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Beyond Customer Relationship Management: From Encirclement to Open Partnership

by

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Introduction

This paper discusses customer relationship (customer strategy) in its proper perspective in order to focus on a common misperception among companies practicing CRM (Customer Relationship Management). This misperception is epitomized in the concept of "encirclement." It is said that CRM is a "management technique for encirclement." However, the concept of "encirclement" itself is contradictory to the fundamentals of customer strategy. More specifically, if the notion that customer strategy means managing a company from a "customer-centric" point of view, then "encirclement, " because it pursues a company-centric mindset, may very well conflict with the customer's interest. To develop this idea, let us first examine CRM and "encirclement."

What is CRM?

CRM is a series of activities to create and maintain a desirable relationship with the customer based on central control of customer information and shared utilization of that information by the departments concerned. Information systems enable CRM to organically combine and collectively control information on inquiries, orders, complaints, requirements and the like with "customer" as a key. This information is shared by all customer-related departments including marketing, planning, services, logistics and product development. The purpose of CRM is to continually improve customer satisfaction by enhancing the relationship with the customer.

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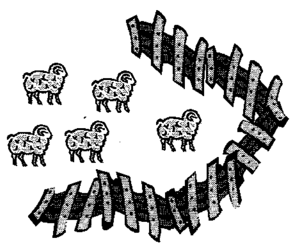
Implication of the word "encirclement"

The etymology of the word "encirclement" dates back to the era of the industrial revolution in England. The word originally meant to "buy out publicly owned land, convert it to private property and turn it to a sheep meadow by fencing it in." In other words, it was the act of demonstrating the ownership of the land by the erection of fences to prevent sheep from escaping. If the intention of a company that plans to implement CRM is to "prevent the customer from escaping, "then the company cannot be said to care much for the customer. The customer is not a sheep and he or she surely does not wish to be treated as such.

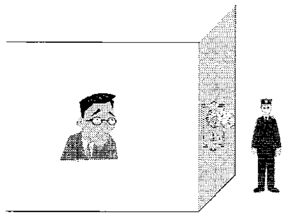
Figure 1 Encirclement "Put up a Fence to Prevent Escape"



Recently, the concept has expanded to embrace use of the term "Customer lock-in."This phrase is even more insulting to the customer than the term "encirclement, " because of its blatant implication that the company "locks up the customer" in its realm. The same goes for the phrase "customer loyalty", frequently used in CRM literature. This phrase implies that the customer offers the supplier his or her allegiance, again emphasizing a ruler-subject relationship.

If CRM is a series of activities to win customer loyalty, it translates into activities that "work" the customer to generously pour his or her time, money and enthusiasm into a company's products. From the perspective of the customer, however, there is nothing desirable about being "worked" into doing anything, even if that customer may occasionally feel like supporting a particular company's growth. CRM is designed to deepen the relationship with the customer, but it should not be used to facilitate "encirclement" or to gain "customer loyalty" at the customer's expense.

Figure 2 Lock-in

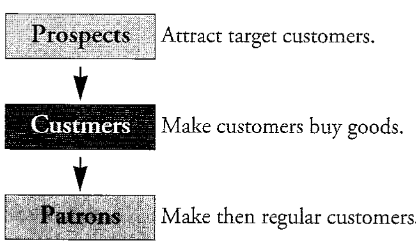


Dynamism of customer relationship : Three steps of evolution

Strengthening the relationship with the customer will bring about long-term success in business. There are three steps (phases of customer evolution) to follow in building a stable customer relationship. The first step is to attract the interest of "prospects" to the products and services of a company. The second step is to induce them to buy those products or services. Upon purchase, a prospect becomes a "customer." The final step is to nurture customers into "patrons" who repeatedly buy the products and services of that company. A company must strive not only to increase the prospect population, but also to turn them into customers and then convert them into patrons.

A prospect is a potential customer who may yield profit, but this will only happen if he or she becomes a customer. A customer who buys only once is a "non-profitable customer."A"profitable customer"is one who comes back to buy a number of times. In other words, a patron.

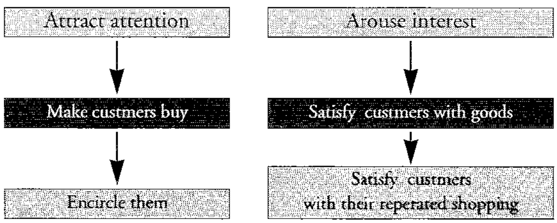
Figure 3 Deepening of Customer Relationships in CRM



One problem here is that the corporate psychology to "encircle" patrons does not necessarily serve the company's long-term interest in turning customers into patrons. Strengthening customer relationships through encirclement will result in the following pattern of thought: "Get the attention of prospects," "Induce customers to buy products and services, " and "Stop patrons from going away." If we look at these three steps of customer development from the customer's point of view, however, it is clear that a prospect thinks, "I may buy the goods," a customer thinks, "I will buy the goods, " and a patron thinks, "I will buy the goods again."

