WINNING THE COMPETITION

for

CUSTOMER RELATIONSHIPS

by

George S. Day

The Wharton School

University of Pennsylvania

October 2002

WINNING THE COMPETITION FOR CUSTOMER RELATIONSHIPS

In most markets there are one or two relationship leaders who outperform their rivals by staying more closely connected to their customers. Among these leaders are Enterprise Rent-A-Car, Pioneer Hi-Bred Seeds, Fidelity Investments, Lexus, and Intuit. They are well rewarded for their prowess. In the credit card industry, Capital One has consistently out-performed First USA with a strategy that leverages their superior customer-relating capability.[1] They earn 40 percent more interest income from each customer, with double the profit margin, despite being half the size of First USA. The boxed insert – “Winning the Credit Card War” – explains why Capital One is a relationship leader.

Place Boxed Insert about here.

What accounts for the advantage these relationship leaders have earned? Is it deeply embedded in their culture and capabilities, which would make it hard for followers to catch up? Or could a technological leap-frog with the latest CRM databases and customer information systems close the gap? If we believe the mounting evidence that 55 to 75 percent of all CRM initiatives have a negligible impact,[2] then CRM technology on its own is not the answer.

In seeking a deeper answer, we interviewed managers in 14 diverse companies, including Dow Chemical, Verizon Information Systems, GE Aircraft Engines, Ford Motor Company, and Fidelity Investments, and surveyed senior managers in 342 medium to large businesses (See Appendix 1 for a description of the study). We found three distinct approaches to CRM, with dramatically different results.

Market-driven approaches make customer relationship management a core element of a strategy that aims to deliver superior customer value through complete solutions, superior service and a willingness to cater to individual requirements.[3] CRM technologies support this strategy by facilitating the supporting business process, and giving customers tangible benefits by saving them time and effort, speeding the resolution of problems and recognizing past patronage.

Inner-directed initiatives aim to gain a coherent and comprehensive picture of customers, that is otherwise lost in a proliferation of data bases and customer contact points. The intent is to better organize internal data to cut service costs, help sales staff close deals faster, and improve the targeting of marketing activities. These operational tasks are often assigned to the information technology group who use available software packages, and have little connection to the competitive strategy. The odds of disappointment with this approach are high, because the primary motivation is to solve the company's problems, not to offer better value to customers.

Defensive approaches. Some CRM initiatives – including loyalty programs based on redeeming points in a frequent-flyer or frequent-buyer program – are undertaken to deny an advantage to a competitor. Like all reactive strategies there is little chance of gaining an advantage, but at least the status quo is maintained. The CRM initiative then becomes part of the price the firm pays for being in the market.[3]

The market-driven approach that characterizes relationship leaders gives them an advantage that is difficult to copy. Their rivals will have to think long and hard about whether to also strive for leadership. But at a minimum they need to avoid being at a disadvantage. Meanwhile the leaders can't relax; they need to understand why they are ahead, and how to stay ahead. To guide both the leaders and the followers, we devised and tested the diagnostic framework in Figure 1.

Place Figure 1 about here.

How Relationship Leaders Gained Their Advantage

Our diagnostic framework distinguishes the *sources* of relational advantage – which are the competitive strategy and customer-relating capability – from the *positions* of advantage based on whether they deliver superior relational value, and the resulting *performance* outcomes. [4] Each block in the figure corresponds to a set of questions that were framed relative to competition. Table 1 describes the data in more detail.

Place Table 1 about here.

Relationship leaders were the 18 percent of the sample with a superior customer-relating capability. They had a significant advantage in developing and managing customer relationships,[5] which gave them a significant performance advantage over the followers.

Performance in Past Two Years	Relationship Leaders (Top 18% of sample)	Relationship Followers (Bottom 33% of sample)
Customer retention much better than competition	33%	7%
Sales growth much better than competition	51%	15%
Profitability much better than competition	38%	15%

A more persuasive demonstration of the importance of the customer-relating capability, in explaining performance differences, came when this variable was incorporated with strategy and positional advantages in regression equations for each of the relative performance measures (see Table 2 for the details). There were two kinds of positional advantage: *relational* advantages based on how the business compared to competition in customer service, responsiveness to individual requirements, ease of collaboration, and understanding of customer needs, and *product* advantages based on quality, performance, and value for money. As expected, the relational advantages were especially influential in explaining customer retention and growth. Neither type of advantage was significantly related to profitability – once the strong direct effect of the customer-relating capability was incorporated.

Place Table 2 about here.

