Chapter 10

Managing networks for customer relationship management performance

Chapter objectives

By the end of this chapter, you will understand:

1. **the meaning and composition of a business network**
2. **how networks contribute to the achievement of CRM objectives**
3. **the meaning of network position and network competence**
4. **the SCOPE network model of CRM**
5. **that network management is about both managing in networks and management of networks**

Introduction

This chapter focuses on networks and their influence on CRM. Companies do not exist in splendid isolation. They are positioned within a network, and it is the performance of that network which determines whether companies achieve their goals. CRM performance is more assured when the resources of the network are aligned and coordinated to contribute to the creation and delivery of value to the focal company's customers.

Our definition of CRM, repeated below, recognizes the role of the business network in the achievement of CRM outcomes.

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

Competition for the customer's spend is changing. In the past, competition has been head to head between independent companies. Today, competition is increasingly between networks. A good illustration of this is the motor industry. In the 1920s Ford not only assembled cars, they also owned steel mills, coal mines, iron ore mines, steam ships, rubber plantations, sheep farms and railroads. It was standard practice for companies to own and manage as many factors of production that they could. Today it is different. In the year 2000, Ford only produced about 50 per cent of the value of their cars. The rest was outsourced to members of their supplier network. In Ford's strategic group, General Motors produces 70 per cent of the value of its cars, Chrysler 30 per cent and Toyota only 20 per cent.

Conventionally it has been the manufacturer or service provider that dominates business networks through their brand power. Companies like IBM, GE (General Electric), UPS (United Parcel Service) and AMP (Australian Mutual Provident) are examples. This is changing. Sometimes the members of the supply chain can be so powerful that they call the shots. Intel and Microsoft carry so much weight that computer manufacturers such as Dell, Toshiba and Compaq take great risks if these components are not part of the finished product.

Members of the demand chain can also wield significant power and influence. A high percentage of sales in some retail categories are retailer brands (own brands). Wal-Mart and Tesco both specify precisely what they require from their own brand manufacturers. Sometimes manufacturers have a role in helping determine the specification, but ultimately it is clear where the final decision rests: with the retailer. Multiple retailers also have sufficient power to expect compliance from manufacturers of major brands. Even Procter and Gamble, Unilever and General Foods are not exempt from their influence. Wal-Mart, however, does claim to want closer relationships based on open dialogue and information exchange with key vendors (see Case 10.1).

Case 10.1

Wal-Mart's commitments to key vendors

Wal-Mart makes a number of commitments to major suppliers with whom it wants to develop partner-like relationships.

- Wal-Mart looks for a very close relationship and strong commitment from its key vendors. Highly valued qualities are trust and integrity.
- Wal-Mart is willing to listen to new solutions, opinions and ideas. Don't be afraid to contribute.
- Analytical skills are essential when dealing with Wal-Mart. We will give you access to all kinds of data. Use the data to build a win–win relationship.
- Wal-Mart is hungry for consumer insight. We place great value on any information that can improve our understanding of the people who shop in Wal-Mart stores.
- Prepare to engage management. Wal-Mart management is as keen as anyone to hear what business partners have to say. Don't feel bound by hierarchy or categories.

What is a network?

The term 'network' can, in general terms, be thought of as a structure made up of nodes that are related to each other by threads. Figure 10.1 shows the nodes and threads of a simplified social network, that is, a group of friends and acquaintances. The nodes are the ovals and the lines joining them are the threads. The nodes are people (lettered A to L) and the threads are the social links between them. This network has been drawn from the perspective of person A. She is a very well-connected person. Persons B to I are all connected to A by direct threads. One step removed from person A is person K. A does not know K personally, but she knows persons I and J, both of whom know K. K knows L, who is two steps removed from A. Where does A's network finish? Clearly, the answer is 'not at the edge of the diagram'. Each of the people with whom A is directly connected has relationships with other people, many of whom are not shown on this diagram. They in turn have connections with others, and so on. Person A's network, in principle, contains all her direct connections, their direct connections, and their direct connections, and their direct connections, and their … *ad infinitum*. Network analysts tend to draw boundaries around networks to make them more visible and amendable to analysis.