The ultimate purpose of CRM is to achieve long-term success by putting oneself into the customer's shoes. The belief that CRM can be achieved through encirclement may prevent customers from evolving into patrons. Therefore, what is needed is a new paradigm that goes beyond "encirclement." As long as a company sticks to "encirclement" in order to keep the customer from escaping, customer satisfaction will not improve because the customer's inherent tendency is to reject being forced to do something.

Figure 4 Viewpoints : Encirclement and Customer Satisfaction



Everything starts from customer satisfaction

The ultimate goal of a company looking for long-term success is to gain customer satisfaction. A basic premise of CRM is considering customer satisfaction as the starting point for everything else. If one looks at the dynamism of the customer relationship from the point of view of "customer satisfaction, " it becomes clear that products and services should be positioned to "arouse the interest of prospects, " to "satisfy customers who made a purchase, " and to "motivate satisfied patrons to repeat purchases." The customer has full discretion to go elsewhere if not satisfied. To put oneself into the customer's shoes is to realize that the customer has that freedom.

Do not impose costs on customer for switching

CRM is designed to help fulfill the following three purposes: to select profitable customers with whom to continue trade, to motivate them to use the company's products and services throughout their lifetime, and, as a result, to increase the in-customer share (share within a customer) and LTV (Life Time Value). There is nothing inherently wrong with these goals as profit-making is a legitimate activity of a company. The problem is that excessive pursuit of "continued trade, " may lead to the temptation to rob the customer of the "freedom to take his or her business elsewhere."

It is common for a company to give perks to the customer as an incentive to continue trade, which itself is not a problem. However, it is unfair to force the customer to continue trade by imposing a penalty for switching loyalty. In other words, it is wrong to put the customer in a situation in which he or she will suffer a loss by switching to a competitor's products and services.

The existence of a "switching cost" makes it difficult for the customer to change companies even if the choice made turns out to be inappropriate to the new situation. Consequently companies utilizing the high switching cost paradigm focus on persuading prospects to make the first purchase, often by not showing the comparative information of the product needed for rational choice. Imposing switching cost on the customer, accordingly, tends to lead to "opaque" business without full information disclosure.

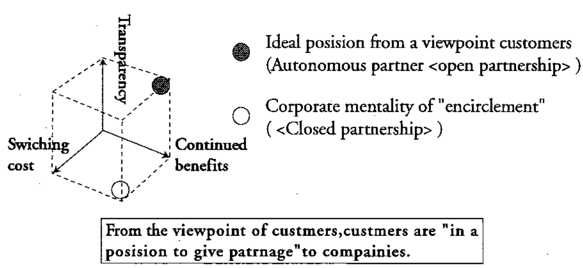
From the customer's perspective, however, desirable buying behavior is to "make a purchase of products or services that best fit his needs based on accurate and sufficient information available at the time of purchase without getting bound by past selections." In other words, being able to select products without the penalty of a switching cost is a desirable aspect of a purchase. In addition, when engaged in continued trade the customer wishes to enjoy "benefits he deserves to receive by virtue of his continued business."

Therefore, customer-centered corporate behavior (corporate behavior to create an ideal customer relationship) is as follows: "Provide the customer with sufficient information for him or her to (re-)select products, " "protect him from the wasteful expense necessary when switching products, " and "provide favorable treatment in return for lasting trade" if he decides to continue trade as a result.

What is an ideal customer relationship?

The author argues that an ideal customer relationship can be characterized by the three notions of "transparency, " "continued-trade benefits, " and "(zero) switching cost." Transparency means information disclosure that enables the customer to perform function and price comparisons with competitive products. Continued-trade benefits means providing the repeat customer with perks such as discounts on continued trades, one-to-one services, and improved quality and efficiency through repeat purchases and new orders for related products or services based on the customer's purchase history. Switching cost involves not only tangible costs such as initial investment (sunk investment) (including purchase cost of the first trade and cost of education and training for the use of products), but also intangible costs such as the psychological burden (sense of obligation felt toward the supplier). Blind dependency on outsourced processes (unavoidable when services are provided as a black box) is also considered an intangible cost.