Strategy was also important in explaining differences in performance. We asked about the thrust of the strategy – was customer relationship management the defining theme of the strategy or a low priority (on a 5-point scale), and was their motivation mainly defensive or primarily offensive. Both these aspects of strategy were correlated with all three measures of performance, and with each other. However in the regression analysis of Table 2 it was motivation that proved more significant, suggesting that a strategy gains the most traction in an organization when it has an explicit goal of beating the competition by offering relational value that cannot be matched.

THE ANATOMY OF A SUPERIOR CAPABILITY

Case studies, such as the comparison of Capital One and First USA, led us to conclude that superior performance came from orchestrating the three components of the customer-relating capability:[6] (1) an organizational *orientation* that makes customer retention a priority, and gives employees wide latitude to satisfy customers, as part of an overall willingness to treat customers differently; (2) *information* about relationships, reflecting the availability, quality, and depth of relevant customer data and the systems for sharing this information across the firm; and

(3) a *configuration* that includes the structure of the organization, processes for personalizing the offering, and the incentives for building relationships.

Our exploration of the roles of these three components began by asking the survey respondents about a large set of indicators of each component. This ensured that respondents had a common understanding of what was included in each of the components. This set the stage for an overall judgment of how their ability on each component compared to their direct competitors.

The first step in the analysis was to see what effect each component had on the overall customer-relating capability (CRC). The results are shown in Table 3 using both ordinary least squares regression and a continuation ratio logit model. The latter analysis allowed us to overcome some of the restrictions of the regression analysis by comparing respondents in each category of the CRC scale with those in worse categories.

Place Table 3 about here.

Our findings confirm that a *superior* capability is all about how a business builds and manages its organization, and does not have much to do with CRM tools and technologies:

- *Configuration* best explains differences between businesses in customer-relating capability. The alignment of the organization toward building customer relationships, achieve through incentives, metrics, organization structure, and accountabilities was consistently the most influential component of the capability.
- *Orientation* sets the leaders apart. This component had an effect only at the top end of the capability scale. It takes leadership and organization-wide emphasis on customer retention to really excel.

- *Information* technology is merely a necessary condition – on its own, it contributes little to a superior capability. This reinforces the conclusion that inner-directed CRM initiatives have little chance of succeeding when the culture and organization are not supportive.

These broad conclusions held up in all types of markets, whether B2B or B2C, with many or few customers, slow or fast growing, and extremely or moderately competitive.

While these conclusions are important and validate anecdotal evidence about why there is often little to show for CRM investments, the real question is what can be done to improve the customer-relating capability. A battery of indicators was developed to diagnose each of the components (see Table 4).

Place Table 4 about here.

Orientation Toward Relationships

There are many facets to a relationship orientation. The most important in this study was the shared belief that customer retention is a high priority for everyone; not just a concern to be delegated to marketing or sales that does not engage the rest of the organization. This aspect swamped the effect of some other facets that were closely correlated, such as employees' freedom to take action to satisfy customers, and whether the mindset was transactional or relational.

Next in importance as an indicator of orientation was the openness of the organization to sharing information about customers. An orientation is counter-productive when one function such as sales believes it "owns" the customer. Potentially useful information is then held closely by one person who knows the customer and their history, vulnerabilities, and requirements, and is unlikely to be converted into knowledge that can be shared across teams and functions. Similarly, if the mindset and history of the business celebrates customer acquisitions through individual effort, little energy will be spent on capturing customer information or assembling it all in one place.

To some degree, a relationship orientation is also shaped by the belief that different customers should be treated differently, based on their long-run value. Most companies give lip-service to this notion, but few in the computer industry went so far as IBM where Lou Gertsner infused the value of taking on only the best customers – and then doing everything possible to cater to their needs. This hard-nosed approach saved IBM from the worst of the problems that HP, Cisco, and Compaq encountered by chasing every internet start-up without regard to their long-run ability to pay.

Configuration

The strongest indicator of a superior configuration was the availability of resources to support CRM initiatives. Perhaps this reflected frustration among respondents, of whom only 10 percent could say that resources were adequate and deployed effectively. (Another 28 percent said resources were somewhat adequate). Resources are both fuel for the organization and a signal of the commitment of the organization to building the proper infrastructure.

Surprisingly few businesses emphasized customer satisfaction and retention in their incentives. Over half gave them no emphasis at all. Yet the use of these incentives is another important indicator of a superior configuration. The role of these incentives is well known but few companies act as though they believe it. So it is not surprising that Siebel Systems, the leader in CRM software, is obsessively focused on customer satisfaction and ties 50 percent of the incentive compensation of management to measures of customer satisfaction.[7] Fully one quarter of the salespeople's compensation is based on these measures – but is only paid a year after the sales contract has been signed and the level of satisfaction with their performance is known. In most other software companies, salespeople are paid when a sales contract is signed, which fosters a one-time transaction mindset.