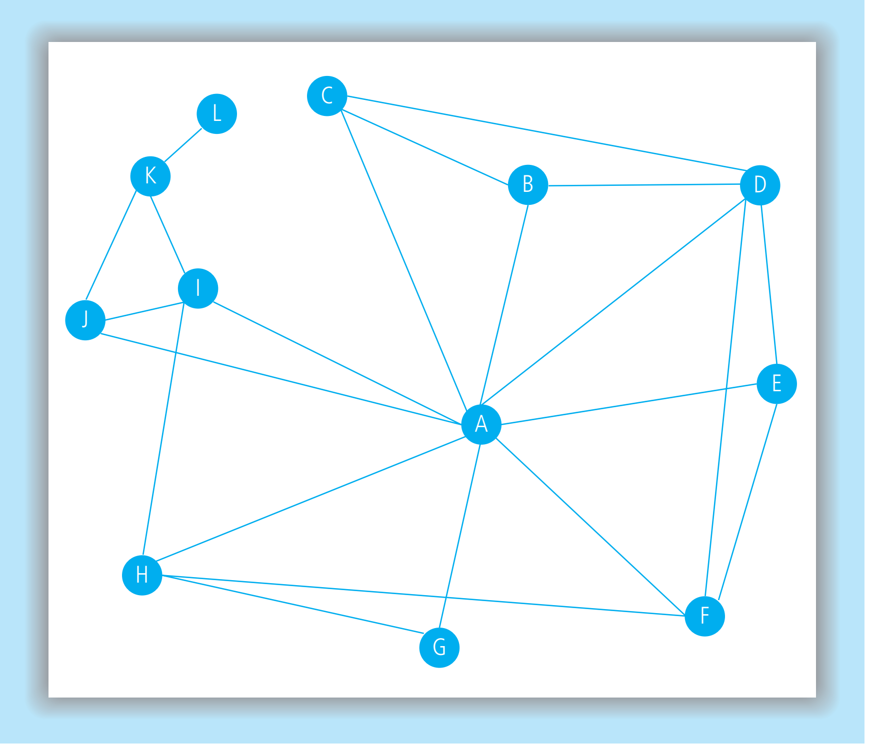

Figure 10.1
A network

Business networks

Business networks exist. They are unavoidable. They are a fact of business life whether they are actively coordinated or not. A business network can be defined as follows:

> A business network is made up of nodal companies, organizations and individuals, and the relationships between them.

In the context of business markets, these nodes are business units such as suppliers, producers, distributors, partners, regulators, contractors, customers and other companies, organizations and individuals. The relationships between these business units are expressed in actor bonds, activity links and resource ties. To recap material that was introduced in Chapter 2, actor bonds are interpersonal contacts between people in network-related firms; activity links are the commercial, legal, administrative and other connections that form between companies as they interact; resources are the human, financial, legal, physical, managerial, intellectual and other strengths or weaknesses of firms in the network.

Intercompany and interpersonal relationships within a network form a complex social structure. This happens in many ways. Equity stakes in companies make for complex patterns of ownership and influence. Company A has a stake in company B; company B has a stake in companies A and C. Company C has stakes in companies A and D. Directors have multiple memberships of network companies' boards. Marketers meet up at branch meetings of their professional organizations. Salespeople organize social events for their key account holders. Personal relationships contribute to the atmosphere of a business relationship, making it close or distant, friendly or antagonistic, open or closed. Established interpersonal relationships both enable and constrain the development of other interpersonal relationships.

Any firm participates in a host of different relationships, and the firms with which it has relationships also have relationships with other firms. Therefore, any one firm occupies a position within a network of other firms. Each firm in a network is likely to have its own picture of the network, which may be very different from other firms in the same network. Each firm tries to exert some influence over significant parts of its network, for example to ensure that manufacturing inputs are available and customer demand is constant. Some research has suggested that the average firm has ten such strategically important network relationships.[1]

Network position

Every company occupies a network position. Network positions are the products of an organization's past and present operations. They result from relationships and interactions that were, or are, needed for the firm to do what it was set up to do. Every company in every network occupies a particular position in relationship to other network members. Network position can be defined as follows:

> A company's network position is the sum total of a company's network relationships and all the activity links, resource ties and actor bonds that these relationships contain.

