Customer Relationship Management Strategies for Business Markets

A well-developed ability to create and sustain successful working relationships with customers gives business marketing firms a significant competitive advantage. After reading this chapter, you will understand:

1. the patterns of buyer-seller relationships in the business market.

2. the factors that influence the profitability of individual customers.

3. a procedure for designing effective customer relationship management strategies.

4. the distinctive capabilities of firms that excel at customer relationship management.

5. the critical determinants of success in managing strategic alliances.

Every night, John Chambers, CEO of Cisco Systems, receives a personal update on 15 to 20 major customers via voice-mail. "E-mail would be more efficient but I want to hear the emotion, I want to hear the frustration; I want to hear the caller's level of comfort with the strategy we're employing," says Chambers. "I can't get that through e-mail."[1] In addition to giving day-to-day attention to monitoring relationships with the firm's most valuable customers, John Chambers has personally taken the lead in forging important strategic alliances.[2]

Leading business marketing firms like Cisco succeed by providing superior value to customers, by satisfying the special needs of even the most demanding customers, and by understanding the factors that influence individual customer profitability. Compared with the consumer packaged-goods sector, customer profitability is particularly important in business markets because marketing managers allocate a greater proportion of their marketing resources at the individual customer level.[3] The ability of an organization to create and maintain profitable relationships with these most valuable customers is a durable basis of competitive advantage.

A business marketer who wishes to find a place on Cisco's preferred supplier list must be prepared to help the firm provide more value to its demanding customers. To this end, the marketer must provide exceptional performance in quality, delivery, and, over time, cost competitiveness. The supplier must also understand how Cisco measures value and how its product and service offering can meet or surpass these value expectations. Building and maintaining lasting customer relationships requires careful attention to detail, meeting promises, and swiftly responding to new requirements.

The new era of business marketing is built upon effective relationship management.[4] Many business marketing firms create what might be called a **collaborative advantage** by demonstrating special skills in managing relationships with key customers or by jointly developing innovative strategies with alliance partners.[5] These firms have learned how to be good partners, and these superior relationship skills are a valuable asset. This chapter explores the types of relationships that characterize the business market. What market and situational factors are associated with different types of buyer-seller relationships? What factors influence customer profitability? What strategies can business marketers employ to build profitable relationships with customers? What are the distinctive capabilities of firms that excel at customer relationship management and consistently deliver superior financial performance in managing strategic alliances?

Relationship Marketing[6]

Relationship marketing centers on all activities directed toward establishing, developing, and maintaining successful exchanges with customers and other constituents.[7] Nurturing and managing customer relationships have emerged as an important

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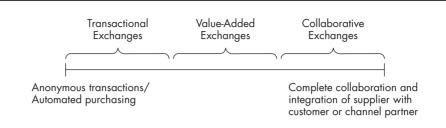[1]Frederick E. Reichheld, "Lead for Loyalty," *Harvard Business Review* 79 (July–August 2001): p. 82.

[2]"Cisco: Perspective on Strategic Alliances: An Interview with Greg Fox, Director of Marketing for Cisco's Strategic Alliances," *Leading Edge Newsletter*, Volume 1, No. 5 (May 2006), accessed at http://www.amanet.org on July 5, 2008.

[3]Douglas Bowman and Das Narayandas, "Linking Customer Management Effort to Customer Profitability in Business Markets," *Journal of Marketing Research* 41 (November 2004): pp. 433–447.

[4]For a comprehensive review, see Robert W. Palmatier, *Relationship Marketing* (Boston: Marketing Science Institute, 2008).

[5]Rosabeth Moss Kanter, "Collaborative Advantage," *Harvard Business Review* 72 (July–August 1994): pp. 96–108.

[6]This section is based on George S. Day, "Managing Market Relationships," *Journal of the Academy of Marketing Science* 28 (Winter 2000): pp. 24–30, except when others are cited.

[7]Robert M. Morgan and Shelby D. Hunt, "The Commitment-Trust Theory of Relationship Marketing," *Journal of Marketing* 58 (July 1994): pp. 20–38.

FIGURE 4.1 | THE RELATIONSHIP SPECTRUM

Transactional Exchanges   Value-Added Exchanges   Collaborative Exchanges

Anonymous transactions/ Automated purchasing

Complete collaboration and integration of supplier with customer or channel partner

SOURCE: Figure from "Managing Market Relationships" by George S. Day from *Journal of Academy of Marketing Science* 28 (Winter 2000): p. 25. Copyright © 2000. Reprinted by permission of Springer.

strategic priority in most firms. Why? First, loyal customers are far more profitable than customers who are price sensitive and perceive few differences among alternative offerings. Second, a firm that is successful in developing strong relationships with customers secures important and durable advantages that are hard for competitors to understand, copy, or displace.

Types of Relationships

A business marketer may begin a relationship with GE as a supplier (one of many), move to a preferred supplier status (one of a few), and ultimately enter a collaborative relationship with GE (sole source for particular items). Observe in Figure 4.1 that buyer-seller relationships are positioned on a continuum, with transactional exchange and collaborative exchange serving as the endpoints. Central to every relationship is an exchange process where each side gives something in return for a payoff of greater value. **Transactional exchange** centers on the timely exchange of basic products for highly competitive market prices. George Day notes that such exchanges

> include the kind of autonomous encounters a visitor to a city has with the taxi or bus from the airport, as well as a series of ongoing transactions in a business-to-business market where the customer and supplier focus only on the timely exchange of standard products at competitive prices.[8]

Moving across the continuum, relationships become closer or more collaborative. The open exchange of information is a characteristic of collaborative (close) versus transactional (distant) exchange. Likewise, **operational linkages** reflect how much the systems, procedures, and routines of the buying and selling firms have been connected to facilitate operations.[9] These relationship connectors are a feature of a collaborative relationship. For example, such linkages provide the basis for order replenishment or just-in-time deliveries that Honda receives each day from suppliers at its Marysville, Ohio, production facility. **Collaborative exchange** features very close information, social, and operational linkages as well as mutual commitments

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[8]Day, "Managing Market Relationships," p. 25.

[9]Joseph P. Cannon and William D. Perreault, Jr., "Buyer-Seller Relationships in Business Markets," *Journal of Marketing Research* 36 (November 1999): pp. 439–460.

made in expectation of long-run benefits. According to James Anderson and James Narus, collaborative exchange involves

> a process where a customer and supplier firm form strong and extensive social, economic, service, and technical ties over time, with the intent of lowering total costs and/or increasing value, thereby achieving mutual benefit.[10]

Value-Adding Exchanges

Between the two extremes on the relationship continuum are value-adding exchanges, where the focus of the selling firm shifts from attracting customers to keeping customers. The marketer pursues this objective by developing a comprehensive understanding of a customer's needs and changing requirements, tailoring the firm's offerings to those needs, and providing continuing incentives for customers to concentrate most of their purchases with them. To illustrate, W.W. Grainger provides a customized Web page for each of its premier corporate customers that individual employees in the customer organization can use to track expenditures on maintenance and operating supplies against key performance benchmarks.

Nature of Relationships

Transactional exchange involves items like packaging materials or cleaning services where competitive bidding is often employed to secure the best terms. Such exchanges are purely contractual arrangements that involve little or no emotional commitment to sustaining the relationship in the future. By contrast, customized, high-technology products—like semiconductor test equipment—fit the collaborative exchange category. Whereas transactional exchange centers on negotiations and an arm's-length relationship, collaborative exchange emphasizes joint problem solving and multiple linkages that integrate the processes of the two parties. Trust and commitment provide the foundation for collaborative exchange.[11] **Relationship commitment** involves a partner's belief that an ongoing relationship is so important that it deserves maximum efforts to maintain it. In turn, **trust** exists when one party has confidence in a partner's reliability and integrity. Recent research highlights the powerful role that contact personnel (for example, salespersons) assume in forging a long-term relationship. "Individuals who build trust in each other will transfer this bond to the firm level."[12]

Strategic Choices

Business marketers have some latitude in choosing where to participate along the relationship continuum. However, limits are imposed by the characteristics of the

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[10]James C. Anderson and James A Narus, "Partnering as a Focused Market Strategy," *California Management Review* 33 (Spring 1991): p. 96. See also Ven Srivam, Robert Krapfel, and Robert Spekman, "Antecedents to Buyer-Seller Collaboration: An Analysis from the Buyer's Perspective," *Journal of Business Research* (December 1992): pp. 303–320.