Superior configurations also have organization structures that ensure the customer has a seamless interaction with the company, rather than "seeing" several companies because different functional groups do not know about their other interactions. This seamless connection is often best achieved when there are clear accountabilities for the overall quality of customer relationships. Firms organized around customer groups and processes (rather than products, functions, or geographies) had much higher accountability for the overall quality of customer relationships. Forty-nine percent of those saying there was clear accountability were organized by customer group versus only 2 percent for functional. These benefits were not lost on other firms, as the number of firms with a customer-facing organization design is expected to increase by 65 percent within three years.

The real pay-off comes when all the elements of a configuration – metrics, incentives, and structures – are properly aligned. This was the challenge to the General Electric Aircraft Engine Business Group when they found their jet engine customers were not happy with their service, even though the company's internal (Six-Sigma Quality) metrics were showing the opposite. This triggered a CRM project, based on an in-depth study of what customers really wanted in terms of responsiveness, reliability, value added, and help in improving their productivity. This led to wholesale changes in their configuration: new metrics based on customer requirements were added to traditional functional metrics and the sales, marketing, and product support groups were organized around customer-facing processes rather than functions. A corporate Vice

President was assigned to each of the top 50 customers for the sole purpose of building the relationship, so each customer had a clear channel to the top of the GEAE organization.

To help customers improve their productivity – which was what they really wanted out of the relationship – GEAE put leaders of their vaunted Six-Sigma quality program on site with customers to provide training and work hand-in-hand on engine service projects as well as inventory management. Working and learning together, they found the internet was the best tool for personalizing the delivery of parts, and it became part of the CRM project. The technology was not the driver of the project, but it did help to tighten the connections. The last step was to incorporate customer service metrics into the employee evaluation criteria and provide rewards for superior service. Throughout the capability-building process all employees were kept informed; for example a screen appeared in the morning on their workstations with a summary of GEAE's performance on key customer requirements, as well as current engine-related problems such as delays or aborted take-offs, so corrective action could swiftly be taken.

Information

This component of the customer-relating capability is problematic for most companies. On one hand it is the least important of the three components when distinguishing leaders from followers. This is not surprising as most firms were unhappy with the poor quality of their data and continuing inability to obtain a full picture of their customer's history, activity, requirements, and problems. Yet when we asked our interview respondents how their time and money were being allocated for building the capability, almost everything was being spent on databases, software, and data mining. The typical rationales for this imbalance were "this is the easiest area to compare to competitors – so we can tell where we are ahead or behind … we have to match what our competitors are doing … we can get funding for a focused initiative with clear-cut deliverables and track our progress …" and "software vendors and consultants keep bringing us new solutions to our database management problems. We know they are making the same pitch to our competitors and we don't want to fall behind." In short, big investments in CRM technology are yielding negligible competitive advantages. It is the classic "Red Queen" syndrome; although they are going faster and faster they stay in the same place.

IMPROVING THE CUSTOMER-RELATING CAPABILITY

The design and reach of the improvement program depends on whether the firm is a leader that wants to stay ahead, a follower trying to avoid a disadvantage, or an aspirant that sees a chance to change the game in a market where no one is offering superior relationship value or the leader is vulnerable. These strategic choices require different objectives and resource commitments. Followers in particular may have to accept a meager return on their investment – especially if it involves CRM technology – and base their objectives on where they would be if they did not have a least a parity level of relational value.

The process of improving any customer-relating capability has much in common with the allied process of creating a market-driven organization,[8] where success comes when (1) leadership commitment signals that the firm is serious about the initiative, (2) the key implementers understand the need for change and see what to do differently, and (3) there is a sense of urgency. The best impetus for the improvement process is a realistic assessment of how the firm compares to its rivals in orientation, information, and configuration. This must also consider the likely moves and countermoves of the competitors. What are the consequences of not catching up? How much will the competitors have improved by the time our initiative is finished?

These general guidelines are not sufficient because a program for improving a customer-relating capability introduces additional complications and pressure points. One recurring problem is that success depends on bringing IT, marketing, and sales together. These groups are not instinctively adversarial, but deep differences in interests, priorities, and backgrounds often frustrate cooperation. Divergent approaches may escalate to turf wars where one part of the business that has a customer database resists having others tap into it because they don't want someone else spoiling their relationship, or getting a free ride after they have borne the costs.