These relationships both constrain and enable what that firm can do in the future. A company that has all the relationships in place to be a successful shipbuilder cannot become a financial institution without creating new relationships that provide the necessary skills and resources. Relationships can have more advantageous consequences. A supplier might introduce a firm to one of its customers, enabling them to work on a project of shared interest. Alternatively, a supplier might choose to withdraw from a relationship with a customer in order not to endanger a relationship with a bigger, more profitable customer.

A company's network position is a resource that can create competitive advantage. Networks supply the resources and perform the activities that enable companies to create and deliver value to their customers. Network positions are dynamic. Members adapt their network positions to ensure their survival and prosperity. They look for opportunities to exploit. For example, they seek out relationships that can be used to lift sales or reduce costs. Avon Rubber, for example, manufactures engine mounts for the car industry and counts Ford as one of its strategically significant customers. It leveraged its relationship with this reference customer to win business from Saab, and to enable it to present its credentials to other car manufacturers.

Clearly, some network positions are more influential than others. For example, a network member might be positioned as a gatekeeper to opportunities that are highly sought after by other network members. The supplier of a subassembly, such as a braking system for a car, has considerable network power in enabling or disabling access of component suppliers to the car manufacturer.

Whether a desired network position is achieved is determined at least in part by the firm's network competence. This is the firm's ability to accrue and/or utilize the necessary knowledge, skills, qualifications and experience to successfully manage network interactions.[2] Skilful management of the company's network position can realize several benefits. Toyota uses its network position to enhance their cars' reliability, economy and design. Toyota works with and through its network members to keep costs low, while ensuring product quality is high. Every company's network position is subject to a set of relational obligations and restraints among network members. For example, in the Toyota scenario (see Figure 10.3) the company expects tier one suppliers to develop and strengthen their relationships with tier two suppliers to ensure that Toyota gets the quality they require. Tier two suppliers expect tier one suppliers to maintain a good relationship with Toyota to ensure that they have ongoing access to a strategically significant customer.

It is unlikely that all the potential for competitive advantage that is contained in a network is presently exploited. Focal companies may not be fully aware of the opportunities that exist for cooperation and rationalization between network members. For example, there may be opportunities to bring together the innovative competencies of one network member, the manufacturing expertise of another and the marketing know-how of a third company, to create and launch successful new products. Or there may be opportunities to develop joint purchasing arrangements. Perhaps it might be possible to eliminate some processes that are duplicated. For example, a supplier may have a quality assurance programme in place; the supplier's customer may not need a quality control programme based on inspection of that supplier's products.

What is meant by ‘focal firm?’

We’ve already used the expression ‘focal firm’ in this chapter. The focal firm is the firm whose network is being considered. If you are examining Delta Plastics’ network, Delta Plastics is the focal firm. Sometimes the threads linking a focal firm to its network are loosely connected; at other times they are contractually defined and tightly controlled, as in the relationship between Dell Computers and its component suppliers.

There is growing recognition that the resources within networks need to be actively coordinated and managed. A focal organization must take responsibility for managing its network so that it creates and delivers sustainable value to customers. Failure by a network member to provide the necessary resources or perform the required activities could threaten the performance of the focal organization. Although firms do try to exert influence within their immediate network neighbours, actions elsewhere in the network – though several steps removed from the focal firm – might make a considerable difference to that firm’s performance. For example, the collapse of an agricultural chemical firm in Brazil might lead to a dramatic rise in the cost of coffee beans, which in turn drives up the retail price of coffee in overseas markets, in turn fuelling consumer demand for an alternative hot beverage, tea.

Business networks and CRM

Networks are important from a strategic CRM perspective, because network members supply the material inputs, services, funding, people, technology and knowledge that are used to create value propositions for the focal firm’s customers. They also provide services such as advertising, logistics and distribution that help raise and satisfy customer demand.

