THE IMPACT OF CUSTOMER RELATIONSHIP MANAGEMENT

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INTRODUCTION

Customer relationship management (CRM) is a management strategy that unites information technology with marketing. It originated in the United States in the late 1990’s, and, to date, has been accepted in a significant number of companies worldwide. On the other hand, some people have negative opinions of CRM; such views hold that it is difficult to implement successfully and that its cost-benefit performance is low, among others.

This paper attempts to cast light on the true nature of CRM and to explore how it should be dealt with in the future.
CHAPTER 1
THE EVOLUTION OF MARKETING STRATEGY

The Changing Market Environment

In the early 20th century in the United States, demand outpaced supply to the extent that companies concentrated on selling as many products as possible. Suppliers focused on product development, manufacturing capacity, and securing distribution outlets, without regard to their consumers. They did not pay much attention to who bought their products or what their customers needed. They used classic marketing tactics, i.e., mass marketing – primarily print and broadcast advertising, mass mailings, and billboards.

By the middle of the 20th century, however, the economy had matured to a point where consumers had the power of choice because supply had outstripped demand. The era of the passive consumer was coming to an end. Companies began to find out who their customers were, what they wanted, and how they could be satisfied. They analyzed data about their customers and segmented them based on their demographics, such as age, gender, and other personal information. Then they promoted their product or service to a specific subset of customers and prospects. This was called “target marketing.” Each company thought seriously about the “four P’s” (price, promotion, product, and placement), the basic concept of modern marketing, which was first suggested by the expert in the field, Jerome McCarthy, in 1960.

By the middle of the 1980’s, when the economy was highly matured, it had become extremely difficult to sell things. Traditional target marketing was not so gratifying under circumstances in which it was so difficult to cultivate new customers that this tactic could not sustain cost efficiency. At this point, the idea of “relationship marketing” gained the confidence of the business sector. This concept was aimed at building long-term relationships with
customers and placed a great deal of value on the retention of existing customers rather than the acquisition of new ones. I will explain this in detail below.

**Retention and Acquisition**

Marketing operations consist of two activities: acquisition and retention of customers. In the world of mass and target marketing, the focus was on the acquisition side. On the other hand, in the world of relationship marketing, attention shifted to retention.

This happened mainly because of the cost involved. In general, it is believed that “it is five to 10 times more expensive to acquire a new customer than obtain repeat business from an existing customer.”\(^1\) As the needs of customers became diversified, conventional promotions became less efficient and drove up costs.

According to the well-known empirical “Pareto principle,” it is assumed that 20 percent of a company’s customers generate 80 percent of its profits.\(^2\) In other words, retention of a large customer base is a major issue.

**Birth of Customer Relationship Management**

In this context, CRM came into existence in the late 1990’s. Although there is no clear definition of CRM, Jeffrey Peel, CEO of Quadriga Consulting, defined it as follows:

[CRM] is about understanding the nature of the exchange between customer and supplier and managing it appropriately. The exchange contains monetary considerations between supplier and customer – but also communication. The

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\(^2\)The Pareto principle (also known as the 80-20 rule, the law of the vital few, and the principle of factor sparsity) states that for many phenomena, 80 percent of the consequences stem from 20 percent of the causes. 21 June 2006 [http://en.wikipedia.org/wiki/Pareto_principle](http://en.wikipedia.org/wiki/Pareto_principle) Wikipedia: The Free Encyclopedia.
challenge to all supplier organizations is to optimize communications between parties to ensure profitable long-term relationships. CRM is a key focus for many organizations now as a shift away from customer acquisition toward customer-retention and churn reduction strategies dictates a need for best practice CRM processes.3

“Share of Wallet” and Life Time Value

In the age of target marketing, marketers aimed at the expansion of their companies’ market share. With the advent of CRM, on the other hand, they shifted their emphasis to increasing the “share of wallet”4 of their customers. As mentioned above, they try to establish close connections with their customers and offer products that the customers really want, so that the customers will be satisfied.