A further complication is that CRM initiatives prone to being inner-directed when they are undertaken to fix productivity or service shortcomings. The antidotes are a deep immersion in the customer experience and an understanding of what they expect from a closer relationship.[9]

Those firms aspiring to leadership must also recognize that it is the collective mind-set, beliefs, and values embedded in an orientation toward relationship that sets the leaders apart. Yet efforts to change this aspect of the organization culture directly are unlikely to succeed. Instead, change happens by altering behavior patterns and helping people understand how the new behaviors lead to better performance. Eventually these changes will be absorbed into the underlying norms, beliefs, and mind-set.

To gain organization-wide commitment to the improvement program, we advocate investing in market understanding, and then aligning the configuration, before installing CRM technology. Our research also shows that skimping on resources is a sure way to underperform. Thus, it is crucial to play to win.

Invest in Understanding Customers

The experience of Fidelity Investments is instructive. In 1997 they began a transformation from a product-centered orientation, which meant pushing only their own funds and treating all customers the same way, toward a relational orientation based on tailored education and investment recommendations. The value proposition was to "provide busy, affluent investors a complete range of innovative investment solutions for their goals and lifestyles delivered on their terms." This meant broadening their offerings to include non-Fidelity funds, providing education and recommendations tailored to each investors needs, and giving complete flexibility in the choice of channel.

What made the strategy come alive for the organization was the ability to vary the value proposition in systematic ways within each of 17 customer segments. These segments were based on four larger groupings of customers: first was the *high value* segment with large complex portfolios where hand-holding was key; second were the *core customers* who were not actively involved in investing activities, but recognized they needed to invest to meet their goals; third were *active traders* who simply wanted top-notch execution of their trades; and fourth were *institutions and small businesses* offering retirement plans for employees. Each segment was served with a different organization that could undertake customer lifetime value analysis, and give each customer a tailored experience. The intent was to offer such compelling value, and make access so easy, that the customers would find it very hard to leave for a competitor.

A major publisher of directories also used segmentation to shape its transformation. They had always done conventional segmentation studies – which mostly served to satisfy their curiosity about a very diverse customer base. Because of the strong conquest mentality of the sales force, and the unwillingness of the other functions to disrupt their processes, the organization was not interested in having different types of relationships with customers of differing value.

The turning point came when they set out to understand how their customers viewed the total experience of dealing with them. But rather than dwell on what it was, they also asked what it should be. A diverse array of customers was asked for their ideal experience. The difference between the expectations of the largest customers (the 4 percent that represented 45 percent of their revenues) and the smallest, local customers was startling. The largest customers wanted a single point of contact where they could resolve issues, coupled with service tailored to their needs, consultation on how to use the directory to build relationships, and help in tracking results. The smallest customers wanted a simple experience with low risk; the predominant view was "leave me alone unless I need you." They clearly didn't require a sales call, and the economics seldom justify a call. This gave the organization clear signals about how to organize to meet customer expectations.

Change the Configuration Before Installing CRM

Most post-mortems of CRM failures trace the problems back to the alignment of incentives and metrics, and the absence of a customer-facing organization. A common pitfall is to concentrate on the customer contact processes without making corresponding changes in internal structures and systems.[10] This study provides guidance on how to overcome these problems and give the CRM initiative a chance to succeed.

Metrics and Incentives. Superior configurations utilize incentives that emphasize customer retention. But before this can happen, the right metrics must be in place. This is an immediate problem for companies that don't know their customer defection rate. Overall 21 percent of our sample did not know their customer defection rate, and 24 percent of those who said they knew had no idea whether it was better or worse than competitors.

Other loyalty measures such as share of customer purchases are equally problematic. Even if these metrics are available, they cannot easily be traced back to specific parts of the organization. Are the defections and declining share of wallet due to service shortcomings, quality problems, or delivery missteps? Alternatively, are the defectors simply attracted by a competitor or consciously polygamous? This prompts many firms to tie their incentives to customer satisfaction measures, as we saw with Siebel. But for this to work the organization has to believe the metric, which is hard to do when as many as 90 percent of customers do not respond and those that do may have a courtesy bias and not give a rating below four on a five-point scale.

A better approach is to have a portfolio of metrics that collectively reveal the long-term profitability of the customers. This does not preclude loyalty or customer satisfaction, but supplements them with measures of cost to acquire and serve, share of wallet, and proxies such as employee retention, complaints, and performance on attributes that are important to customers.