Figure 5 Comparison between an ideal position and encirclement



The obverse side to selection of customers is the selection of companies by the customer. Useless products are, naturally, not selected. The customer should not be deprived of his or her right to choose. It is advisable to disclose even information disadvantageous to a company and let the customer assess the value of that company's products. By doing so, the customer can be expected to select a company's products and make repeat purchases without the burden of switching costs.

Providing arbitrary information advantageous to a company amounts to supplier-centered promotional activity, but it does not help improve transparency for the customer. Ideal information disclosure would be to provide sufficient data for comparisons tailored to the needs of individual customers. An ultimate example would be to disclose the cost of products and let the customer assess added value to justify purchase.

Open Partnership as an ideal position

An ideal position from a customer's point of view is the "autonomous partnership" ("Open Partnership") illustrated in Figure 5, in which the transparency and continued-trade benefits are maximized. In contrast, the customer relationship viewed from an encirclement standpoint falls into the "prisoner-type partnership" ("Closed Partnership")" position shown in Figure 5, where the switching cost becomes the highest.

The author maintains that every company should strive to realize Open-Partner-oriented customer relationships. In the real world, however, the position that a company can take is limited by factors such as unique technical characteristics and the structure of the distribution channels of a given industry. In the life insurance business, for example, products are designed in such a way that switching cost is intrinsically high (changing the company causes loss) throughout the industry. Another example is in the electrical appliance industry. There, it is difficult to provide continued-trade benefits other than a reward point service.

Nevertheless, the relationship the customer wants to establish is Open Partnership and a company should make every effort to strive toward that goal through technical breakthroughs and innovations in business. The history of the computer industry provides an example of how the industry has moved in this direction. In the era of general-purpose computers, selling mainframe computers on outright purchase or long-term lease contracts made up the bulk of marketing activities of a company. Computer companies were competing with each other in a world where high switching costs were the business rule. However, as the industry entered the era of open systems, selling mainframes did not necessarily bring related business (on terminals and software) to the mainframe supplier, because the terminals and software of other companies could be used even on the mainframes. The era of open systems has meant lowered switching costs. Today, at the dawn of the era of ASPs (Application Service Providers), a business climate is being created in which changing the system is more affordable for the customer because transaction-based pricing has drastically reduced the initial cost of information system introduction.

Open Partnership strategy

Open Partnership strategy, a strategy for transformation of customer relationship to Open Partnership, is considered to provide an edge to latecomers, among others, when competing with front-running companies adhering to the "prisoner-type partnership" paradigm. Front-runners will therefore also have to change to Open Partnership practice if they want to secure long-lasting customer satisfaction.

The technology trend in the Internet era seems to be on the right track in terms of retaining transparency and reducing switching costs. At any rate, a strategy shift toward Open Partnership seems to be inevitable.

The world of Open Partnership is a realm which will not allow companies to survive unless they have exclusive value, which compensates for any weak points in comparison to others. In other words, only the top company in a given market segment can survive in the Open Partnership world.

Open Partnership of Matsui Securities

President Michio Matsui of Matsui Securities, a prime company in the online securities market said, "We do not intend to do encirclement. I do not think it is possible." To have competitive power, Matsui believes, is to have magnetism that draws customers back again and again after trying competitors in an environment in which there are no barriers preventing customer movement. The Internet is a "mobility oriented world, " where encirclement tactics do not work, as far as Matsui is concerned.

In his book "Oyannasai yo demo tsumannai yo (Go Ahead and Do It, but It's Not Fun)" (2001) Matsui discusses customer strategy and in the following excerpt he dismisses the idea of encircling the customer by imposing switching costs:

"At one time I had an opportunity to talk with the president of an online securities company in the U. S. He said to me, 'Brokerage charges on online securities will come down to extremes. Lowering charges as a tactic to keep the customer from going away has its limits. The customer is no longer impressed by fees one dollar, two dollars cheaper.... In such a business climate it is the quality of applications that counts, I'm sure. Good quality applications - that's the key to successful encirclement. In fact my company is heavily investing in software to win. I am sure it will bear fruits soon or later.' Hearing this I thought, 'This CEO is not a good merchant. He is a fool. He holds the customers cheap.' ... How will the customer behave? If the software is good the customer will be lured naturally. He may pretend that he has been captured for a while. But this status will not last long because software developed by a securities company will soon or later give way to better software developed by specialized software companies. The customer will soon escape. Huge investment will go down the drain. What will the company do next? It goes without saying that it will develop Version 2 of the software to regain competitiveness. The customer will come back temporarily. Soon better software will appear. The customer will go away again. In the end the CEO will mutter to himself, 'I should have known better. All that the customer wanted was to skim off the cream.' It's too late....