[11]Morgan and Hunt, "The Commitment-Trust Theory," pp. 20–38. See also Patricia M. Doney and Joseph P. Cannon, "An Examination of the Nature of Trust in Buyer-Seller Relationships," *Journal of Marketing* 61 (April 1997): pp. 35–51.

[12]Das Narayandas and V. Kasturi Rangan, "Building and Sustaining Buyer-Seller Relationships in Mature Industrial Markets," *Journal of Marketing* 68 (July 2004): p. 74; and Robert W. Palmatier, Lisa K. Scheer, and Jan-Benedict E. M. Steenkamp, "Customer Loyalty to Whom? Managing the Benefits and Risks of Salesperson-Owned Loyalty," *Journal of Marketing Research* 44 (May 2007): pp. 185–199.

B2B TOP PERFORMERS

Understanding the Customer's Business—The Key to Success

To forge a collaborative relationship with a customer, the business marketer requires a deep understanding of the customer's business, its key competitors, and its goals and strategies. In turn, a wealth of communication links are required across the partnering organizations at all levels of management. Salespersons not only work with the purchasing staff but also have close ties to senior executives. For example, for some of IBM's Fortune 500 customers, account executives are direct participants in the customer firm's strategy planning sessions. Here IBM adds value to the relationship by providing specific recommendations concerning how its products and services can be used to advance the firm's competitive advantage. As a relationship with a large account grows and flourishes, a full-time sales team is often created to serve the needs of that customer. The team comprises sales, service, and technical specialists who have extensive knowledge of the customer's industry. Some team members have worked exclusively with a single customer organization for years.

market and by the significance of the purchase to the buyer. A central challenge for the marketer is to overcome the gravitational pull toward the transaction end of the exchange spectrum. According to Day,

> Rivals are continually working to attract the best accounts away; customer requirements, expectations, and preferences keep changing, and the possibility of friction-free exploration of options in real time on the Web conspire to raise the rate of customer defections.[13]

Managing Buyer-Seller Relationships

Buyers and sellers craft different types of relationships in response to market conditions and the characteristics of the purchase situation. To develop specific relationship-marketing strategies for a particular customer, the business marketer must understand that some customers elect a collaborative relationship, whereas others prefer a more distant or transactional relationship. Figure 4.2 highlights the typical characteristics of relationships at the endpoints of the buyer-seller relationship spectrum.

Transactional Exchange

Customers are more likely to prefer a **transactional relationship** when a competitive supply market features many alternatives, the purchase decision is not complex, and the supply market is stable. This profile fits some buyers of office supplies, commodity chemicals, and shipping services. In turn, customers emphasize a transactional orientation when they view the purchase as less important to the organization's objectives. Such relationships are characterized by lower levels of information exchange and are less likely to involve operational linkages between the buying and selling firms.

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[13] Day, "Managing Market Relationships," p. 25.

FIGURE 4.2 | THE SPECTRUM OF BUYER-SELLER RELATIONSHIPS

	Transactional Exchange ⟷	Collaborative Exchange
Availability of Alternatives	Many Alternatives	Few Alternatives
Supply Market Dynamism	Stable	Volatile
Importance of Purchase	Low	High
Complexity of Purchase	Low	High
Information Exchange	Low	High
Operational Linkages	Limited	Extensive

SOURCE: Adapted from Joseph P. Cannon and William D. Perreault Jr., "Buyer-Seller Relationships in Business Markets," *Journal of Marketing Research* 36 (November 1999): pp. 439–460.

Collaborative Exchange

Buying firms prefer a more **collaborative relationship** when alternatives are few, the market is dynamic (for example, rapidly changing technology), and the complexity of the purchase is high. In particular, buyers seek close relationships with suppliers when they deem the purchase important and strategically significant. This behavior fits some purchasers of manufacturing equipment, enterprise software, or critical component parts. Indeed, say Cannon and Perreault,

> the closest partnerships . . . arise both when the purchase is important and when there is a need—from the customer's perspective—to overcome procurement obstacles that result from fewer supply alternatives and more purchase uncertainty.[14]

Moreover, the relationships that arise for important purchases are more likely to involve operational linkages and high levels of information exchange. Switching costs are especially important to collaborative customers.

Switching Costs

In considering possible changes from one selling firm to another, organizational buyers consider two **switching costs**: investments and risk of exposure. First, organizational buyers invest in their relationships with suppliers in many ways. As Barbara Bund Jackson states:

> They invest *money*; they invest in *people*, as in training employees to run new equipment; they invest in *lasting assets*, such as equipment itself; and they invest in changing basic business *procedures* like inventory handling.[15]

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[14]Cannon and Perreault, "Buyer-Seller Relationships," p. 453.

[15]Barbara Bund Jackson, "Build Customer Relationships That Last," *Harvard Business Review* 63 (November–December 1985): p. 125.

Because of these past investments, buyers may hesitate to incur the disruptions and switching costs that result when they select new suppliers.

Risk of exposure provides a second major category of switching costs. Attention centers on the risks to buyers of making the wrong choice. Customers perceive more risk when they purchase products important to their operations, when they buy from less established suppliers, and when they buy technically complex products.

Strategy Guidelines

The business marketer manages a portfolio of relationships with customers—some of these customers view the purchase as important and desire a close, tightly connected buyer-seller relationship; other customers assign a lower level of importance to the purchase and prefer a looser relationship. Given the differing needs and orientations of customers, the business marketer's first step is to determine which type of relationship matches the purchasing situation and supply-market conditions for a particular customer. Second, a strategy must be designed that is appropriate for each strategy type.

Collaborative Customers   Relationship-building strategies, targeted on strong and lasting commitments, are especially appropriate for these customers. Business marketers can sensibly invest resources to secure commitments and directly assist customers with planning. Here sales and service personnel work not only with purchasing managers but also with a wide array of managers on strategy and coordination issues. Regular visits to the customer by executives and technical personnel can strengthen the relationship. Operational linkages and information-sharing mechanisms should be designed into the relationship to keep product and service offerings aligned with customer needs. Given the long time horizon and switching costs, customers are concerned both with the marketers' long-term capabilities and with their immediate performance. Because the customers perceive significant risk, they demand competence and commitment from sellers and are easily frightened by even a hint of supplier inadequacy.

Value Drivers in Collaborative Relationships   A recent study examined this intriguing question: What avenues of differentiation can suppliers of routinely purchased products use to create value in business-to-business relationships, thereby winning key supplier status?[16] From Table 4.1, observe that the study uncovered three sources of value creation—value creation through the core offering, within the sourcing process, and at the level of the customer's operations. The associated relationship benefits and costs for each are listed. Consistent with the total cost of ownership (Chapter 2) perspective that purchasing managers apply, costs as a value driver center on the degree to which the supplier offers a lower price or adds value by taking costs out of the sourcing process or the customer's operations.

The results suggest that relationship benefits display a much stronger potential for differentiation in key supplier relationships than cost considerations. Importantly, service support and personal interaction were identified as the core differentiators,

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[16]Wolfgang Ulaga and Andreas Eggert, "Value-Based Differentiation in Business Relationships: Gaining and Sustaining Key Supplier Status," *Journal of Marketing* 70 (January 2006): pp. 119–136.

TABLE 4.1 | VALUE DRIVERS IN KEY SUPPLIER RELATIONSHIPS

Sources of Value Creation	Relationship Value Dimensions	
	Costs	Benefits
Core offering	Product quality Delivery performance	Direct costs
Sourcing process	Service support Personal interaction	Acquisition costs
Customer operations	Supplier know-how Time to market	Operation costs

SOURCE: Wolfgang Ulaga and Andreas Eggert, "Value-Based Differentiation in Business Relationships: Gaining and Sustaining Key Supplier Status," *Journal of Marketing* 70 (January 2006): p. 122. Copyright © 2001. Reprinted by permission of Warren, Gorham, Lamont via Copyright Clearance Center.

followed by a supplier's know-how and its ability to improve a customer's time to market. Product quality and delivery performance, along with cost savings associated with the acquisition process and from operations, display a moderate potential to help a firm gain key supplier status. Finally, price displayed the weakest potential for differentiation. The researchers, Wolfgang Ulaga and Andreas Eggert, conclude: "Whereas cost factors serve as key criteria to get a supplier on the short list of those vendors considered for a relationship, relationship benefits dominate when deciding which supplier" should be awarded key supplier status.[17]

Transaction Customers   These customers display less loyalty or commitment to a particular supplier and can easily switch part or all of the purchases from one vendor to another. A business marketer who offers an immediate, attractive combination of product, price, technical support, and other benefits has a chance of winning business from a transactional customer. The salesperson centers primary attention on the purchasing staff and seldom has important ties to senior executives in the buying organization. M. Bensaou argues that it is unwise for marketers to make specialized investments in transactional relationships:

> Firms that invest in building trust through frequent visits, guest engineers, and cross-company teams when the product and market context calls for simple, impersonal control and data exchange mechanisms are overdesigning the relationship. This path is not only costly but also risky, given the specialized investments involved, in particular, the intangible ones (for example, people, information, or knowledge).[18]

Rather than adopting the approach of "one design fits all," the astute marketer matches the strategy to the product and market conditions that surround a particular customer relationship and understands the factors that influence profitability.