Organization Structure. Companies with a superior customer-relating capability were much more likely than others to be organized by customer group or segment. This ensures the entire organization focuses on the needs of a distinct set of customers, enables a more integrated picture of the customer, and ensures clear accountability for customer relationships. This is one reason why Nokia has split its monolithic $21 billion mobile-phone unit into nine customer units, each with its own product R&D, marketing, and P&L responsibility.[11] One unit will serve business users, while another will focus on barebones handsets for users in developing countries.

However, this organizational model is not always appropriate. It works best when there are distinct segments, the customers want a bundle of products and services, and the strategy is motivated to deliver superior relational value through intimate understanding of customers. There must be a willingness to treat different kinds of customers differently, and a tolerance for the accounting and organizational complexities that threaten to erode economies of scale. Microsoft has tried to organize around different types of customers to get product-development groups closer to customers. The intent was admirable but the effort came undone because decisions about wide-utility products such as Windows were spread across too many of the new divisions. Short of organizing entirely around customer segments, there are intermediate practices that offer some of the benefits, by using key account managers and orienting customer contact functions around segments while leaving manufacturing and development organized by product.

Orchestrating the Improvement Program

Canadian Pacific Hotels has very successfully combined deep customer insights with configuration changes to build greater loyalty with business travelers. Although CP Hotels had 27 hotels in the quality tier, and were proficient with conventions and group travel, the chain was not well regarded by business travelers. This is a notoriously demanding and diverse group to serve, but also very lucrative and much coveted by other hotel chains. CP Hotels began by investing in deep learning about this segment to find what would most satisfy them. Frequent guest programs had little appeal, because they preferred airline mileage. They also appreciated beyond-the-call-of-duty efforts to rectify problems immediately. What they mostly wanted was recognition of their individual preferences and lots of flexibility on when to arrive and check out.

CP Hotels responded by committing to customers in its frequent-guest club that they would make extraordinary efforts always to satisfy their preference for type of bed, location in hotel, and other amenities. Delivering on this promise proved remarkably difficult. The company began by mapping each step of the "guest experience" from check-in and parking valet to check-out and setting a standard of performance for each activity. Then it looked to see what had to be done to meet the commitment to personalized service. What services should be offered? What processes were needed? What did the staff need in order to make the process work flawlessly?

The biggest hurdle was the firm's historic bias toward handling large tour groups, so the skills, mind-sets, and processes at hand were not the ones needed to satisfy individual executives who didn't like to be asked about their needs every time they checked in. Even small enhancements such as free local calls or gift shop discounts required significant changes in information systems. The management structure was changed, so each hotel had a champion with broad, cross-functional authority to ensure the hotel lived up to its ambitious commitment. Lastly, they put further systems and incentives in place to make sure every property was in compliance and performance was meeting or exceeding the standards.

After implementing these changes, CP Hotels' share of Canadian business travel jumped by 16 percent in a flat market, without adding any new properties. By all measures CP Hotels had won greater loyalty from its target segment. Long-term success will take sustained commitment to keep ahead of competitors who want to match or leap-frog. In this spirit, it is important to keep improving by continually experimenting, and questioning familiar assumptions. Firms that sustain their commitment this way send a signal to both their employees and customers that their customer-relating capability is one of the centerpieces of their strategy.

WINNING THE CREDIT CARD WAR

The differences between Capital One and First USA begin – and also end – with their strategies. First USA's priority is rapid growth in the "prime market." They target these relatively low-risk customers, who have established credit histories, with low interest cards. Since many other card issues are chasing the same people, these customers are neither loyal or especially profitable. First USA have been more successful selling "affinity" cards, through organizations like universities who offer the cards to their members. Otherwise, they gave little consideration to differences between customers in credit risk or potential profitability. The real thrust of First USA's strategy, according to Richard Vague, the former chairman, was "to be laser focused on operating efficiency and pass those savings on to customers."

The essence of Capital One's strategy is to "deliver the right product, at the right price, to the right customer, at the right time." They have consciously avoided the low profit and high churn prime market, in favor of the super prime and sub prime segments. In the super prime segment, their focus is on the "high chargers" who generate high merchant fees in place of interest charges from revolving balances. In the less appealing sub prime market, they target people with limited credit histories, like college students. Risks are contained with cards that have low credit limits and are partially secured. They want to begin a relationship with these people while they are early in their credit life cycle, so they stay loyal when they become more affluent.

First USA would like to be able to do what Capital One can do. As the credit environment worsens, they have had to deal with a customer attrition rate that climbed from 12 to 19 percent and contributed to a 23 percent decline in revenue in 2000 and their first loss. Their efforts to change will be severely hamstrung by not having the right orientation, information, or configuration for forging customer relationships.

