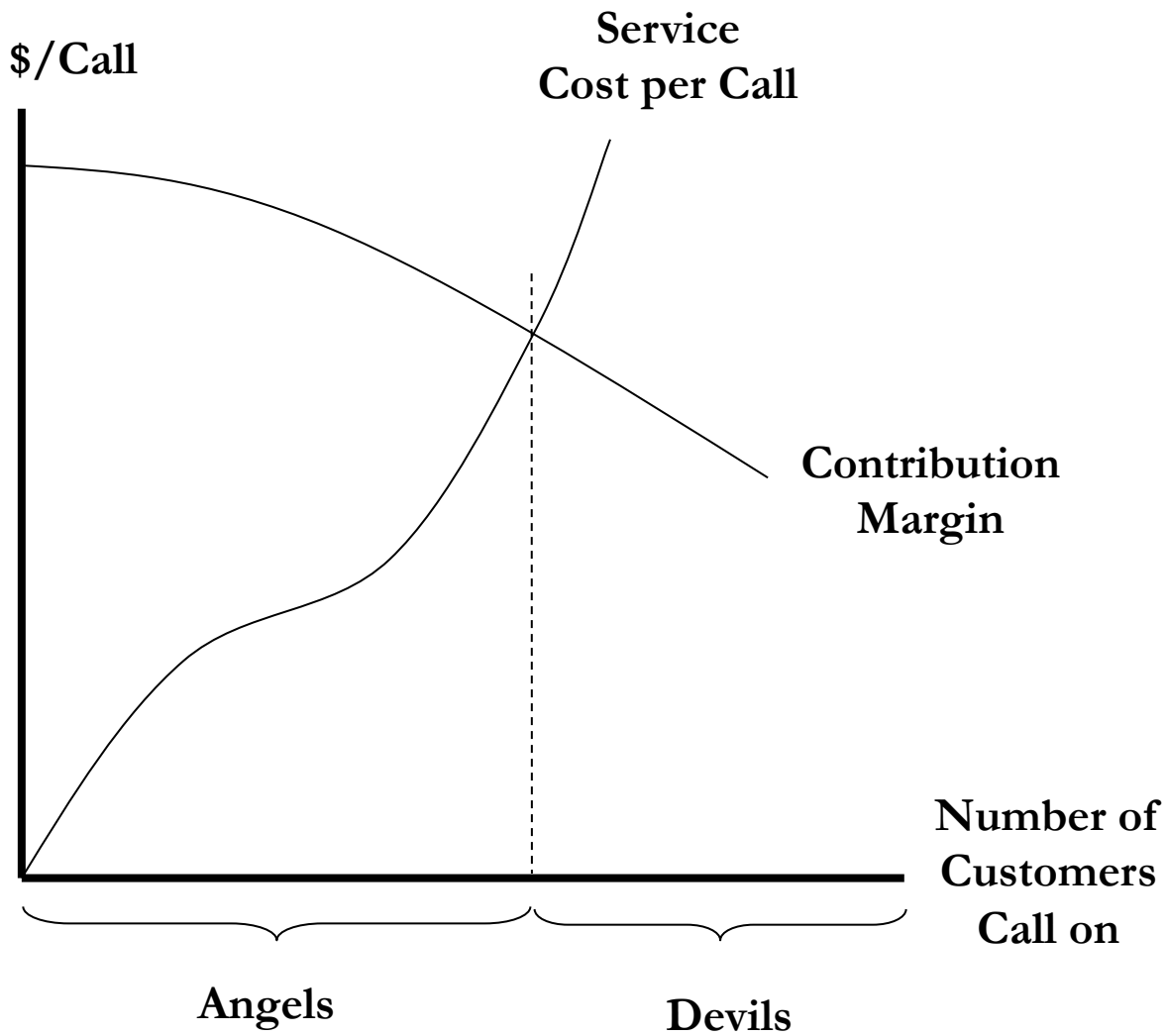
Examples

- All customers equal
- Harrah's: 23% account for 80%+ of profits
- First Manhattan: 20% account for 200%+ of profits in retail business

Sprint “fired” customers!

- “The number of inquiries you have made has led us to determine that we are unable to meet your current wireless needs. Therefore after careful consideration, the decision has been made to terminate your wireless service agreement…" (Wall Street Journal 2007).

