

Can CRM Be a Differentiation Strategy?: Pitfalls of Customer Retention Activities

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1. Introduction

When CRM (Customer Relationship Management) became a popular trend in business, many companies were too quick to embrace the concept of customer retention - a primary CRM component - before grasping all the facts. As a result, they have been unable to achieve the results they had expected. Customer retention policies should not be perceived as cure-alls; instead, they should be positioned as mere components of comprehensive differentiation strategies.

Two representative examples of customer retention measures are “point systems” and “recommendation services,” both of which are employed to encourage repeat purchases. In the following section, however, we focus on those measures and their effectiveness as customer retention activities. To do this, two analytical frameworks are used.

2. Point Systems and Recommendation Services

There is a growing trend among some major corporations toward the termination of point systems. In 2002, casual apparel giant Uniqlo in 2002 abolished the point card service that it had established in 1984. In the same year, restaurant chain Jonathan abolished the “J Friend Card” service that it had launched in 1999. In both cases, the reason for discontinuing the point systems was poor cost-effectiveness.

The Jonathan chain spent roughly 30 million yen each year on managing customers’ point card data, and additional 300 million yen on redeeming accumulated

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points (equivalent to a 5% discount). The company claims, however, that the effect of its point system on sales was not commensurate with the amount the company was spending to maintain the system.

Online bookseller Amazon is a well-known example of a company that offers recommendation services. Each page on the company's Web site lists additional items that were bought by customers who purchased the currently displayed item. Furthermore, the Web site also displays personalized product recommendations based on each customer's purchase history. Customers can also sign up to receive e-mail notifications whenever new products arrive that match keywords specified by the customer.

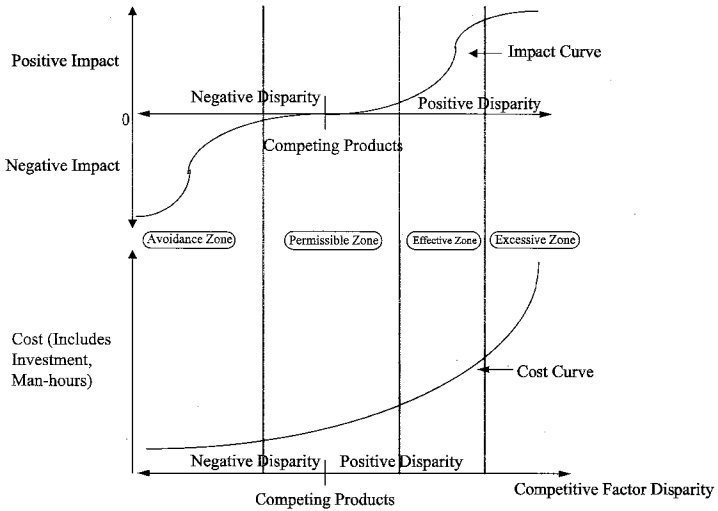
Has Amazon's recommendation service contributed to the company's ability to distinguish itself from other online booksellers? Negoro and Kadowaki (2003) conducted a study of 500 online bookstore customers in Japan, and found that 47% of them shopped primarily at Amazon.co.jp. When we asked them what their reasons were for purchasing books online, the most frequent answers were "abundant selection" and "cheap shipping costs." Even when we asked for additional reasons behind purchasing online, or why some customers had switched from other stores, the existence of a recommendation service was rarely mentioned as a factor. Only a portion of "heavy users" mention "because the recommendation service was helpful" as a factor in switching from another store.

Based on these findings, we see that offering a recommendation service does not contribute to a company's ability to differentiate itself from its competitors. Instead, lower shipping costs, wide variety, and search functionality seem to be the most decisive factors. When it comes to heavy users, however, recommendation services are somewhat effective. The same thing can be said of point systems; while they can have some impact, the cost-effectiveness of these services can be questionable.

2. Competitive Zone Analysis

"Competitive zone analysis" is a useful method, or framework, for analyzing competitive tools that are only subtly effective. The upper graph in Figure 1 indicates the impact that disparity between competitive factors has on consumers. The lower graph indicates the costs associated with this impact.

Figure 1: Competitive Factor Disparity & Effectiveness



(Source: Ono K. and T. Negoro, *Management Strategies & Corporate Innovation*, Asakura Shoten, 2001)

People tend to think that the degree of disparity between competitive factors is proportionate to the impact on consumers. However, when the value of positive disparity exceeds a certain point (called the “threshold”), the impact on consumers rises sharply. On the other hand, when the value of positive disparity continues to increase and exceeds a second threshold, the impact on consumers suddenly begins to drop. The same is true of negative disparity. This means that impact curves for both positive and negative disparity are symmetrical.

