Customer Relationships Evolve — So Must Your CRM Strategy

A new way of classifying business relationships can boost long-term profitability.

BY JONATHAN Z. ZHANG, GEORGE F. WATSON IV, AND ROBERT W. PALMATIER

THE RELATIONSHIP BETWEEN Apple Inc. and Corning Inc. is like a marriage. Corning makes Gorilla Glass, which is in the screen of every iPhone, and the two companies have been together since the iPhone's introduction in 2007. Each has made extensive commitments to the other.

Corning commercialized the glass, which is strengthened with potassium ions, at the urging of Steve Jobs. When Corning's CEO, Wendell Weeks, initially hesitated, saying the Corning, New York-based company didn't have the capability, the notoriously demanding Jobs responded: "Don't be afraid. … You can do it." Six months later, Corning delivered. Just last year, Apple responded in kind by making a $200 million research-and-development investment in Corning and its plant in Harrodsburg, Kentucky, that specializes in making cutting-edge glass.

Long-term relationships like the one between Apple and Corning are paramount for the health of any business, and companies spend more than $12 billion annually on customer relationship management, or CRM. But understanding and measuring a company's return on CRM can be difficult. Customer relationship health is hard to quantify — while many companies rely solely on common metrics, such as sales and profit, to gauge performance, those metrics can mislead. That's because relationships, like marriages, evolve. A company must not only assess a relationship's current state but also anticipate potential ups and

THE LEADING QUESTION

Does your customer management strategy keep pace with your customer relationships?

FINDINGS

- Few approaches to CRM recognize the evolving nature of B2B customer relationships.
- Customer relationships can move through four stages.
- Companies should classify customers by relationship state and tune their CRM strategies accordingly.

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downs. And — most important but least understood — not all CRM efforts work equally well in all stages of a relationship. Making a big investment in a customer-specific product line, as Corning did with Apple, might help realize the full potential of a promising partnership. But such an investment can be wasted early on if a customer is content to do business at an arm's length. Similarly, providing an appealing product assortment can help in capturing early customer interest, but, as relationships evolve, communicating the breadth of your offerings becomes less important.

For a study that appeared in the *Journal of Marketing*, we spent six years analyzing the B2B relationships of a Fortune 500 wholesaler that serves retailers around the country. That effort showed us that customer relationship quality can be summarized along four dimensions — trust, commitment, dependence, and norms, each covering a different facet of a relationship. (See "Survey Questions for Relationship Measures.") Using these four measures in a short survey given periodically to customers and matched with traditional performance measures, such as sales growth, will enable you to quickly assess whether your customer relationships are thriving. Knowing how to categorize each relationship will then let you tailor the way you manage them. Without this kind of tailoring, you're likely wasting some of your CRM budget.

Identifying the State of the Customer Relationship

We found that customer relationships can evolve through four states. They can be transactional, transitional, communal, or damaged, with each state determined by varying mixtures of our four relationship dimensions.

The *transactional* state is where most relationships begin and where most remain. The partners exhibit low to medium levels of trust, commitment, and dependence and relatively low relational norms, such as coordination in product design or delivery schedules. The relationship is undeveloped, and low levels of sales and sales growth are typical. The partners are checking each other out, the way a couple might on early dates — think of this the "let's meet for coffee at Starbucks" stage. Each partner is exploring the possibilities of the relationship before making a significant commitment. According to our data, transactional relationships are the most common (they account for 54% of the wholesaler's 552 B2B relationships), and many relationships never mature beyond this stage. Some customers prefer — or their company purchasing policies require — conducting business at arm's length and do not want deeper entanglement. Thoroughly understanding a customer's needs and goals at this stage can prevent wasting CRM resources.

Some transactional relationships do deepen, entering the *transitional* state. These relationships exhibit higher levels of trust and commitment and greater relational norms and mutual dependence. Two characteristics define this state. First, all four relationship dimensions grow, reflecting a substantial increase in partners' understanding of how to best communicate and cooperate; they become familiar with each other's corporate cultures and idiosyncrasies. Sales growth is high here, indicating even greater potential. This is also the *least stable* state: In each period, 75% of these relationships evolve into another state, year to year, with most (60%) strengthening but a few (15%) weakening. Many transitional relationships are on their way to becoming communal, the next stage in our framework.

Communal relationships exhibit the highest levels of all of the relationship measures and produce the highest sales as well as consistent sales growth. The 80/20 rule applies here, as in so many things in life — the customers in communal relationships typically account for about 80% of sales while comprising 20% of the customer portfolio. In our research sample, a 1% increase in the number of

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SURVEY QUESTIONS FOR RELATIONSHIP MEASURES

The authors' analysis of 552 B2B relationships uncovered four dimensions of customer relationships: trust, commitment, dependence, and norms. Use these sample survey questions to determine whether your customer relationships are thriving and to customize how you manage them.