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[17]Ibid., p. 131.

[18]M. Bensaou, "Portfolio of Buyer-Seller Relationships," *Sloan Management Review* 40 (Summer 1999): p. 43.

Measuring Customer Profitability[19]

To improve customer satisfaction and loyalty, many business-to-business firms have developed customized products and increased the specialized services they offer. Although customers embrace such actions, they often lead to declining profits, especially when the enhanced offerings are not accompanied by increases in prices or order volumes. For a differentiation strategy to succeed, "the value created by the differentiation—measured by higher margins and higher sales volumes—has to exceed the cost of creating and delivering customized features and services."[20] By understanding the drivers of customer profitability, the business marketing manager can more effectively allocate marketing resources and take action to convert unprofitable relationships into profitable ones.

Activity-Based Costing

Most studies of customer profitability yield a remarkable insight: "Only a minority of a typical company's customers is truly profitable."[21] Why? Many firms fail to examine how the costs of specialized products and services vary among individual customers. In other words, they focus on profitability at an aggregate level (for example, product or territory), fail to assign operating expenses to customers, and misjudge the profitability of individual customers. To capture customer-specific costs, many firms have adopted activity-based costing.

Activity-based costing (ABC) illuminates exactly what activities are associated with serving a particular customer and how these activities are linked to revenues and the consumption of resources.[22] The ABC system and associated software link customer transaction data from customer relationship management (CRM) systems with financial information. The ABC system provides marketing managers with a clear and accurate picture of the gross margins and cost-to-serve components that yield individual customer profitability.

Unlocking Customer Profitability

By accurately tracing costs to individual customers, managers are better equipped to diagnose problems and take appropriate action. For example, Kanthal, a heating wire manufacturer, learned to its surprise that one of its largest and most coveted accounts—General Electric's Appliance Division—was also one of its most unprofitable customers.[23] A customer order that normally would cost Kanthal $150 to process cost more than $600 from GE because of frequent order changes, expedited deliveries, and scheduling adjustments. A senior manager at Kanthal suggested to GE that the numerous change orders were costly not only to Kanthal but also to GE. After a quick internal review, GE managers agreed, corrected internal inefficiencies, and then

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[19]This section, unless otherwise noted, draws on Robert S. Kaplan and V. G. Narayanan, "Measuring and Managing Customer Profitability," *Journal of Cost Management* 15 (5, September–October 2001): pp. 5–15.

[20]Robert S. Kaplan, "Add a Customer Profitability Metric to Your Balanced Scorecard," *Balanced Scorecard Report*, July–August 2005 (Boston: Harvard Business School Publishing Corporation), p. 3.

[21]Kaplan and Narayanan, "Measuring and Managing Customer Profitability," p. 5.

[22]Ibid., p. 7. See also Robert S. Kaplan and Steven R. Anderson, "Time-Driven Activity-Based Costing," *Harvard Business Review* 82 (November 2004): pp. 131–138.

[23]Kaplan and Narayanan, p. 11.

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awarded Kanthal with the largest contract in the firm's history. The contract incorporated a surcharge for any change GE made to an existing order and established a minimum order size. By isolating the true cost of serving GE, Kanthal converted an unprofitable relationship to a profitable one and provided further value by helping a key customer reduce costs.

The Profitable Few

Once a firm implements an ABC approach and plots cumulative profitability against customers, a striking portrait emerges that is often referred to as the *whale curve* (Figure 4.3). Robert S. Kaplan, who is codeveloper of activity-based costing, and his colleague, V. G. Narayanan, describe the pattern that many companies find:

> Whereas cumulative sales usually follow the typical 20/80 rule (that is, 20 percent of the customers provide 80 percent of the sales), the whale curve for cumulative profitability usually reveals that the most profitable 20 percent of customers generate between 150 percent and 300 percent of total profits. The middle 70 percent of customers break even and the least profitable 10 percent of customers lose from 50 to 200 percent of total profits, leaving the company with its 100 percent of total profits.[24]

[24]Ibid., p. 7. See also Robert S. Kaplan and David P. Norton, *The Execution Premium* (Boston: Harvard Business Press, 2008), pp. 255–261.

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As a rule, large customers tend to be included among the most profitable (see left side of Figure 4.3) or the least profitable (see right side of Figure 4.3)—they are seldom in the middle. Interestingly, some of the firm's largest customers often turn out to be among the most unprofitable. A firm does not generate enough sales volume with a small customer to incur large absolute losses. Only large buyers can be large-loss customers. In Figure 4.3, low-cost-to-serve customers appear on the profitable side of the whale curve and high-cost-to-serve customers end up on the unprofitable side unless they pay a premium price for the specialized support they require.

Managing High- and Low-Cost-to-Serve Customers

What causes some customers to be more expensive than others? Note from Table 4.2 that high-cost-to-serve customers, for example, desire customized products, frequently change orders, and require a significant amount of presales and postsales support. By contrast, low-cost-to-serve customers purchase standard products, place orders and schedule deliveries on a predictable cycle, and require little or no presales or post-sales support.

Look Inside First   After reviewing the profitability of individual customers, the business marketer can consider possible strategies to retain the most valuable customers and to transform unprofitable customers into profitable ones. However, managers should first examine their company's own internal processes to ensure that it can accommodate customer preferences for reduced order sizes or special services at the lowest cost. For example, a large publisher of business directories reduced the cost of serving its customer base by assigning key account managers to its largest customers (that is, the 4 percent of customers who accounted for 45 percent of its sales)
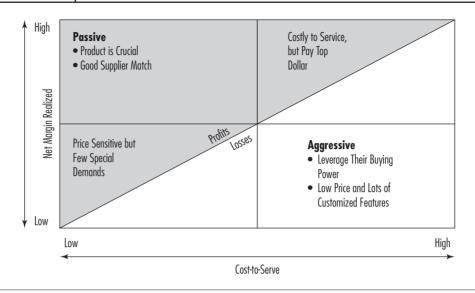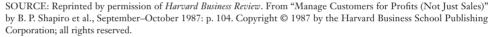
FIGURE 4.4 | **Customer Profitability**

and serving the smallest customers over the Internet and by a telephone sales force.[25] These actions not only cut costs dramatically but also gave each group of customers what they had wanted all along: Large customers wanted a central point of contact where they could secure services customized to their needs; small customers preferred minimal contact with a direct salesperson but wanted the assurance that they could receive advice and support if required.

A Sharper Profit Lens   Business marketing managers can view their customers through the lens of a simple 2×2 diagram (Figure 4.4). The vertical axis shows the net margin earned from sales to a particular customer. The **net margin** equals the net price, after all discounts, minus manufacturing costs. The horizontal axis shows the **costs of serving the customer**, including order-related costs plus the customer-specific marketing, technical, and administrative expenses.

Identifying Profitable Customers   Observe from Figure 4.4 that profitable customers can take different forms. To illustrate, a customer like Honda of America would be at the lower left corner of the diagram: demanding low prices, so net margins are low, but also working with its suppliers to streamline activities so that the cost-to-serve is also low. High-cost-to-serve customers who occupy the upper right corner of Figure 4.4 can also be profitable if the net margins earned on sales to them more than compensate the company for the cost of the resources used in serving them.

   A company is indeed fortunate if several of its customers occupy the upper left-hand quadrant of the diagram: high margins *and* low cost-to-serve. Because these

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[25] George S. Day, "Creating a Superior Customer-Relating Capability," *MIT Sloan Management Review* 44 (Spring 2003): pp. 77–82.

customers represent a valuable asset, marketing managers should forge close relation-ships with them, anticipate their changing needs, and have protective measures (for example, special services) in place in case competitors attempt to win them away.