The efficiency thrust bias of the First USA strategy contributes to a self-centered orientation that doesn't see customers as individuals. Their insensitivity has led to some notably wrong-footed decisions. In mid-1999 they eliminated the grace period for late payments, while raising late fees. Not surprisingly customers departed in droves, and the bank was forced to rescind the move. But this move revealed a deeper problem. The policy was applied across the board, paying no attention to differences in the lifetime value of their customers.

First USA got big by acquiring customer portfolios from other credit card companies, or using third parties like Affinity Partners, to source potential relationships with associations. This puts more distance between them and their customers and prevents them from building data warehouses to hold the rich customer information that is the raw material of the customer-relating capability.

The configuration of First USA also gets in the way. They have historically been hierarchically organized around products or functions like operations, collections, and systems. Within Brand Marketing, which manages all cards under the First USA name, there are separate groups for acquisitions, portfolios, and e-business – but no one has responsibility for customer retention. Incentives are also misaligned. Because their information system can't tease out individual customer profitability, the front-line contact employees can't be rewarded for keeping valuable customers. Instead, they try to retain everyone – whether they are good, bad, or indifferent long-run prospects.

By contrast, customer responsiveness is deeply embedded within Capital One. Their orientation is fundamentally shaped by the belief that micro-segmentation of their customers is the only way to identify and keep those that are most valuable. One results is that employees at all levels have implicit permission to act as customer advocates, and take initiate to solve customer problems. Customer representatives are not just measured on their performance, but on how supportive they are to colleagues as well. The sense of shared values and collaboration contributes to a low turnover rate – 5 percent per year among customer contact people versus an industry average of 30 percent – which further improves service and helps keep costs down.

Their ability to handle customer information is unsurpassed in the industry. Whenever a customer calls, computers instantly access the full history of the account and cross-reference it with data about how millions of customers behave. Poor prospects are routed to a voice response unit and allowed to close their account. The others are routed to a representative along with two-dozen pieces of information about the caller and their likely reason for calling. Suppose a customer calls to cancel their card. The Intelligent Call Routing system immediately displays three counter-offers, from 12.9 percent to 9.9 percent. This arms the customer service representatives with the information they need to negotiate, and they have the freedom to take action. If the customer accepts the 12.9 percent proposal, the retention specialist is rewarded for keeping the customer with a bonus that acknowledges the preservation of extra profitability over the 9.9 percent final offer.

Few companies invest more in learning about their customer than Capital One. In 2001 they ran 45,000 tests on product variants, procedural changes, and customer interactions. They can try out an idea for a new product on a small sample of customers, tweak it, and then launch fast. With over 6,000 product variants, they are approaching mass customization.

The alignment of the whole organization with strategy is further reinforced by their configuration. Within Capital One, the U.S. card business is structured by market segment groups such as Prime, Medium Response, High Response, Partnership, Affinity, and Small Business. Each of these segments is further divided down to the Individual Business Manager level where profit responsibility resides. The manager of lifestyle cards, within the Prime segment, has the autonomy and the team to run a small business. Instead of a cumbersome top-down organization, Capital One is adroit at sensing opportunities from the bottom-up, and motivated to pursue them fast.

Appendix

HOW THE DATA WAS COLLECTED

A representative sample of senior marketing, sales, and MIS managers and executives was drawn from a database combining information from Dun & Bradstreet and Market Place. Companies were selected from the manufacturing, transportation, public utilities, wholesale and retail trade, finance, insurance, and real estate sectors. Companies located in all 50 states with more than 500 employees were included in the sample. The questionnaire was mailed to the most senior person responsible for CRM initiatives who was also knowledgeable about the competitive strategy. The cover letter explained how to access the same questionnaire on the web if the participant preferred. The web survey was password protected and designed to look as similar as possible to the paper survey. Two weeks after the mailing, follow-up telephone calls were used to remind people to complete the survey and surveys were remailed if requested. 1,100 surveys were sent out in the first mailing, and a second wave was sent out about four weeks later to 900 new contacts. The two mailings had similar response rates and the final response rate was 17 percent with 24 percent of respondents choosing to complete the survey via the internet. Although surveys were collected from 342 businesses, problems with missing data restricted the analysis group to 299 businesses. Data collection was completed in March 2001.

Footnotes

[1] This case comparison is based on interviews with the management of Capital One and First USA, plus security analysts reports, public sources, and "Capital One Financial Corporation," Harvard Business School case 9-700-124 (May 1, 2001).