Consider, for example, that some retailers have developed relationships with banks to offer financial services products to the retailer’s customers. You can find this arrangement in the UK, where Tesco and Royal Bank of Scotland are partners, and in Australia where Woolworths and Commonwealth Bank partner. This is an arrangement that blurs the conventional customer-perceived distinctions between retailer and bank. For partnerships like these to succeed, each partner needs to understand the other party’s competences, to share customer-related information, to align their technologies and to be clear about the goals of the partnership. If the relationship between the retailer and the bank is poorly managed, value will not be delivered to customers or created for the partners. Liberating the potential value in customer relationships also hinges on companies effectively managing their non-customer network relationships, that is, relationships with alliance partners, suppliers, distributors, financiers and so on.

The need to manage business networks is recognized in modern CRM systems, with the move towards extra-enterprise, or collaborative, CRM. CRM systems now include applications for managing relationships with partners (PRM), the integration of websites for investor relations, the management of relationships with employees (ERM) and, through integration with enterprise resource planning (ERP), the management of suppliers.

The SCOPE of CRM

There are four main constituencies of a focal organization's network. As illustrated in Figure 10.2, they are suppliers, owners/investors, partners and employees. This figure shows the focal firm's customers at the heart of the network and the four constituencies rotating around them. You can use the mnemonic SCOPE to remember the constituencies in the network: S = suppliers, C = the focal firm's customers who are at the hub of the network, O = owners/investors, P = partners and E = employees. The direction of the arrowhead in the outer wheel is meant to indicate that they are all aligned to the common goal of helping the focal firm create and deliver value for, and from, their chosen customers. Three of these constituencies are external to the company: suppliers, owners/investors and partners. One is internal: employees. We can even think of this internal constituency as being a network in its own right. Individuals within firms have formal relationships with colleagues, for example in a reporting hierarchy or cross-functional teams. They also have informal relationships that are not task oriented. We examine relationships with suppliers, partners and employees in subsequent chapters.

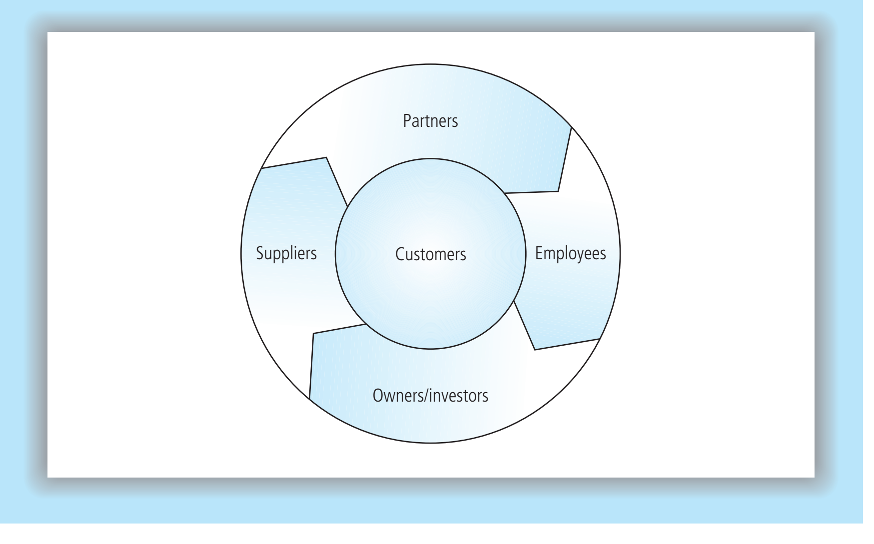

Figure 10.2
The SCOPE of CRM

Most companies operate within and through two major network constituencies: supplier networks and distribution networks. We introduce these in the following sections.

Supplier networks

As you read earlier, Toyota only manufactures about 20 per cent of the value of its cars. It relies on a network of approximately 50 000 supplier relationships to create and supply the inputs required for car manufacture. This is not to say that Toyota tries to manage 50 000 relationships. The company has a number of critical relationships with tier one suppliers (see Figure 10.3); these in turn have a number of important relationships that enable them to create and deliver what Toyota wants. They have relationships with third tier companies that enable them to meet their customers' requirements, and on.[3]