Managing Unprofitable Customers[26]

The most challenging set of customers for marketing managers is found in the lower right-hand corner of Figure 4.4: low margins and high cost-to-serve. First, the mar-keting manager should explore possible ways to reduce the cost of activities associated with serving these customers. For example, perhaps postsales support could be shifted to the Internet. Second, the manager should direct attention to the customer actions that contribute to higher selling costs. To illustrate, the high cost-to-serve may be caused by the customer's unpredictable ordering patterns or by the large demands it places on technical and sales personnel. By detailing the costs of these activities and openly sharing this information with the customer, the business marketing manager can encourage the customer to work with the company more efficiently. From the earlier example, recall that Kanthal used this approach not only to restore profitability but also to help one of its largest customers, General Electric's Appliance Division, refine its internal processes and reduce its costs.

Firing Customers

By improving processes and refining pricing strategies, business marketing man-agers can transform many, but not all, customers from unprofitable to profitable. What should we do with those unprofitable customers that remain in the high-cost-to-serve quadrant of Figure 4.4? To answer this question, we have to dig deeper into the customer relationship and assess the other benefits that certain customers may provide. Some customers are new and the initial investment to at-tract them will ultimately be repaid in higher sales volume and profitability. Other customers provide an opportunity for learning. For example, some firms that serve Toyota or Honda incurred initial losses in serving these demanding customers but secured insights into management processes and technology they could effectively apply to all their customers.

Suppose, however, that a customer is unprofitable, not new, and offers little or no opportunity for learning. Furthermore, suppose that the customer resists all attempts to convert the unprofitable relationship into a profitable one. Under these conditions, Robert S. Kaplan and Robin Cooper observe that we might con-sider firing them, but a more subtle approach will do: "We can, perhaps, let the customer fire itself by refusing to grant discounts and reducing or eliminating mar-keting and technical support."[27] Customer divestment is a viable strategic option, but one that must be exercised sparingly and only after other options have been thoroughly examined.[28]

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[26]This section is based on Robert S. Kaplan and Robin Cooper, *Cost and Effect: Using Integrated Cost Systems to Drive Prof-itability and Performance* (Boston: Harvard Business School Press, 1998), pp. 193–201.

[27]Ibid., p. 200.

[28]Vikas Mittal, Matthew Sarkees, and Feisal Murshed, "The Right Way to Manage Unprofitable Customers," *Harvard Business Review* 86 (April 2008): pp. 95–102.

Customer Relationship Management

Customer retention has always been crucial to success in the business market, and it now provides the centerpiece of strategy discussions as firms embrace customer relationship management. **Customer relationship management** (CRM) is a cross-functional process for achieving

- a continuing dialogue with customers
- across all their contact and access points, with
- personalized treatment of the most valuable customers,
- to ensure customer retention and the effectiveness of marketing initiatives.[29]

To meet these challenging requirements, business marketing firms, large and small, are making substantial investments in CRM systems—enterprise software applications that integrate sales, marketing, and customer service information. To improve service and retain customers, CRM systems synthesize information from all of a company's contact points or "touch points"—including e-mail, call centers, sales and service representatives—to support later customer interactions and to inform market forecasts, product design, and supply chain management.[30] Salespersons, call center personnel, Web managers, resellers, and customer service representatives all have the same real-time information on each customer.

For an investment in CRM software to yield positive returns, a firm needs a customer strategy. Strategy experts contend that many CRM initiatives fail because executives mistake CRM software for a marketing strategy. Darrell Rigby and his colleagues contend: "It isn't. CRM is the bundling of customer strategy and processes, supported by relevant software, for the purpose of improving customer loyalty and, eventually, corporate profitability."[31] CRM software can help, but only after a customer strategy has been designed and executed. To develop responsive and profitable customer strategies, special attention must be given to five areas: (1) acquiring the right customers, (2) crafting the right value proposition, (3) instituting the best processes, (4) motivating employees, and (5) learning to retain customers (Table 4.3). Observe how CRM technology from leading producers such as Oracle Corporation and Siebel Systems can be used to capture critical customer data, transform it into valuable information, and distribute it throughout the organization to support the strategy process from customer acquisition to customer retention. Thus, a well-designed and executed customer strategy, supported by a CRM system, provides the financial payoff.

Acquiring the Right Customers

Customer relationship management directs attention to two critical assets of the business-to-business firm: its stock of current and potential customer relationships and its collective knowledge of how to select, initiate, develop, and maintain profitable

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[29]George S. Day, "Capabilities for Forging Customer Relationships," Working Paper, Report No. 00-118, Marketing Science Institute, Cambridge, MA, 2000, p. 4.

[30]Larry Yu, "Successful Customer-Relationship Management," *MIT Sloan Management Review* 42 (Summer 2001): p. 18.

[31]Darrell K. Rigby, Frederick F. Reichheld, and Phil Schefter, "Avoid the Four Perils of CRM," *Harvard Business Review* 80 (January–February 2002): p. 102.

TABLE 4.3 | CREATING A CUSTOMER RELATIONSHIP MANAGEMENT STRATEGY

CRM Priorities				
Acquiring the Right Customers	**Crafting the Right Value Proposition**	**Instituting the Best Processes**	**Motivating Employees**	**Learning to Retain Customers**
Critical Tasks				
• Identify your most valuable customers. • Calculate your share of their purchases (wallet) for your goods and services.	• Determine the products or services your customers need today and will need tomorrow. • Assess the products or services that your competitors offer today and tomorrow. • Identify new products or services that you should be offering.	• Research the best way to deliver your products or services to customers. • Determine the service capabilities that must be developed and the technology investments that are required to implement customer strategy.	• Identify the tools your employees need to foster customer relationships. • Earn employee loyalty by investing in training and development and constructing appropriate career paths for employees.	• Understand why customers defect and how to win them back. • Identify the strategies your competitors are using to win your high-value customers.
CRM Technology Can Help				
• Analyze customer revenue and cost data to identify current and future high-value customers. • Target marketing communications to high-value customers.	• Capture relevant product and service behavior data from customer transactions. • Create new distribution channels. • Develop new pricing models.	• Process transactions faster. • Provide better information to customer contact employees. • Manage logistics and the supply chain more efficiently.	• Align employee incentives and performance measures. • Distribute customer knowledge to employees throughout the organization.	• Track customer defection and retention levels. • Track customer service satisfaction levels.

SOURCE: Adapted from Darrell K. Rigby, Frederick F. Reichheld, and Phil Schefter, "Avoid the Four Perils of CRM," *Harvard Business Review* 80 (January–February 2002): p. 106.

relationships with these customers.[32] Customer portfolio management, then, is the process of creating value across a firm's customer relationships—from transactional to collaborative—with an emphasis on balancing the customer's desired level of relationship against the profitability of doing so.[33]

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[32] Ruth N. Bolton, Katherine N. Lemon, and Peter Verhoof, "Expanding Business-to-Business Customer Relationships," *Journal of Marketing* 72 (January 2008): pp. 46–64.

[33] Michael D. Johnson and Fred Selnes, "Diversifying Your Customer Portfolio," *MIT Sloan Management Review* 46 (Spring 2005): pp. 11–14.

INSIDE BUSINESS MARKETING

Diversify a Customer Portfolio Too!

For an investor, modern portfolio theory demonstrates that optimal performance, for a given level of risk, can best be achieved by building a diversified mix of investment assets that includes the stocks of both large and small firms, representing both U.S. and foreign companies. In building a customer portfolio, similar benefits can be realized by viewing customers as assets and diversifying across categories of customers. For example, after the technology bubble, many information technology (IT) companies, like IBM and Microsoft, were surprised to observe that small and medium-sized businesses (SMB) fueled the recovery in IT spending. Why? Most of the SMB customers did not overindulge in massive hardware and software upgrades to the same extreme extent during the bubble as their large-enterprise counterparts did. So, SMB customers were the first to return and aggressively buy IT products and services. Because Dell, Microsoft, and IBM each have a customer portfolio that includes a strong representation of SMB customers, these firms enjoyed an edge over rivals such as Hewlett-Packard and Sun Microsystems that were less focused on this customer group (that is, asset category) and were "caught waiting" for large-enterprise customers to return.

SOURCE: Mark Veverka, "Little Guys Lead IT Spending Recovery," *Barron's*, October 20, 2003, p. 73.