They are deeply buried in the paradigm of encirclement, so they lack awareness of the problem. I think that the sole reason why many online securities companies in the U. S. are suffering the agony of red-ink business is that they adhere to encirclement tactics. They're under the illusion that huge investment on encirclement will pay later. They never recover the cost. ... In the world of the Internet, changing a company is only a click away. If they invest big money on encirclement tactics, the customer just pretends he is encircled because it is not his money.

Then what is the solution to this problem? It's simple. You just play the game on the same level as the customer. You invite a software developer to become the vendor of your application software and let him do his business with his product running on your platform. If the customer abandons the application then you also abandon it and replace the application with a better one....

What about encircling the customer by providing him with information? It's absurd. You just put an end to encirclement tactics and provide information by a specialized company through the network. The customer will pay money for information if it is useful. The company that provided the information should take the sales. If, however, information is obsolete the customer will not pay even a cent. No customer wants to share the burden of cost of information available anywhere. This implies that we ought to let information providers compete with each other on the value of information. We provide the platform to send out information but it is not our intention to encircle the customer with information as the bait.

Suppose information owned by a securities company has a value and the company is making it available to its customers free of charge. If the customer gets the information there and does actual trade with Matsui Securities, can you fault him for this? The moment you create a scheme that "prevents the customer from trading with other companies, " the number of customers who want to stay with the company to obtain information even at the cost of expensive brokerage fees will drastically fall off. You cannot pin down the customer with offers of information. To the customer, information is one thing but trading is another. The paradigm of offline securities companies does not work with online securities companies."

Open Partnership of Misumi

Hiroshi Taguchi, former President of Misumi, whose business is catalog sales of metallic molds, says, "Our company is a purchase agent for the customer, not a sales agent for suppliers." He argues the following: "To put yourself into the purchaser's shoes is to set the added value of Misumi at a level that matches the cost the purchaser bears. Having accomplished this framework, there will be no problem if you disclose Misumi's cost of buying from suppliers. Rather, you can heighten customer satisfaction much more in this way."

The philosophy that underpins Taguchi's assertion is "Serve the customer to facilitate his selection, " which is exactly what this paper argues. Let us see how Taguchi talks about his customer strategy. The following are excerpts from his book "Kakusuna! (Don't Conceal!)" (1997) that illustrate to his argument for information disclosure from a customer's point of view.

"I tell our people to disclose Misumi's information to anyone who needs it in principle.... More concretely, Misumi positively discloses each and every piece of information on purchase conditions such as distribution markup, amount and volume of the trade to all bidders and lets them compete openly with each other to get selected.... From the beginning Misumi's objective was to procure goods from suppliers that best benefit our customers, not to sell by all means whatever was produced by manufacturers from the standpoint of suppliers....

Recently there have appeared companies that copy the business method of catalog selling that is the lifeblood of Misumi.... It is possible to legally foreclose those copycat competitors. You just sue them for the infringement of intellectual property rights.... But I did not go with that idea because it is not a solution from the perspective of the purchase agent business that cannot be carried on without putting yourself into customer's shoes. Instead I urged my people to reflect on our operations and told them, 'The reason why we lost our customers to competitors is because we have our own weakness, isn't it?'

This is because the customer is happy if he can buy necessary goods from latecomers at less cost than from Misumi. It doesn't matter to the customer whether or not the latecomers imitated Misumi's scheme. The customer will gain nothing if we crucify those imitators. I always insist that we should not assume a monopolistic position. It is not only because we must abide by the antimonopoly law, but also because it will not do our customers any good.

This is a natural conclusion as long as we value the concept of 'Openness.' If we try to encircle the customer, it not only will do him harm, but come back and haunt us. It is important to create an environment in which the customer can leave us for competitors whenever he wants to. Still we strive to win customers who are satisfied with buying goods from us.... If the customer choses us it is because he appreciates the merits in trading with us. Once we get monopolistic, competition stops. Then we get arrogant and hit a plateau. That is what I'm afraid of most. As long as there is competition we cannot afford to sit idly and there will be no room for arrogance to sneak in."

Matsui Securities is a paragon of business built on elimination of switching costs, whereas Misumi is a top company run thorough transparency. A common denominator of both companies is that they hold the customers' freedom of choice in high esteem. The fact that they are both successful is a proof that the "Open Partnership", as outlined by the paper, is not necessarily in contradiction with the pursuit of profits.

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