Marketers estimate the value of customers on a long-term basis, that is to say, life time value (LTV).5 Basically, LTV is calculated as follows: “Multiply a customer’s expected number of visits times the average amount of money spent per visit. Deduct your costs of acquiring and servicing that customer. Add in the value of accounts this customer refers to you, and discount the sum appropriately for the time period you’re analyzing.”6 It is difficult to ascertain the exact LTV of customers, but there is evidence that significant concern over creating long-term relationships with customers is warranted.

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4Gray and Byun 12.


Cross-Selling and Up-Selling

Cross-selling is the behavior of selling a product or service in addition to another purchase. Up-selling is the behavior of stimulating a customer to trade up to a more expensive or profitable product or service. These strategies are aimed at selling more to existing customers for the reasons mentioned above. Taking an automobile dealer as an example, suggesting a car navigation system for a buyer is cross-selling; advising a higher-class car for a potential customer is up-selling.

Workflow of CRM

A simplified CRM workflow is as follows.

1. Collecting Customer Data and Information

   Acquisition of customers and basic data including name, address, gender, age, etc, is fundamental, but transaction data such as date, time, item, value, etc. at every “touch point,” i.e., a point of interaction when the company communicates with a customer, or vice versa, are also essential. Information is often needed to complement these data. It is “a knowledge that comes from asking questions to customers such as why and how.”

2. Analyzing Data to Predict Customer Behavior

   Marketers use these data and information so that they can record the interests and preferences of customers. Furthermore, they attempt to ascertain purchasing patterns on the basis

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7Dyche 297.

of transaction records. “Using sophisticated modeling and data mining techniques, behavior prediction uses historical customer behavior to foresee future behaviors.”

Understanding the tendency that a certain type of customer is apt to purchase a specific product (“propensity-to-buy analysis”) and that certain products are often bought with other specific products by a particular type of customer (“product affinity analysis”) has a beneficial effect on making marketing decisions.

3. Marketing Campaigns: Applying the Results of Analysis

Companies conduct marketing campaigns that are designed on the basis of the results of analysis or on hypotheses. They promote their products through various channels, such as e-mail, the Internet, telemarketing, or direct mail. They also contact their customers for follow-up after purchase. And, of course, they have to monitor the results of that campaign in order to refine future campaigns. With CRM software, they can, for the most part, automate these processes.

4. Measuring Results, Revising Hypotheses, and Repeating This Workflow Process

To improve their results, companies need to evaluate the effects of their marketing campaigns. They should measure whether and how a given campaign achieves its original goal and revise their hypotheses according to the results. After that, they should repeat the workflow process, thereby making gradual progress.

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*Dyche 33.*
CHAPTER 2
CRM TODAY

The Current Status of CRM

According to a survey by Gartner, Inc., the world’s largest technology research and advisory firm, more than 50 percent of CRM implementations are considered failures from the company’s point of view. CRMretail Study 2004, a survey conducted by the National Retail Federation in the United States for its more than 100 member companies, showed that only about 30 percent of that year’s respondents said that their CRM initiatives are fully meeting or exceeding their expectations at this point (Fig. 1).

It is interesting to note that this survey also showed that 80 percent of the respondents were either increasing their CRM budgets or holding them at the same level as in the previous year (Fig. 2).

In addition, Bain & Company, one of the world’s leading global business consulting firms, conducted a survey entitled “Management Tools & Trends 2005,” which showed that “CRM is now only surpassed globally by the practice of strategic planning as the most used management tool” (Fig. 3). The use of CRM has surged tremendously in the past five years or so. According to statistics published by Gartner, worldwide CRM license revenue has remained strong without any significant increase (Fig. 4).

\[^{10}\text{Gartner, Inc, } \langle\text{http://www.gartner.com/5\_about/press\_releases/2001/pr20010912b.html}\rangle.\]

\[^{11}\text{National Retail Federation and Ogden Associates, “CRMretail Study 2004.”}\]


\[^{13}\text{Gartner, Inc, } \langle\text{http://www.gartner.com/media\_relations/asset\_61871\_1595.jsp}\rangle.\]
As stated above, CRM has become very popular and is now widely accepted, but putting it to practical use seems to be difficult.