Account selection requires a clear understanding of customer needs, a tight grasp on the costs of serving different groups of customers, and an accurate forecast of potential profit opportunities. The choice of potential accounts to target is facilitated by an understanding of how different customers define value. **Value**, as defined by James Anderson and James Narus, refers to "the economic, technical, service, and social benefits received by a customer firm in exchange for the price paid for a product offering."[34] By gauging the value of their offerings to different groups of customers, business marketers are better equipped to target accounts and to determine how to provide enhanced value to particular customers.

The account selection process should also consider profit potential. Because the product is critical to their operations, some customers place a high value on supporting services (for example, technical advice and training) and are willing to pay a premium price for them. Other customers are most costly to serve, do not value service support, and are extremely price sensitive. Because customers have different needs and represent different levels of current and potential opportunities, a marketer should divide its customers into groups. The marketer wishes to develop a broader and deeper relationship with the most profitable ones and assign a low priority to the least profitable ones.[35] Frank Cespedes asserts that

> account selection, therefore, must be explicit about which demands the seller can meet and leverage in dealings with other customers. Otherwise, the seller

[34]Anderson and Narus, p. 98. See also Ajay Menon, Christian Homburg, and Nikolas Beutin, "Understanding Customer Value in Business-to-Business Relationships," *Journal of Business-to-Business Marketing* 12 (2, 2005): pp. 1–33; and Ulaga and Eggert, "Value-Based Differentiation," pp. 119–136.

[35]Frederick F. Reichheld, "Lead for Loyalty," *Harvard Business Review* 79 (July–August 2001): pp. 76–84.

risks overserving unprofitable accounts and wasting resources that might be allocated to other customer groups.[36]

Crafting the Right Value Proposition

A **value proposition** represents the products, services, ideas, and solutions that a business marketer offers to advance the performance goals of the customer organization. Recall from Chapter 1 that the customer value proposition must address this essential question: How do the value elements (benefits) in a supplier's offering compare to those of the next-best alternative? A value proposition may include points of parity (certain value elements are the same as the next-best option) and points of difference (the value elements that make the supplier's offering either superior or inferior to the next-best alternative). For example, a supplier may offer improved technology (positive) at a higher price (negative) and fail to convince customers that the new technology justifies the price increase.

> Best-practice suppliers base their value proposition on the few elements that matter most to target customers, demonstrate the value of this superior performance, and communicate it in a way that conveys a sophisticated understanding of the customer's business priorities.[37]

The Bandwidth of Strategies To develop customer-specific product offerings, the business marketer should next examine the nature of buyer-seller relationships in the industry. The strategies competing firms in an industry pursue fall into a range referred to as the industry bandwidth of working relationships.[38] Business marketers either attempt to span the bandwidth with a portfolio of relationship-marketing strategies or concentrate on a single strategy, thereby having a narrower range of relationships than the industry bandwidth.

Observe in Figure 4.5 how two different industries (medical equipment and hospital supplies) are positioned on the relationship continuum. Because the underlying technology is complex and dynamic, collaborative relations characterize the medical equipment industry. Here, a range of services—technical support, installation, professional training, and maintenance agreements—can augment the core product. By contrast, collaborative relations in the hospital supply industry tend to be more focused and center on helping health-care organizations meet their operational needs (for example, efficient ordering processes and timely delivery).

By diagnosing the spectrum of relationship strategies competitors in an industry follow, a business marketer can tailor strategies that more closely respond both to customers who desire a collaborative emphasis and to those who seek a transaction emphasis. The strategy involves *flaring out* from the industry bandwidth in the collaborative as well as in the transactional direction (see Figure 4.5b).

Flaring Out by Unbundling An unbundling strategy can reach customers who desire a greater transaction emphasis. Here, related services are unbundled to yield the
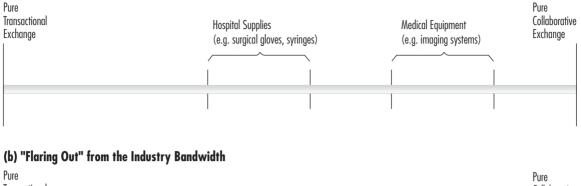
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[36]Frank V. Cespedes, *Concurrent Marketing: Integrating Product, Sales, and Service* (Boston: Harvard Business School Press, 1995), p. 193. See also Don Peppers, Martha Rogers, and Bob Dorf, "Is Your Company Ready for One-to-One Marketing?" *Harvard Business Review* 77 (January–February 1999): pp. 151–160.
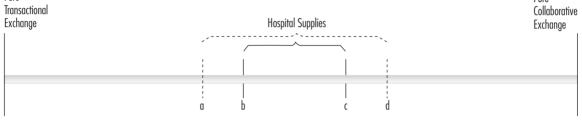
[37]James C. Anderson, James A. Narus, and Wouter van Rossum, "Customer Value Propositions in Business Markets," *Harvard Business Review* 84 (March 2006): p. 93.

[38]This discussion draws on Anderson and Narus, "Partnering as a Focused Market Strategy," pp. 95–113.

FIGURE 4.5 | **TRANSACTIONAL AND COLLABORATIVE WORKING RELATIONSHIPS**

(a) Industry Relationship Bandwidths

Pure
Transactional
Exchange

Hospital Supplies
(e.g. surgical gloves, syringes)

Medical Equipment
(e.g. imaging systems)

Pure
Collaborative
Exchange

(b) "Flaring Out" from the Industry Bandwidth

Pure
Transactional
Exchange

Hospital Supplies

Pure
Collaborative
Exchange

a   b   c   d

SOURCE: Adapted from James C. Anderson and James A. Narus, "Partnering as a Focused Marketing Strategy," *California Management Review* 33 (Spring 1991): p. 97.

core product (**a** in Figure 4.5b), which meets a customer's basic price, quality, and availability requirements. For each service that is unbundled, the price is lowered. Augmented services, such as technical assistance, consulting, and just-in-time delivery, are each offered, but in a menu fashion, on an incremental price basis. Importantly, the price increments for the entire set of unbundled services should be greater than the price premium sought for the collaborative offering. This reflects the efficiencies of providing the complete bundle of services to a collaborative account. This pricing policy is market oriented in that it allows customer firms to choose the product and relationship offering that *they perceive* to provide the greatest value.

Flaring Out with Augmentation   At the other extreme, the collaborative offering (**d** in Figure 4.5b) becomes the augmented product enriched with features the customer values. Augmented features might include coordinated cost-reduction programs, technical assistance, delivery schedule guarantees, and cooperative advertising. Because collaborative efforts are designed to add value or reduce the costs of exchange between partnering firms, a price premium should be received for the collaborative offering.

Allegiance Healthcare Corporation has developed ways to improve hospital supply ordering, delivery, and billing that provide enhanced value to the customer.[39]

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[39]Valarie A. Zeithaml, Roland T. Rust, and Katherine N. Lemon, "The Customer Pyramid: Creating and Serving Profitable Customers," *California Management Review* 43 (Summer 2001): p. 134.

Instead of miscellaneous supplies arriving in boxes sorted at the convenience of Allegiance's needs, they arrive on "client-friendly" pallets customized to meet the distribution needs of the individual hospital. Moreover, hospitals can secure a structural connection to Allegiance through its ValueLink ordering system for added value and convenience.

Creating Flexible Service Offerings   Business marketers can gain a competitive edge by creating a portfolio of service offerings and then drawing on this portfolio to provide customized solutions for groups of customers or even individual customers.[40] First, an offering should be created that includes the bare-bones-minimum number of services valued by all customers in a particular market segment. Microsoft refers to these offerings as "naked solutions." Second, optional services are created that add value by reducing costs or improving the performance of a customer's operations. To meet the needs of particular customers, optional services can then be "custom wrapped" with the core offering to create added value.

Instituting the Best Processes

The sales force assumes a central relationship-management role in the business market. Technical service and customer service personnel also assume implementation roles that are important and visible in buying organizations. Successful relationship strategies are shaped by an effective organization and deployment of the personal selling effort and close coordination with supporting units, such as logistics and technical service. Some firms divide the sales organization into units that each serve a distinct relationship category such as transactional accounts or partnership accounts. Through a careful screening process, promising transaction accounts are periodically upgraded to partnerships.