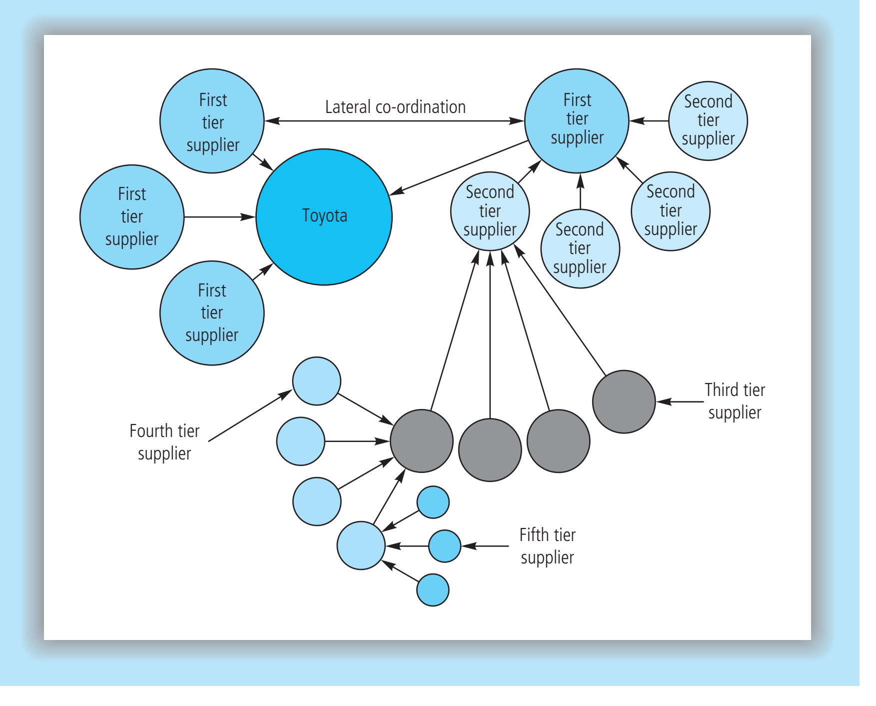

Figure 10.3
Toyota's supplier network

Toyota regards these tier one suppliers as 'systems suppliers'. This means that they not only supply the parts that they manufacture, but they are also responsible for managing the contributions of a network of lower tier suppliers. This is much the same idea as the 'category captain'. Some large supermarket operators have appointed category captains to work cooperatively with them to create profitable product categories. A category is a class of product, such as men's shaving supplies, hosiery or ice-cream. The category captain is responsible to the retailer for assembling a network of complementary lower tier suppliers that contribute to the category performance.

This illustrates a number of features of networks. Unlike single supplier–customer relationships, networks consist of a large number of indirect relationships. They also demand careful coordination. Toyota needs to work closely with tier one suppliers, so that they know exactly what Toyota wants and when. Many of these tier one suppliers will have their own CRM systems to manage their relationships with Toyota. Tier one, in turn, needs to coordinate with tier two suppliers. There might also need to be lateral coordination between suppliers at any tier. For example, this might be needed when Toyota's tier one suspension subassembly manufacturer needs to coordinate with Toyota's tier one braking system subassembly manufacturer.

Large companies within networks can exert considerable influence on the overall structure and performance of the network. Toyota might, for example, insist on specific product quality standards, not only from tier one suppliers, but also from tier two, three or four suppliers. It might also require a tier three supplier to stop purchasing from a tier four supplier, if that supplier also supplies a competitor. Toyota does, in fact, try to influence suppliers up to three tiers away.

Networks may be global. With increased concentration of manufacturing and globalization of brands, companies are faced with the challenge of sourcing inputs that are of a universal standard, whether the end customer is in America or Azerbaijan, Sydney or Shanghai. Kodak has addressed this problem by classifying its suppliers into three groups, world source suppliers, preferred suppliers and niche suppliers, as shown in Figure 10.4. This enables Kodak managers to purchase with confidence.

- World-source supplier
  - Required sources of specified products. Global suppliers. Prices negotiated centrally. Formal variance approval required for purchasing from other sources.
- Preferred supplier
  - Kodak identifies a few specific sources for a specific input. Purchasing from these sources is encouraged though not mandated. May have global or regional pricing agreements.
- Niche supplier
  - Specific suppliers of input for specific applications.