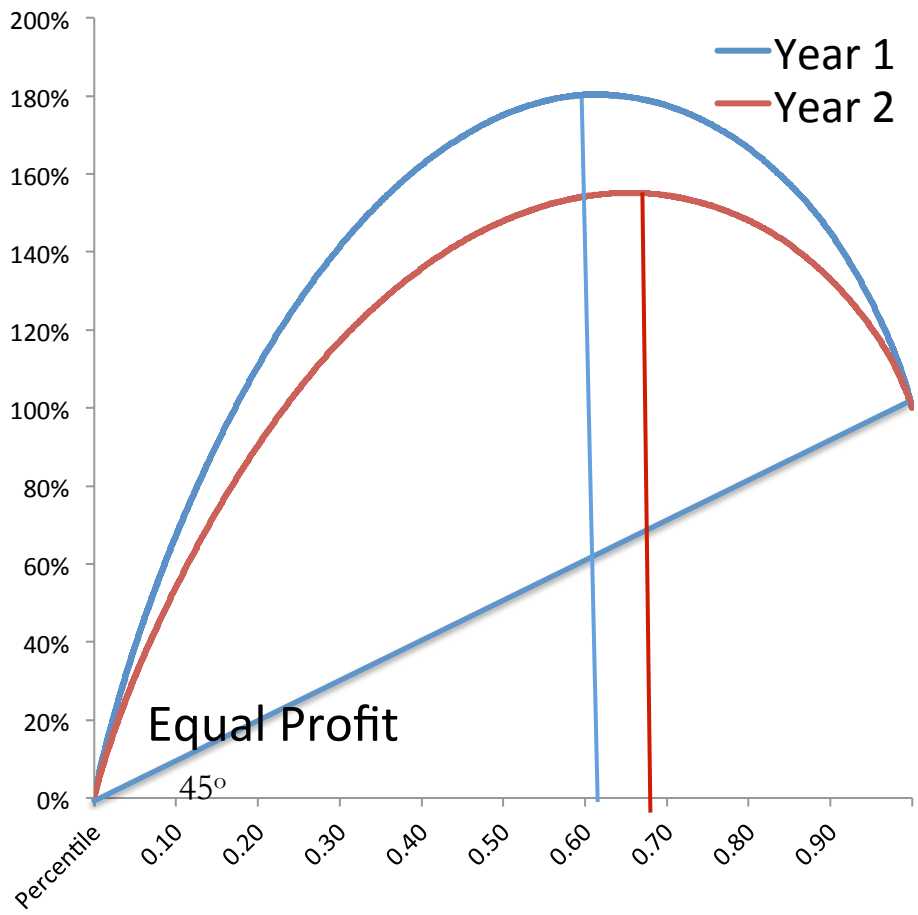
Customer valuation



What options before firing?

- Education
  - Show lower cost approaches
  - Sensitize them to costs imposed, identify lower cost approaches
- Menu Pricing (based on services used)
  - Challenge: Nickel and diming perception
- "Fire" as last resort
  - Challenge: Risk of bad publicity
  - Provide unfavorable terms so bad customers "self-fire"

Flattening of the cumulative profit curve through selective firing and replacement



For example: Cumulative Profits in Year 1=56K; Cumulative Profits in Year 2= 72 K

* Source: Shin et al. (Management Science 2013)

Whom Should We Love?
- Acquisition or retention

- Is it better to reward existing customers for loyalty? (Retention strategy)
- Or spend our marketing dollars on attracting new ones? (Acquisition strategy)

“Punish”/“Reward” current customers?
- WLC (We Love Our Customers) Bank

- Bob took a home mortgage with an interest rate of 6% at 2006 from WLC Bank
- WLC Bank called him to offer 5%, because he was a very valuable customer and they wanted to keep him.
- He went to a rival bank and got the offer to new customers of 4%

- Was WLC right in “treating” a valued current customer such as Bob?
  - Should WLC have offered the same rate it provides to its new customers to retain Bob as a customer?
  - Or given that WLC recognizes Bob as a valuable customer, should it have “rewarded” him by offering an even lower rate than for new customers?

Customer management dilemma

- When should a firm offer better value to its current customers or new customers?
  - Catalog retailers send special discount “value” catalog to existing customers
  - Magazines offer discounts to new customers
  - Cable TV, Hotel, wireless carrier,….

Whom do we have to reward?

- Give the best deal to your own customers!
  - "…to maximize loyalty and profitability, a company must give its best value to its ***best*** customers. … they will then become even more loyal and profitable."

    O'Brien and Jones, HBR 2004
  - CRM leads to a "virtuous" cycle

- Give your best deal to Competitor's Customers
  - Competitor Customers - Lower Willingness to Pay
  - Charge a higher price to one's own customers because that's where the money is! → Harvest Brand Equity (Fudenberg and Tirole 2000, Villas-Boas 1999)

What should be considered?

- Value concentration (customer heterogeneity): 80/20 rule
  - Some customers are worth keeping more than others
    - High heterogeneity: Retail store
    - Low heterogeneity: Magazine, Software
- Shopping flexibility
  - Customer preference is not fixed but may change across purchase occasions (correlated across time)
    - High mobility: Airline, Hotel
    - Low mobility: Telephone, Cable TV
  - Main reason to treat own customers better to make them stay

Dichotomy of CRM strategy

		Shopping Flexibility	
		Low	High
80 / 20 Rule	Low	**Acquisition: Reward new customers**	Acquisition
	High	Acquisition	Retention

Magazine subscription

* Source: Shin and Sudhir (Marketing Science 2010)

Dichotomy of CRM strategy

		Shopping Flexibility	
		Low	High
80 / 20 Rule	Low	Acquisition	**Acquisition: Reward new customers**
	High	**Acquisition: Reward new customers**	Retention

Cellphone contracts

Dichotomy of CRM strategy

		Shopping Flexibility	
		Low	High
80 / 20 Rule	Low	Acquisition	Acquisition
	High	Acquisition	**Retention: reward your best customers**

Retail industry

Acquisition vs. Retention

- The question is not whether to reward own customers or new customers
- The key question demands knowing **under what circumstances to take which action**
  - Both "heterogeneity in lifetime value" and "threat of moving away" are necessary to focus on retention (reward existing customers).

Takeaways

- Three ways to acquire competitive advantage
  - Innovation
  - Cost leader
  - Customer intimacy

- Customer relationship management framework
  - From your customers base, identify Angels <u>and</u> Devils, and do something special for them

- Acquisition vs. retention
  - In markets that have a high degree of "heterogeneity in lifetime value" and "threat of moving away," firms should focus on reward existing customers.