To be more specific, products that are slightly superior to competing products do not have much influence on the buying behavior of customers; the same may be said of products that are slightly inferior to competing products (this realm of little influence is called the “permissible zone”). When the degree of disparity between products crosses the threshold, however, it gives a major impact on buying behavior. For example, the company could acquire many new customers in a short amount of time (the “effective zone”), or it could lose customers (the “avoidance zone”). Then, when the second threshold is crossed, the degree of impact suddenly lessens. In short, a company will not be able to acquire more customers by boosting disparity beyond a certain point (the “excessive zone”); furthermore, the costs required to continue to boost disparity are disproportionately high.

By performing a competitive zone analysis on each individual competitive factor

and combining the data, it is possible to determine the current competitive advantage (differentiation) of a product.

Eliminating the avoidance zone is one of the strategic ways in which to clearly differentiate a product from competitors' products. If a particular competitive factor of a product is inferior to that of competing products, then the negative disparity should be kept in the permissible zone. If the negative disparity enters the avoidance zone, it could have a detrimental effect on overall differentiation efforts.

At the same time, it is necessary to increase the number of competitive factors in the effective zone. If a competitive factor falls into the excessive zone, emphasis should be placed on cost reduction rather than improvement of the disparity level; resources should be allocated to other competitive fields.

When we conduct a competitive zone analysis on Amazon.co.jp's recommendation service, we can determine that for light users the service falls into the permissible zone and for heavy users it moves to the effective zone. If we compare the investment made by the company to develop the recommendation system to the system's effectiveness, we may see that it contributes to overall differentiation (although its effectiveness is limited).

3. A Case Illustrating Pitfalls of Customer Retention Activity

In this section, we conduct a competitive zone analysis on customer retention activities implemented by Tsutaya Online (TOL), a leading Japanese online entertainment store. TOL ranks third in mail-order sales of music CDs, followed by Amazon.co.jp and HMV. Compared to its competitors, the company devotes considerable resources to managing a point system and an e-mail recommendation service.

According to a 2003 comparative study of online music stores (see Figure 2) that was conducted by the Japanese Internet survey company Vagabond, CD buyers choose online stores based on "inexpensive shipping," "selection," and "real-time availability information." TOL ranked third in all three categories; Amazon.co.jp ranked the top in all three, followed by HMV. These rankings are the same as their respective mail-order sales rankings.

In respect to the less important factors - "payment methods" and "point systems" - TOL ranked first and Amazon co. jp ranked third. Based on these results, we conduct a competitive zone analysis of TOL's point system and recommendation service.

Because we do not know the detailed costs of these two customer retention

measures, the outcome of our analysis could be an illustrative guess. We can say, however, that TOL's point system and recommendation service fall into the permissible zone with respect to light users. With respect to heavy users, the recommendation service falls into the permissible zone, but the point service may have exceeded the effective zone and fallen into the excessive zone. This likely means that TOL's customer retention activities have not effectively contributed to increase its sales, and that the company is paying too much to maintain its point system. (Based on this observation, it is also possible to reach a different conclusion: we could also claim that the point system and recommendation service are ineffective because the company lacks heavy users due to inadequate retention activities. Further research is required to obtain conclusive results.)

Figure 2: Tsutaya Online's Ranking According to Customer Priorities

Tsutaya Online ranks poorly based on customer priorities								
Category	Reasonable Shipping	Selection	Real-time Inventory Info	Delivery Time	Payment Methods	Point System	Order Pickup Method	Music Previewing
Music CD customer Priority Ranking	86%	85%	74%	58%	46%	42%	36%	35%
No. 1	Amazon	Amazon	Amazon HMV	All 3 rank the same	TOL	TOL	HMV	HMV
No. 2	HMV	HMV			HMV	HMV	TOL	TOL
No. 3	TOL	TOL			TOL	Amazon	Amazon	Amazon

(Source: 2003 Vagabond comparative survey of online music stores)