Figure 10.4 Kodak's supplier classification

Distribution networks

All companies have distribution networks. Some commentators prefer to use the term 'demand chain' to describe the linear arrangement of customers of the focal firm, their customers, and the customers of these customers, until the end user is reached. However, closer examination shows these to be network arrangements, not linear chains. Figure 10.5 shows how IBMs demand network moves computers so they reach end users in Italy.[4]

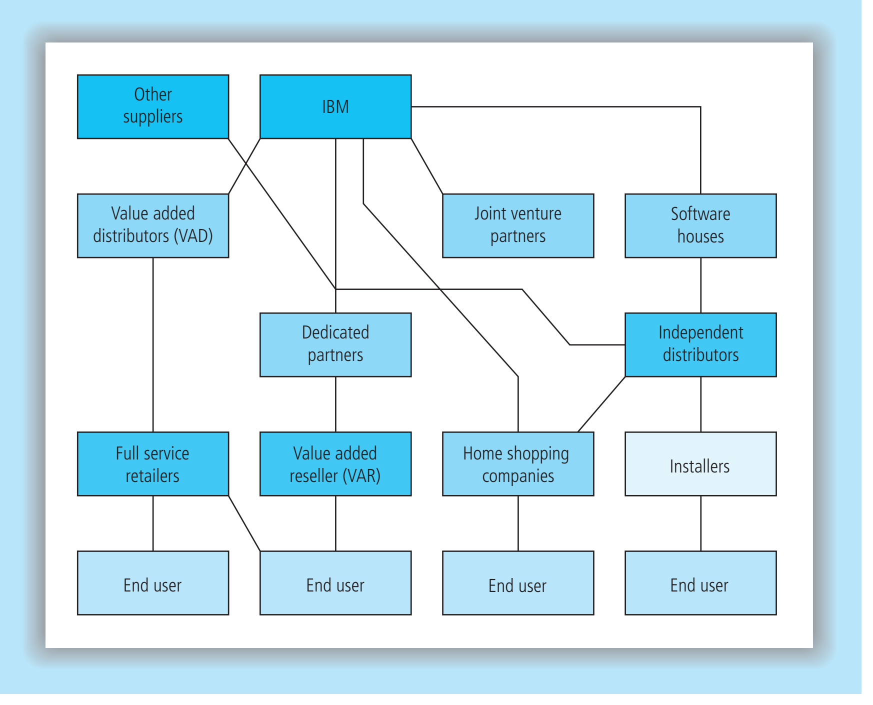

Figure 10.5
IBM's distribution network in Italy

This network illustrates a number of other features of business networks. Networks comprise a variety of organizations that contribute in different ways to the performance of a focal organization. Companies bring different competencies, resources, relationships, management styles and histories to the network. Quite possibly, each company will have been established and developed for different purposes, and may be working towards objectives that are in conflict with those of the focal firm. There is often potential for conflict in the relationships of customers and the focal firm. In this illustration, IBM supplies home shopping companies directly, thus denying its other first tier customers the opportunity to develop their own relationships with these catalogue companies. Managing network relationships can be very demanding. Customers will probably require different forms of contact with the focal company. Some might want the support of a key account management team; others might want to self-manage their purchasing through a portal. The focal company may or may not be willing to accommodate these requirements, depending upon the profit potential of the customer, or other considerations.

Principles of network management

In this section we set out a number of principles of network management.[5]

Networks are not controlled by single companies. There is no senior management team directing the operation of any network. All networks are complex, adaptive, self-regulating systems. Networks evolve as companies interact with each other over time, each member jostling for position, acting and reacting as they see fit.

However, there are circumstances where single companies do have significant influence, though not absolute control, over business networks. It is also true that all companies, whether they are bit players or star performers, want to exert influence over important network relationships in order to enhance and protect their competitive positions.

The degree of interdependence between network members plays a big role in determining the extent to which any party can influence, or be influenced by, others. If company A is highly dependent on company B, company B has the power to manage the relationship as it sees fit. If company A is also dependent on B, in other words the parties are mutually dependent, the power balance is likely to tend towards equilibrium and the relationship is likely to be managed as a partnership. If neither party is dependent on the other, then there may be no relationship to manage. It is clear that network management can be as much about being manageable, as about managing.[6]

Thomas Ritter and his colleagues have developed the idea of 'network competence' to describe the proficiency of companies in the twin tasks of managing both networks and individual relationships within networks. A company that is high in network competence not only has the necessary knowledge, skills, and qualifications, but also uses them effectively to manage relationships at both the network level and the individual level.[7] This suggests an important distinction that can be made between management of networks and management in networks.