CUSTOMER RELATIONSHIP DIMENSIONS	ROLE IN RELATIONSHIP STATE	SAMPLE SURVEY QUESTIONS
Trust Confidence in a business partner's integrity	Trust entails an evaluation of a partner's reliability and intentions. It can prompt risky but rewarding investments out of the belief that the partner will not shirk or exploit. It facilitates sharing of information and resources.	• [Company X] can be counted on to do what is right. • [Company X] stands by its word.
Commitment The desire to maintain a valued relationship	Commitment reflects a self-focused evaluation of the intention to continue the relationship, including a company's dedication, its identification with the partner, and its willingness to accept long-term benefits over short-term gains.	• We continue to represent [Company X] because we enjoy working with them. • We intend to continue representing [Company X] because we feel like we are part of their family. • We work with [Company X] because we admire their values.
Dependence Reliance on each other for benefits for which few easy alternatives exist	Dependence captures evaluations of the structural constraints of a relationship; interdependence promotes collaboration, while one-sided dependence can undermine it if trust or commitment is low.	• If for some reason, our relationship with [Company X] ended … … we would compensate by switching our effort to other lines. [R] … it would be relatively easy for us to diversify into new product lines. [R]
Norms Expectations about each other's conduct as you work toward mutual and individual goals	Relational norms develop from repeated interactions between partners and guide their trade by reflecting concerns about each other's prosperity, the equitable sharing of costs and benefits, and the reduction of opportunism.	• Even if costs and benefits are not evenly shared between us in a given period, they balance out over time. • We each benefit and earn in proportion to our efforts. • We usually enjoy a fair share of the rewards and cost-savings in doing business with [Company X]. • In our relationship, neither of us benefits more than deserved.

NOTES: All items were measured using five-point scales, from 1 (strongly disagree) to 5 (strongly agree). [R]=reverse-coded.

communal customers translated to a $4.5 million increase in sales. Communal relationships are the most stable (61% remain year to year). But if one of these relationships changes, it is more likely to become damaged (21%) than to slip back to, say, transactional status. Transgressions, such as inadvertent neglect of customers or betrayals of trust, are more harmful in the communal state.

Finally, the *damaged* state is marked by low levels of trust and commitment and very low levels of relational norms, but medium to high levels of customer dependence. That last point is key — the customer may want to leave but can't, often because of reliance on a critical part or input in the short run. This dependence represents the potential for saving these relationships. Sales growth here is weak, if it exists at all, since these relationships likely persist only because of a customer's lack of alternatives. Exiting the damaged state is difficult; 56% of the relationships remain stuck here, and if they recover, they may only move to the neutral transactional state. If not for the high dependence, many of these relationships would dissolve.

Tailoring Your Strategy to the Relationship State

Correctly categorizing customer relationships isn't just an interesting thought experiment. Doing so enables a company to apply the right CRM strategy at the right time; not every technique for managing and

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improving customer relationships works equally well in every state. A transactional relationship, for example, calls for regular communication and a varied product assortment but won't necessarily reward big investments in, say, dedicated sales staffers. A communal relationship, in contrast, might demand staffing up to meet a particular customer's needs but has often grown beyond the place where that customer cares about the sheer breadth of your company's offerings.

Rules of thumb, distilled from our research, can help managers categorize their customer relationships, deploy the most appropriate CRM strategies for each one, and predict possible payoffs. Doing this kind of planning doesn't require advanced statistical analysis. It can be achieved with annual or semiannual surveys of customers. (We provide possible survey questions in "Survey Questions for Relationship Measures.") From these surveys, a manager can infer not just the state of a particular relationship but also where it's headed. Armed with that information, the company can then apply the best strategies to deepen or preserve the relationship.

For transactional customers, the watchword is communication. These customers aren't seeking deep commitment and aren't expecting it in return. Periodic check-ins from a sales or customer service representative and regular reminders of new product and service offerings may suffice. The goal is to increase sales, but to do so cost-effectively. Don't waste time and money trying to cultivate the many customers who are content to do business at arm's length.

Ideally, some of these customers will show high sales growth. That will signal the possibility of their moving to a transitional relationship. A larger CRM investment then will be called for. That might entail assigning a dedicated sales representative to a customer or making customer-specific investments. Based on our analysis of the Fortune 500 wholesaler and its customers, we would expect these sorts of expenditures to produce significant increases in customer loyalty and account sizes — with account sales growing by a factor of four or five, which was equal to 23% annual sales growth in our sample.

If all goes as planned, some transitional relationships will continue to mature and become communal. Communal customers are typically highly profitable, so managers will want to lavish attention on them. Neglect can harm these relationships, and perceptions of unfairness or a loss of trust can be fatal. Managers should thus regularly assess negotiation procedures and contracts with these customers, with an eye to identifying and addressing potential points of conflict, and regularly review the fairness of business procedures and distribution of profits. In the event of an inadvertent action the customer perceives as unfair, quickly seek compromise. Failure to do so can send a communal relationship spiraling toward the damaged state.

One of the surprises of our research was that not every damaged relationship is destined to divorce. Just as some disgruntled spouses seek counseling and work through their differences, corporate partners can find ways to reconcile and at least preserve a damaged relationship. Striving for this sort of CRM diplomacy can result in reduced customer churn and improved reputation. What's more, keeping customers saves money: On average, it costs five times more to acquire a new customer than to keep a current one, and a 5% reduction in churn can increase profits by 25% or more.

Even a relationship that has backslid into being transactional can represent a new beginning.

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