Best Practices at IBM[41]   In serving a particular customer, a number of IBM employees come into contact with the customer organization. To ensure consistent strategy execution, IBM identifies three customer-contact roles for each of its accounts, specifies desired measurable actions for each role, and monitors the customer's degree of satisfaction with each role (Table 4.4). The IBM client representative assigned to the customer is the *relationship owner*, but the account team may include other specialists who complete a project for the customer (*project owner*) or solve a particular customer problem (*problem resolution owner*). Any IBM employee who works on the account can secure timely information from the CRM system to identify recent actions or issues to be addressed. Moreover, for each role, there is an in-process measure and a customer feedback measure.

Consider an IBM technical manager assigned responsibility for installing CRM software for a large bank. As a project owner, this manager's goal is to determine

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[40]James C. Anderson and James A. Narus, "Capturing the Value of Supplementary Services," *Harvard Business Review* 73 (January–February 1995): pp. 75–83. See also David Rickard, "The Joys of Bundling: Assessing the Benefits and Risks," The Boston Consulting Group, Inc., 2008, accessed at http://www.bcg.com on May 15, 2008.

[41]This discussion is based on Larry Schiff, "How Customer Satisfaction Improvement Works to Fuel Full Business Recovery at IBM," *Journal of Organizational Excellence* 20 (Spring 2001): pp. 3–18.

TABLE 4.4 | **Role-Based Strategy Execution at IBM: Measured Actions and Results**

Role	Strategy Goal	Measured Actions	Measured Results (Customer)
Relationship Owner	Improve Customer Relationships	Meet with customer twice per year to identify customer's expectations and set action plan	IBM Customer Satisfaction Survey Results
Project Owner	Exceed Customer Expectations for Each Transaction	Collect conditions of satisfaction, get customer feedback	IBM Transaction Survey Results
Problem Resolution	Fix Customer Problems	Solve in seven days or meet action plan	Customer Satisfaction with Problem Resolution

SOURCE: Adapted from Larry Schiff, "How Customer Satisfaction Improvement Works to Fuel Business Recovery at IBM," *Journal of Organizational Excellence* (Spring 2001): pp. 12–14.

the customer's conditions of satisfaction and then exceed those expectations. When the work is completed, members of the customer organization are queried concerning their satisfaction and the project owner acts on the feedback to ensure that all promises have been kept. Clearly, a sound complaint management process is essential. Recent research found that if a complaint is ineffectively handled, the firm faces a high risk of losing *even* those customers who had previously been very satisfied.[42]

Research suggests that the performance attributes that influence the customer satisfaction of business buyers include:

- the responsiveness of the supplier in meeting the firm's needs,

- product quality,

- a broad product line,

- delivery reliability,

- knowledgeable sales and service personnel.[43]

Motivating Employees

Dedicated employees are the cornerstone of a successful customer relationship strategy. Frederick F. Reichheld notes:

> Leaders who are dedicated to treating people right drive themselves to deliver superior value, which allows them to attract and retain the best employees. That's partly because higher profits result from customer retention, but more important, it's because providing excellent service and value generates pride and a sense of purpose among employees.[44]

[42]Christian Homburg and Andreas Fürst, "How Organizational Complaint Handling Drives Customer Loyalty: An Analysis of the Mechanistic and the Organic Approach," *Journal of Marketing* 69 (July 2005): pp. 95–114.

[43]Bowman and Narayandas, "Linking Customer Management Effort," pp. 433–447.

[44]Reichheld, "Lead for Loyalty," p. 78.

Employee loyalty is earned by investing heavily in training and development, providing challenging career paths to facilitate professional development, and aligning employee incentives to performance measures.[45] For example, Square D, an Illinois-based producer of electrical and industrial equipment, altered its performance-measurement and incentive systems to fit the firm's new customer strategy. Consistent with the goal of attracting high-value customers, salesperson incentives are no longer based on the number of units sold but on the number of customers acquired and on profit margins.

Research clearly demonstrates the link between salespeople's job satisfaction and customer satisfaction in business markets. Christian Homburg and Ruth M. Stock report that the relationship between salespeople's job satisfaction is particularly strong when there is a high frequency of customer interaction, high intensity of customer integration into the value-creating process, and high product or service innovativeness.[46]

Learning to Retain Customers

Business marketers track customer loyalty and retention because the cost of serving a long-standing customer is often far less than the cost of acquiring a new customer.[47] Why? Established customers often buy more products and services from a trusted supplier and, as they do, the cost of serving them declines. The firm learns how to serve them more efficiently and also spots opportunities for expanding the relationship. Thus, the profit from that customer tends to increase over the life of the relationship. To that end, a goal for IBM is to gain an increasing share of a customer's total information technology expenditures (that is, share of wallet). Rather than merely attempting to improve satisfaction ratings, IBM seeks to be recognized as providing superior value to its customers. Larry Schiff, an IBM strategist, notes: "If you delight your customers and are perceived to provide the best value in your market, you'll gain loyalty and market/wallet share."[48] Although loyal customers are likely to be satisfied, all satisfied customers do not remain loyal. Business marketers earn customer loyalty by providing superior value that ensures high satisfaction and by nurturing trust and mutual commitments.

Pursuing Growth from Existing Customers   Business marketers should identify a well-defined set of existing customers who demonstrate growth potential and selectively pursue a greater share of their business. Based on the cost-to-serve and projected profit margins, the question becomes: Which of our existing customers represent the best growth prospects? In targeting individual customers, particular attention should be given to: (1) estimating the current share of wallet the firm has attained; (2) pursuing opportunities to increase that share; and (3) carefully projecting the enhanced customer profitability that will result.[49]

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[45] Rigby, Reichheld, and Schefter, "Avoid the Perils of CRM," p. 104.

[46] Christian Homburg and Ruth M. Stock, "The Link Between Salespeople's Job Satisfaction and Customer Satisfaction in a Business-to-Business Context: A Dyadic Analysis," *Journal of the Academy of Marketing Science* 32 (Spring 2004): pp. 144–158; and Christian Homburg and Ruth M. Stock, "Exploring the Conditions Under Which Salesperson Work Satisfaction Can Lead to Customer Satisfaction," *Psychology & Marketing* 22 (5, 2005): pp. 393–420.

[47] Reichheld, "Lead for Loyalty," pp. 76–84.

[48] Schiff, "How Customer Satisfaction Improvement Works to Fuel Full Business Recovery at IBM," p. 8.

[49] James C. Anderson and James A. Narus, "Selectively Pursuing More of Your Customer's Business," *MIT Sloan Management Review* 44 (Spring 2003): pp. 42–49.

Evaluating Relationships   Some relationship-building efforts fail because the expectations of the parties do not mesh—for example, when the business marketer follows a relationship approach and the customer responds in a transaction mode. By isolating customer needs and the costs of augmented service features, the marketer is better equipped to profitably match product offerings to the particular customer's needs.

The goal of a relationship is to enable the buyer and seller to maximize joint value. This points to the need for a formal evaluation of relationship outcomes. For example, sales executives at best-practice firms work closely with their partnership accounts to establish mutually defined goals. After an appropriate period, partnerships that do not meet these goals are downgraded and shifted from the strategic market sales force to the geographic sales force.

Business marketers should also continually update the value of their product and relationship offering. Attention here should center on particular new services that might be incorporated as well as on existing services that might be unbundled or curtailed. Working relationships with customer firms are among the most important marketing assets of the firm. They deserve delicate care and continual nurturing!

Strategic Alliances

Not only do business marketing managers form close relationships with customers, they also develop close bonds with other firms. Strategic alliances have become an important tool for achieving a sustainable competitive advantage for leading business firms. To that end, the top 500 global businesses have an average of 60 major strategic alliances each.[50] **Strategic alliances** involve "a formal long-run linkage, funded with direct co-investments by two or more companies, that pool complementary capabilities and resources to achieve generally agreed objectives."[51] In contrast, a **joint venture** involves the formation of a separate, independent organization by the venture partners.

Accessing Complementary Skills

The driving force behind the formation of a strategic alliance is the desire of one firm to leverage its core competencies by linking them with others who have complementary expertise, thereby expanding the product, market, and geographic scope of the organization. Simon Hayes, vice president of Enterprise Strategic Alliances at Cisco Systems, observes: By combining the best that partners have to offer, "strategic alliances are helping companies enhance their strategic presence in the marketplace and develop new solutions to attract new customers or even create whole new market categories."[52] Cisco Systems, a recognized leader in partnering and collaboration, has formed deep, long-term relationships with a host of strategic alliance partners, including Microsoft, IBM, Hewlett-Packard, Nokia, Fujitsu, Accenture, Intel, Italtel,

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[50]Jeffrey H. Dyer, Prashant Kale, and Habir Singh, "How to Make Strategic Alliances Work," *MIT Sloan Management Review* 42 (Summer 2001): pp. 37–43. See also Fred A. Kuglin and Jeff Hook, *Building, Leading, and Managing Strategic Alliances* (New York: AMACOM, 2007).