Management of networks

Single companies, particularly in highly concentrated industries, can exert significant influence over business networks. You have already read about the Toyota case, for example. There are other contexts where this influence is found. Grocery supply-networks are dominated by retail multiples such as Wal-Mart and Tesco. Franchise operations are run by franchisors that typically specify and control every detail of their franchisees' operations. In these situations senior managers of the focal firm might think of themselves as being the network hub or channel captain. Their strategic orientation is towards the performance of the entire network.

New business start-ups are typically faced with the challenge of designing their networks from scratch. They have no relationships *in situ*, so they have to create the relationships that will enable them to create and deliver the desired value proposition and customer experience, in effect facing the same challenges as those charged with responsibility for strategic CRM. These challenges fall into three major categories: identify network requirements, acquire network expertise and manage network performance.

1. **Identify network requirements**: companies need to identify the business activities that must be performed by network members to create and deliver value for and from their chosen customers. These activities may be performed by suppliers, distributors, franchisees, contractors or business partners, for example. Some of these will be critical to value creation and delivery, others will not.
2. **Acquire network expertise**: companies will need to evaluate their current network position to identify current network members and assess whether they have the resources and commitment to perform the activities required. If the present network is inadequate, companies will need to extend their network to find the resources to perform the activities that are required. Effectively, they will be leveraging existing or developing new actor bonds at the organizational or interpersonal level to improve network performance. The resource constellation of the network is the sum of resources that are invested in interfirm relationships across the network as a whole. In a complex network, there is almost certain to be both underemployed resources and resource shortages. Are there ways in which the resources of the network could be better deployed? For example, does the focal company need to run its own fleet of vehicles when a network member has spare capacity in logistics? Must the focal company set up a retail sales-force if another network member can perform the same function on a commission basis?

   New network members are critical for winning a higher share of customer wallet. Tesco, for example, has created partnerships with a number of organizations, including a travel agency, insurance company and car manufacturer, as shown in Case 10.2. It has developed a number of other joint ventures where it does not have the competencies itself to exploit opportunities.

Case 10.2

Network partners at Tesco

Tesco has actively sought to create partnering programmes with other organizations. Partners have included:

- Lunn Poly, one of the UKs multiple travel agencies, to offer a discounted travel service
- B&Q, a major home improvement chain to offer discounted ‘do-it-yourself’ and homeware products
- Royal Bank of Scotland to offer banking and other financial services

- Direct Line to offer household insurance products
- General Motors to enable customers to buy cars at discounted prices.

The objective of all these programmes has been to win a greater share of customer spend.

3. **Manage network performance**: companies will need to brief network members so that they understand the focal company's customers and their role in creating value for them. This may mean writing specifications, implementing common CRM applications, setting and monitoring quality standards or designating people to take an oversight or coaching role. Companies will need to monitor how well the existing network is performing and look for ways to improve performance. Improvements can take two forms: more effective contributions or more efficient contributions from the network. Network members can contribute to CRM performance in a number of ways, including the following:
   - **Offering new customer insight**: they may be able to improve the focal company's understanding of its customers. In Australia when Commonwealth Bank and Woolworth's, the food retailer, created a joint venture to launch Ezi-Bank, the bank learned a lot more about their customers from access to Woolworth's transactional data.
   - **Creating value-adds** for the focal company or its customers as a result of better cost performance at meeting specifications, improved product quality or identifying new opportunities.

There is a clear danger in overspecifying network relationships. Marks & Spencer, for example, had very tight control over its supplier relationships. It established specifications and controlled design and quality rigorously. One effect was to stifle innovation. Suppliers did what they were told and failed to contribute to their full potential.

A number of different managerial roles have been identified in the management of business networks.[8]

- The **network architect** designs a network for a given purpose. This might, for example, be the leader of a joint venture across international borders, involving several companies. Typically, network architects are senior management with strategic responsibility. For example, when companies decide that they want to implement a CRM system, a senior manager often acts as network architect, specifying the various network tasks that need performing as the CRM project takes shape. The architect (we called this person the CRM programme director in Chapter 3) may identify a number of roles for network partners: systems integrators, CRM software vendors, data analytics companies and so on, as outlined in Figure 10.6.
- The **lead operator** introduces particular businesses or individuals into the network.