[2] See, for example, J. Caulfield (2001), 'Facing up to CRM," *Business 2.0* (August-September), 149-150; L. Yu (2001), "Successful Customer Relationship Management," *MIT Sloan Management Review*, 43 (Summer), 89-105; "How to Avoid a CRM Failure," *e-Week* (May 17, 2002); and L. Dignan (2002), "Is CRM All It's Cracked Up to Be?" *CNET*, April 3.

[3] G. Dowling (2002), "Customer Relationship Management: In B2C Markets, Often Less is More," *California Management Review* 44 (Sprint), 87-104.

[4] G. S. Day and R. Wensley (1988), "Assessing Advantage: A Framework for Diagnosing Competitive Superiority," *Journal of Marketing*, (April).

[5] The customer-relating ability is one source of advantage that is supported and facilitated by other resources of the firm. See R. Amit and P. J. H. Schoemaker (1993), "Strategic Assets and Organization Rent," *Strategic Management Journal*, 14, 33-46, and B. Wernerfelt (1984), "A Resource-Based View of the Firm," *Strategic Management Journal*, 5, 171-180.

[6] These three components are also represented in the three factors of resources, processes, and values used to define an organizations' set of capabilities by C.M. Christensen and M. Oberdorf (2000), "Meeting the Challenge of Disruptive Change," *Harvard Business Review*, (March-April), 67-76.

[7] B. Fryer (2001), "High Tech the Old Fashioned Way," *Harvard Business Review*, (March), 99-125.

[8] G. S. Day (1999), "Creating a Market-Driven Organization," *MIT Sloan Management Review*, 41, 11-22.

[9] Other approaches to understanding customers' experiences can be found in P. B. Seybold (2001), "Get Inside the Lives of Your Customers," *Harvard Business Review,* 79 (May), 80-91.

[10] D. K. Digby, F. K. Reichheld, and Paul Scheffer (2002), "Avoid the Four Pitfalls of CRM," *Harvard Business Review*, (February), 101-109.

[11] A. Reinhardt (2002), "Nokia's Next Act," *Business Week*, July 1, 56-58.

Figure 1

Diagnosing the Relationship Advantage

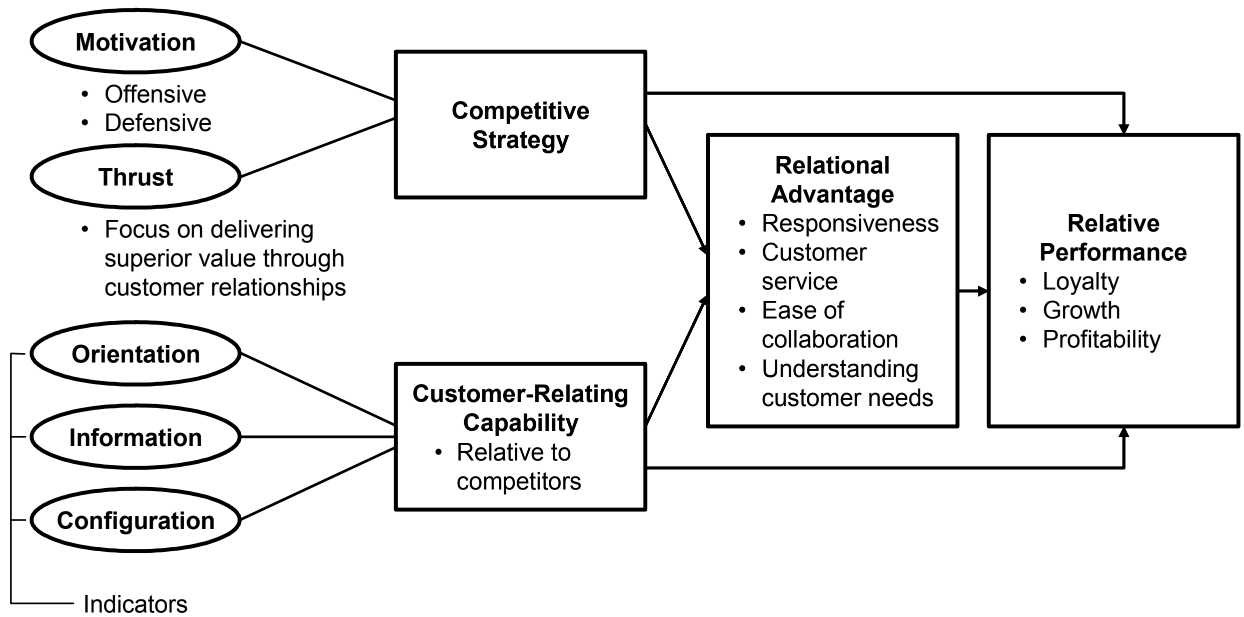

Table One

Distribution of Performance and Capabilities in the Sample

Performance over the past two years compared to competition

	Much Better	Better	Equal	Worse	Much Worse
Sales growth	25%	42%	25%	7%	1%
Profitability	23%	43%	21%	13%	1%
Customer retention	16%	46%	31%	5%	1%