[51]George S. Day, *Market Driven Strategy: Processes for Creating Value* (New York: The Free Press, 1990), p. 272.

[52]Simon Hayes, "Getting Strategic Alliances Right," *Synnovation* 3 (May 2008), p. 72, accessed at www.eds.com/synnovation on July 5, 2008.
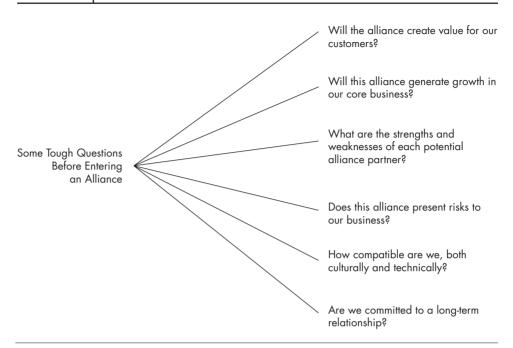
FIGURE 4.6 | **A Strategic Alliance: Before the Handshake**

Some Tough Questions Before Entering an Alliance

Will the alliance create value for our customers?

Will this alliance generate growth in our core business?

What are the strengths and weaknesses of each potential alliance partner?

Does this alliance present risks to our business?

How compatible are we, both culturally and technically?

Are we committed to a long-term relationship?

SOURCE: Adapted from Simon Hayes, "Getting Strategic Alliances Right," *Synnovation* 3 (May 2008): p. 74, accessed at www.eds.com.

and many others. For example, the Microsoft–Cisco alliance, formed more than a decade ago, addresses the needs of enterprise and small and medium-size (SMB) customers who need affordable, integrated customer relationship management (CRM) solutions that advance business results and deliver superior customer service. (See Figure 4.6.)

Benefits of Strategic Alliances

Partners to an alliance seek benefits such as (1) access to markets or to technology (a motivating force for General Electric's partnerships in China and India); (2) economies of scale that might be gained by combining manufacturing, R&D, or marketing activities; (3) faster entry of new products to markets (for example, when partners with established channels of distribution in different countries swap new products); and (4) sharing of risk.[53] Simply put, there is a tremendous cost—and risk—when a firm creates its own distribution channels, supply chain network, manufacturing plant, and R&D function in every key market in the world. Also, it takes time to develop relationships with channel members and customers and to develop the skills of employees. Alliances provide an inviting option.

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[53] Kenneth Ohmae, "The Global Logic of Strategic Alliances," *Harvard Business Review* 67 (March/April 1989): pp. 143–154.

Determinants of Alliance Success

Although offering significant benefits, alliances often fall short of expectations or dissolve. Managing an alliance involves special challenges. Therefore, the ability to form and manage strategic alliances more effectively than rivals can be an important source of competitive advantage.

Building a Dedicated Alliance Function   While many firms generate positive results from strategic alliances, an elite group of firms has demonstrated the capability to generate superior alliance value as measured by the extent to which the alliance met its stated objectives, the degree to which the alliance enhanced the company's competitive position, stock market gains from alliance announcements, and related performance dimensions. Included among the top performers are firms such as Hewlett-Packard, Oracle, Eli Lily & Company, and others. How did they do it? By creating a dedicated strategic alliance function—headed by a vice president or director of strategic alliances with his or her own staff and budget, says Jeffrey H. Dyer and his research team.[54] "The dedicated function coordinates all alliance-related activity within the organization and is charged with institutionalizing processes and systems to teach, share, and leverage prior alliance management experience and know-how throughout the company."[55] Simon Hayes, the Cisco vice president who heads the dedicated alliance function, says:

> At Cisco, we're investing in our alliances with best-practice "videos on demand," strategic alliance leadership-development programs, and strategic scenario-analysis workshops. We believe that the best way to show commitment is with a dedicated, trained, and capable alliance team.[56]

Developing a Joint Value Proposition   Even before negotiations begin, the partners should develop a strategy map that details the shared strategy and the specific value proposition that the partners will deliver to the customer. A close and concise statement of the value proposition is an essential step to getting the organization aligned around a common view of the alliance strategy goals, agreeing upon the unique benefits that the partners will jointly offer to customers.

Developing Close Working Relationships   Rosabeth Moss Kanter emphasizes: "Alliances . . . require a dense web of interpersonal connections and internal infrastructures that enhance learning."[57] Observe the interpersonal connections that unite two *Fortune* 500 firms (referred to as Alpha Communications and Omega Financial Services) in an alliance that markets a cobranded credit and calling card targeted to the business market (see Figure 4.7). The lines connect alliance personnel who have *frequent* and *important* communications and who consider the working relationship to be close. These managers are the **core participants** in the work of the alliance, in contrast to others who are more loosely connected to the alliance team in each

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[54]Dyer, Kale, and Singh, "How to Make Alliances Work," p. 37.

[55]Ibid., p. 38.

[56]Hayes, "Getting Strategic Alliances Right," p. 76.
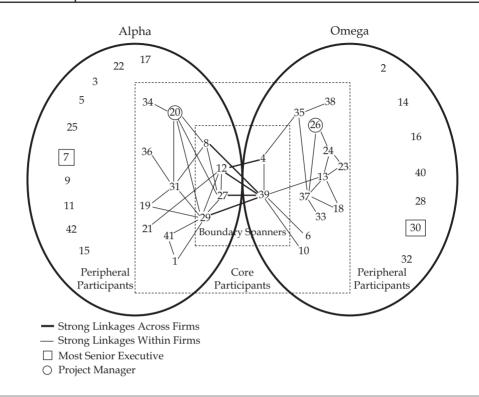
[57]Kanter, "Collaborative Advantage," p. 97.

each other's prerogatives and obligations.[58] By promoting openness and flexibility, these interpersonal bonds can speed alliance progress—decisions can be made quickly, unexpected events can be more readily handled, learning is enhanced, and new possibilities for joint action emerge.

Integrating Points of Contact   Firms that are adept at managing strategic alliances use a flexible approach, letting their alliances evolve in form as conditions change over time. They invest adequate resources and management attention in these relationships, and they integrate the organizations so that the appropriate points of contact and communication are managed. Successful alliances achieve five levels of integration:[59]

1. *Strategic integration*, which entails continuing contact among senior executives to define broad goals or discuss changes in each company;

2. *Tactical integration*, which brings middle managers together to plan joint activities, to transfer knowledge, or to isolate organizational or system changes that will improve interfirm connections;

3. *Operational integration*, which provides the information, resources, or personnel that managers require to carry out the day-to-day work of the alliance;

4. *Interpersonal integration*, which builds a necessary foundation for personnel in both organizations to know one another personally, learn together, and create new value; and

5. *Cultural integration*, which requires managers involved in the alliance to have the communication skills and cultural awareness to bridge the differences.

The Social Ingredients of Alliance Success[60]

In a strategic alliance, interpersonal relationships matter. The goals of an alliance cannot be realized in practice until many managers in both organizations know one another personally and take coordinated action to create new value together. Indeed, many alliances that appear to make strategic sense fail to meet expectations because little attention is given to cultivating the interpersonal connections and communication patterns that underlie effective collaboration. Strong interpersonal ties must be forged to unite managers in the partnering organizations and continuing boundary-spanning activity is required at multiple managerial levels as a relationship evolves.

Laying the Foundation   Alliance negotiations set the tone for the relationship. Smooth alliance negotiations rest on finding the proper balance between the formal, legal procedures that establish detailed contractual safeguards for the parties and the informal, interpersonal processes that are crucial in the successful execution of alliance strategy.

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[58]Peter Smith Ring and Andrew H. Van de Ven, "Developmental Processes of Cooperative Interorganizational Processes," *Academy of Management Review* 19 (January 1992): pp. 90–118.

[59]Kanter, "Collaborative Advantage," pp. 105–107.

[60]This section is based on Michael D. Hutt, Edwin R. Stafford, Beth A. Walker, and Peter H. Reingen, "Defining the Social Network of a Strategic Alliance: A Case Study," *MIT Sloan Management Review* 41 (Winter 2000): pp. 51–62.