4. Systematized Activities Based on Competitive Resources

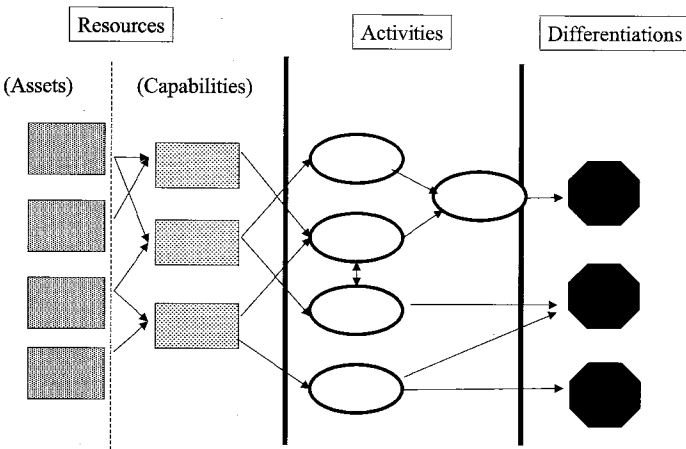
Assuming that the findings above are accurate, what differentiation strategies should Tsutaya Online adopt in the future? TOL will certainly be unable to maintain its favorable market position merely by devoting resources to customer priority areas (i.e., reasonable shipping, selection, and real-time inventory information). Take Japanese home appliance chain store as an example: because they all offer point cards, their point systems fall into the permissible zone. In the home appliance chain store market, a point

system does not effectively enable a company to distinguish itself from its competitors; a chain store cannot compete without offering point cards, and yet it cannot beat its competitors by offering point cards, either.

If TOL simply devoted more resources to customer priority areas in order to compete with Amazon.co.jp and HMV, then the competition would result in a mere battle of strength. Instead, TOL needs to focus on better consistency upon resources, operations, and differentiation efforts. The differentiation system diagram is a useful method, or framework, for analyzing this three-pillar structure.

As Figure 3 indicates, differentiation efforts that attract customer attention are those that have been systematized and are based on the company's resources (assets and capabilities). The greater the consistency upon resources, operations, and differentiation efforts, the more possible it becomes to ensure sustained differentiation (competitive advantage).

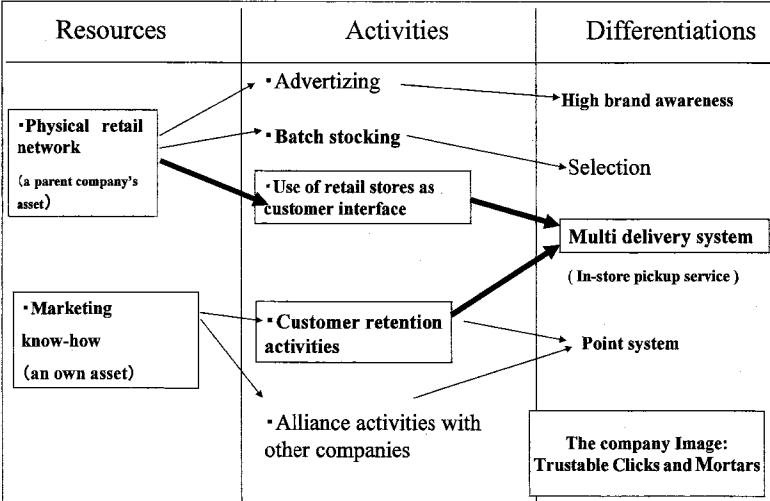
Figure 3: Differentiation System Diagram



TOL has one major business resource that is difficult for its competitors to imitate: a chain of roughly 1,000 stores. TOL is the core business of parent company Culture Convenience Club, and its clicks-and-mortar structure sets it apart from the competition. TOL's physical store network is something that would be extremely difficult for Amazon.co.jp and HMV to imitate.

What type of activities, based on this valuable resource, can be systematized and used to compete and differentiate? One example is a service that Tsutaya is providing: one that enables customers to order music CDs by cell phone and pick them up at local stores. Amazon.co.jp, which has no physical stores, and HMV, which operates a comparatively small chain of stores, would find it difficult to offer a similar service. Tsutaya operates many physical stores, making it convenient for customers to pick up their orders at a neighborhood store; they can receive their items on the first day they become available, and they do not have to pay shipping costs. If TOL were to strengthen its in-store pickup service, it could develop an extremely effective and sustainable strategy for differentiation. This own potential structure of TOL is depicted in Figure 4. In this figure, the differentiation should be strengthened in a total or integrated way of resource layer and activity layer. For example, the company should reallocate the money it spends on its point system (which may be in the excessive zone) to its in-store pickup service. We believe that this would be an effective addition to TOL's overall differentiation strategy. (The above is a personal opinion based on external observation.)

Figure 4: Potential Differentiation System of TSUTAYA Online



5. Conclusion

Using competitive zone analysis, we have examined how various competitive factors, including customer retention measures, contribute to differentiation. We have also considered improving consistency upon resources, operations, and differentiation efforts as a differentiation strategy. As a result, we conclude that strategies that are difficult for competitors to imitate are the most effective. Effective use of these findings could help companies avoid overrating customer retention activities and instead implement CRM that benefits their overall differentiation strategies.

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