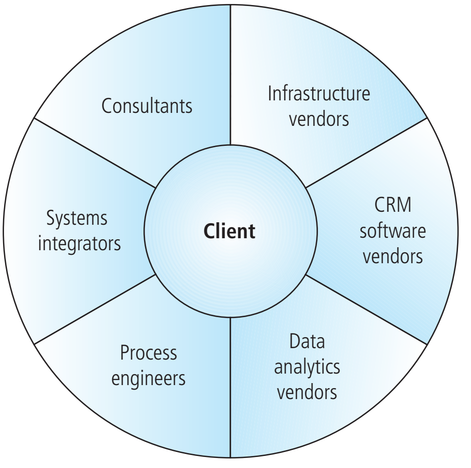

Figure 10.6 Technology partners for CRM implementations

- The **caretaker** takes an overview of the performance of the network, perhaps suggesting ways in which the network resources could be better deployed.

Management in networks

Not all network relationships are alike. The challenge of managing network relationships is all the more apparent when you consider how much variety exists. Network relationships vary in terms of their importance, intensity, closeness, strength, adaptation, commitment and power distribution.[9]

Not all relationships are equally important. Some assume more importance because of their implications for value creation or value destruction. A relationship that is difficult and costly to manage may be important because it is a value destroyer. On the other hand a relationship with a strategically significant customer assumes importance because of the value it produces. Relationship intensity is expressed in the number, frequency and level of contacts between the companies. In a close relationship there would be sharing of information, joint problem solving and commitment of resources by both partners, and trust would evolve over time. Closeness does not necessarily imply a lack of conflict. Conflict and cooperation can coexist in strong relationships; they are not necessarily mutually exclusive. Stronger relationships are more able to withstand challenges to the social and structural bonds that tie them. The power distribution between network members, as you read above, can also have a significant impact on how network relationships are managed.

Management in networks is both about managing individual relationships and managing clusters of relationships. For example, consumer goods manufacturers commonly cluster their customers into two groups: retail multiples and independents. Each is managed in very different ways. Retail multiples are treated as important individual customers and may have dedicated account managers, category specialists, merchandising teams and logistics specialists assigned to them, whereas independents are treated as a homogenous cluster and serviced through independent wholesalers.

Research into network competence

Thomas Ritter and his colleagues have begun to research the influence of network competence on the performance of focal organizations.[10] Using data collected from 308 German mechanical and electrical engineering companies, they found that network competence has a strong positive influence on the focal firm's product and process innovation success. Another study examined the performance of 149 university spin-offs, formed to commercialize technologies originating from publicly funded research institutions. They found that several performance variables, including sales growth, sales per employee, profit, perceived customer relationship quality and long-term survival, are influenced by the spin-off's network competence. Research is in an early stage of development, but it promises to deliver results of use to managers.

Summary

In this chapter you have learned about the importance of business networks to CRM performance. Networks are an inescapable feature of the business landscape. They are complex, interactive systems that are always undergoing change. Every company occupies a network position which is really no more than the sum total of its network relationships and all the activity links, resource ties and actor bonds that these relationships contain. Network constituents can be remembered through the mnemonic SCOPE: suppliers, customers, owners, partners and employees. Two of these are particularly important to CRM. Network members supply the material inputs, services, funding, people, technology and knowledge that are used to create value propositions for the focal firm's customers, and network members play demand chain roles in communicating and distributing products and services to customers. No networks are subject to the absolute control of any single company, though all organizations strive to enhance their network position by exerting influence over other network members. Senior managers need to master two network management competences: managing of networks, and managing in networks. Management of networks involves identifying the activities that need to be performed in order for companies to create and deliver value for and from customers, and to recognize, then coordinate and manage, the actors and resources that are best suited to perform those activities. Sometimes these will be internal to an organization; often they will be external. Management in networks involves managing both clusters of network members, such as segments of customers, and managing individual network members, such as advertising agencies or logistics partners.

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