Customer-relating capability

	Significant Advantage	Moderate Advantage	Parity	Moderate Disadvantage	Significant Disadvantage
	18%	49%	23%	9%	0%

Customer-relating capability components

	The Worst	Below Average	Average	Above Average	Among the Better Firms	The Leader
Orientation	0%	5%	17%	24%	39%	14%
Information	0%	14%	38%	21%	21%	5%
Configuration	0%	11%	31%	26%	26%	6%

Table Two

Explaining Differences in Performance Compared to Competition

	Customer Retention	Sales Growth	Profit
Intercept	2.724***	2.888***	2.807***
	(0.046)	(0.053)	(0.056)
Motivation of Strategy (Defensive or Offensive)	0.106*	0.062*	0.180***
	(0.044)	(0.051)	(0.054)
Thrust of Strategy	0.010	0.031	-0.018
	(0.050)	(0.057)	(0.061)
Relational advantage (RA)	0.378***	0.224*	0.044
	(0.090)	(0.103)	(0.104)
Product advantage (PA)	0.191	0.056	0.107
	(0.097)	(0.111)	(0.118)
RA × PA	-0.143*	-0.258*	-0.223
	(0.103)	(0.119)	(0.126)
Customer Relating Capability	0.160**	0.262***	0.363***
	(0.059)	(0.067)	(0.071)
N	299	299	299
R^2	0.319	0.216	0.204

The values within parentheses are standard errors.

* $p \leq .05$
** $p \leq .01$
*** $p \leq .001$

Table Three

Effect of Orientation, Information, and Configuration on the Overall Customer-Relating Ability

	OLS Model	Continuation Ratio Logit Models		
		Significant advantage vs. worst	Moderate advantage vs. worst	Parity vs. worst
Intercept	2.759***	-2.150***	0.724***	2.337***
	(0.041)	(0.241)	(0.159)	(0.511)
Orientation	0.157**	0.658**	0.291	0.176
	(0.048)	(0.253)	(0.163)	(0.260)
Information	0.102*	0.202	0.306	0.342
	(0.045)	(0.174)	(0.172)	(0.340)
Configuration	0.281***	0.811***	0.560**	1.072**
	(0.051)	(0.231)	(0.182)	(0.413)
N	299	299	244	98
R^2	0.355			
ρ		0.244	0.140	0.181

The values within parentheses are standard errors. The pseudo-R^2 measure ρ is a log likelihood ratio indicating how much smaller the log likelihood value of the fitted model is compared to that of a null model featuring only an intercept, i.e., $\rho = 1 - [LL_{fitted} / LL_{null}]$.

$^{*}\ p \leq .05$
$^{**}\ p \leq .01$
$^{***}\ p \leq .001$

Table Four

Understanding the Components of the Customer-Relating Capability

(1) Orientation (R^2_{ADJ} = .22)

	Coefficient	(Standard Error)
Intercept	1.72***	(.33)
Emphasis on customer retention	.34***	(.08)
Openness to sharing information about customers	.15**	(.05)
Willingness to treat different customers differently	.10*	(.06)
Employee's freedom to take action to satisfy customers	.07	(.06)
Prevailing mindset – transactions vs. relations	.00	(.08)

(2) Information (R^2_{ADJ} = .45)

	Coefficient	(Standard Error)
Intercept	1.19***	(.24)
Availability of databases to give full picture of customer	.26***	(.06)
Quality of data in database	.29***	(.07)
Utilization of CRM software for coordination – today	.12*	(.06)
Utilization of CRM software for coordination – 3 years	.10	(.06)
Ability to differentiate among customers	.04	(.05)
Ability to estimate customer life-time value	.04	(.04)

(3) Configuration (R^2_{ADJ} = .46)

	Coefficient	(Standard Error)
Intercept	1.03***	(.20)
Ability of resources to support CRM initiatives	.38***	(.05)
Emphasis of incentives on customer retention	.20***	(.04)
Number of companies the customer sees	.14***	(.04)
Ability to personalize marketing efforts	.11**	(.04)
Accountability for over-all quality of relationships	.08*	(.04)
Ability to customize products and services	.01	(.04)

* $p \leq .05$
** $p \leq .01$
*** $p \leq .001$

All signs for the coefficients are positive because the questions were constructed to contrast best practice (on the right-hand side of the scale) with poor practice.