Legal documents that establish an alliance and specify the boundaries in elaborate detail are still not complete and exhaustive. Countless ambiguities become evident as middle managers begin to flesh out the specific elements of the alliance plan. To resolve these issues and move the alliance forward, it is here that personal relationships begin to develop and supplement formal role relationships. Alliance negotiations should be structured in a manner that promotes the development of these interpersonal ties.

Experts suggest that more effective transactions are likely to evolve when managers, rather than lawyers, develop and control the negotiation strategy.[61] In turn, "negotiations appear to go more smoothly when parties from different organizations interact with their role counterparts (for example, managers to managers or lawyers to lawyers)."[62] Interactions between lawyers are largely based on institutionalized professional norms, center on a specific activity, and take place over a relatively short period of time. A signed agreement culminates the work of the lawyers; manager-to-manager relationships formed during negotiations provide the social structure through which the goals of the alliance can be realized.

Isolating Top-Management's Role   Beyond establishing joint goals and determining how the alliance fits each firm's total strategy, senior executives define the meaning of the relationship and signal its importance to personnel in the respective firms. Top-management's involvement in a strategic alliance encompasses much more than merely appointing an alliance manager or project leader. In addition to creating a dedicated strategic alliance function, many business-to-business firms, like General Electric and Cisco, appoint an executive sponsor for each alliance. For an alliance-based strategy to succeed, an ongoing level of backing from top management is required.

Executive leadership also assumes a critical role in communicating the strategic role of the alliance and in creating an identity for the alliance within the organization. A senior executive's personal involvement galvanizes support for an alliance throughout the organization. Moreover, direct ties at the top-management level across partnering firms spawn organizational commitment and more active involvement between managers at multiple levels of the hierarchy. If visible participation by senior executives is lacking, the members of the alliance team will begin to question the importance of the initiative to their firm and the value of team membership to their careers.

Cultivating a Network of Relationships   To achieve alliance goals, a well-integrated communication and work-flow network among managers is required within and across firms. A regular audit of evolving social, work, and communication ties can be a valuable tool for management in gauging the health of an alliance and in spotting problem areas. In reviewing the alliance network, attention first should center on relationship patterns at multiple levels. In particular, connections should be examined among **operating personnel** who require timely access to information and resources; between the **project leaders** who establish the climate for the alliance, craft the strategy, and manage execution; and among **senior managers** who signal the importance of the relationship in their respective organizations, lend critical support at key points, and are central to discussions of new opportunities for successful collaboration.

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[61] Peter Smith Ring and G. Rands, "Sensemaking, Understanding, and Committing: Emergent Transaction Processes in the Evolution of 3M's Microgravity Research Programs," in A.H. Van de Ven, H. Angle, and M. S. Poole, eds., *Research on the Management of Innovation: The Minnesota Studies* (New York: Ballinger/Harper & Row, 1989), pp. 337–366.

[62] Peter Smith Ring and Andrew H. Van de Ven, "Developmental Processes of Cooperative Interorganizational Processes," *Academy of Management Review* 19 (January 1992): p. 109.

Summary

Relationships, rather than simple transactions, provide the central focus in business marketing. By demonstrating superior skills in managing relationships with key customers as well as with alliance partners, business marketing firms can create a collaborative advantage.

To develop profitable relationships with customers, business marketers must first understand the different forms that exchange relationships can take. Transactional exchange centers on the timely exchange of basic products and services for highly competitive market prices. By contrast, collaborative exchange involves very close personal, informational, and operational connections the parties develop to achieve long-term mutual goals. Across the relationship spectrum, different types of relationships feature different relationship connectors. For example, collaborative relationships for important purchases emphasize operational linkages that integrate the operations of the buying and selling organizations and involve high levels of information exchange.

Activity-based costing provides a solid foundation for measuring and managing the profitability of individual customers. When the full costs of serving customers are known, many companies find that 15 to 20 percent of the customers generate 100 percent (or much more) of the profits, a large group of customers break even, and 5 to 10 percent of the customers generate sizable losses. By measuring the cost-to-serve and the net profit from individual customers, business marketing managers can take actions to transform unprofitable relationships into profitable ones through process improvements, menu-based pricing, or relationship management.

Customer relationship management involves aligning customer strategy and business processes for the purpose of improving customer loyalty and, eventually, corporate profitability. To that end, a customer strategy encompasses (1) acquiring the right customers, (2) crafting the right value proposition, (3) instituting the best processes, (4) motivating employees, and (5) learning to retain customers.

The driving force behind the formation of a strategic alliance is the desire of one firm to leverage its core competencies by linking with another firm that has complementary expertise, thereby creating joint value and new market opportunities. Firms adept at managing strategic alliances create a dedicated alliance function, develop a shared strategy map and a clear value proposition that the partners will provide to target customers, and nurture the interpersonal relationships that are crucial to success. A well-integrated communication and work-flow network is required within and across firms. And senior executives' personal involvement galvanizes crucial support. A regular audit of evolving relationship ties can be a valuable tool for gauging an alliance's health.

Discussion Questions

1. A marketing research company found that 6 percent of its clients generated 30 percent of sales and nearly all of its profits. At the other end of the continuum, 70 percent of its clients provided annual billings (revenue) that were below break-even levels, because these customers required an extensive amount of service from research employees. The company took immediate action to terminate relationships with clients who would not give them a higher share of their marketing research expenditures. Evaluate this decision and suggest a set of criteria that the firm might use to screen new clients.

2. Describe how a firm might use menu-based pricing to restore profitability to a high-cost-to-serve customer who demands extensive service and customized support.

3. Evaluate this statement: Large customers tend to be either the most or least profitable in the customer base of a business-to-business firm.

4. Sony develops "collaborative relationships" with some suppliers and "transactional relationships" with other suppliers. What criteria would purchasing executives use in segmenting suppliers into these two categories? Describe the steps a business marketer might take to move the relationship with Sony from a transaction relationship to a more collaborative one.

5. Some consulting organizations persuasively argue that by properly incorporating suppliers into their product-development process, firms can cut their bills for purchased parts and materials by as much as 30 percent. Explore how a buyer-seller partnership might create these cost savings.

6. Concerning buyer-seller relationships, compare and contrast the features of a collaborative relationship versus a transactional relationship in the business market. Describe how the operational linkages might differ by relationship type.

7. Why is the cost of serving a long-standing customer far less than the cost of acquiring a new customer?

8. Discuss the switching costs that Southwest Airlines would incur if it began to phase out its fleet of Boeing airliners with replacements from Airbus. What steps could Airbus take to reduce these switching costs? How might Boeing counter to strengthen its relationship with Southwest?

9. Describe how an office supply firm may have a core offering of products and services for a small manufacturer and an augmented offering for a university.

10. Knowing how to be a good partner is an asset in the business market as Cisco Systems clearly demonstrates. Describe the characteristics of a successful strategic alliance and outline the steps that alliance partners can take to increase the odds that alliance goals will be achieved.

Internet Exercises

1. Oracle Corporation provides customer relationship management software solutions to all sectors of the business market. Go to http://oracle.com and review "success stories" and

    a. identify a particular Oracle customer from the government sector, and

    b. describe the benefits that this government customer received from the software solution.

Hewlett-Packard Challenges from a Diverse Mix of Demanding Customers

Hewlett Packard (H-P) serves a diverse set of customers in the business market and devotes special attention to the Global 1,000—the 1,000 largest enterprises in the world. Across these organizations, however, different perspectives and approaches are used in making information technology (IT) purchases. This diversity across customer groups presents a host of challenges for H-P.

- *Customer Group A* demands a wide variety of IT products, routine maintenance support, and customized services. These customers value the relationship with H-P and are willing to pay a premium for product and service quality.

- *Customer Group B* wants high-quality IT products (e.g., printers, servers) but, most of all, these customers want a rock-bottom price and choose suppliers on that basis.

- *Customer Group C* demands both quality products and extensive service support but wants all of this for a "rock-bottom" price. These customers will freely switch from one supplier to the next. As competition intensifies for H-P and others in the IT sector, more customers are moving into this group each month.

First, describe how H-P might develop a portfolio of relationship strategies to meet the needs of such diverse customer groups. Second, some customers in each group are more costly to serve than others. How should such cost differences be reflected in the particular relationship strategies that H-P follows? Third, what strategies can H-P follow to increase the switching costs of customers in Group B or Group C or increase the profits it derives from these customer groups?