Why Has CRM Failed?

Numerous consultants and critics have expressed various opinions as to why so many CRM projects have failed. Darrell K. Rigby and his co-workers at Bain & Company, for example, have cited “the Four Perils of CRM.”\(^{14}\) Below, I will describe these pitfalls and propose some countermeasures.

Peril 1: Implementing CRM Before Creating a Customer Strategy

Many executives mistakenly believe that implementing CRM software is equivalent to creating a marketing strategy. But in fact, CRM software is just an enabler to move their strategy into action. Before implementing CRM software, therefore, a company should formulate its strategy and clarify the purpose for this strategy. In other words, a traditional and well-thought-out marketing strategy concept is necessary.

Peril 2: Rolling Out CRM Before Changing the Organization to Match

After establishing the goals of its strategy, the company should revamp its organization and/or business processes accordingly. This includes not only external operations with customers but internal systems, such as job descriptions, performance measures, compensation systems, training courses, etc. If such reforms are implemented, employees will be able to recognize the nature and benefits of the new strategy.

\(^{14}\)Darrell K. Rigby, Frederick F. Reichheld, and Phil Schefter, “Avoid the Four Perils of CRM,” *Harvard Business Review* February 2002. The following sub-section titles of Perils 1 to 4 are also cited from this article.
Peril 3: Assuming That More CRM Technology Is Better

Many executives also mistakenly believe that CRM is a technology-intensive product and are apt to put emphasis on new functions of CRM software. “CRM can be managed in many ways,” however, “and the objectives of CRM can be fulfilled without huge investments in technology simply by, say, motivating employees to be more aware of customer needs.” When a company begins to use packaged CRM software, it is very important for them to narrow down the specifications of the software in order to minimize the burden on its users and to suppress bugs. If a company concentrates excessively on new functions, this will cause false of integration of CRM software and existing system. This is a costly pitfall.

Peril 4: Stalking, Not Wooing, Customers

With the aid of CRM software, marketing managers can more easily analyze great quantities of customer data than before; thus, they are apt to contact their customers without careful consideration. But the point is that they should establish contact only with individuals who have a real interest in their company and/or products. When they approach the wrong people, they can be perceived as stalkers and lose potential customers.

And Much More...

Other than the four perils described above, there are other issues to take into consideration. At the introductory stage of CRM, regular communication is of considerable importance to entire company. Doug Tanoury, president of Customer Interaction Consulting,
indicated that it “should be delivered throughout the company highlighting ‘where we are’ in the project, sharing milestones and informing staff what happens next.”

Generally speaking, the cost of implementing CRM is quite high. Today, large businesses can spend between $30 and $90 million over a three-year period on software, technology, labor, consulting services, and employee training related to CRM initiatives. Implementing CRM is such a major project that most executives are apt to think that CRM is a software tool that will manage customer relationships by itself. But this is a big mistake. As Rigby pointed out: “CRM is the bundling of customer strategy and processes, supported by the relevant software, for the purpose of improving customer loyalty and, eventually, corporate profitability.”

In recent years, there have been some companies that have been successful in implementing CRM software. Common among such firms is that “they’ve all taken a pragmatic, disciplined approach to CRM, launching highly focused projects that are relatively narrow in their scope and modest in their goals.” They only introduced CRM into the critical process or fatal flaw in their companies’ competitiveness. This method is so effective that it will become a common strategy in the future.

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18 Rigby, Reichheld, and Schefter.

CHAPTER 3
VISION FOR THE FUTURE

In the Light of Return on Investment (ROI)

Although expenditures on CRM can be enormous, companies often invest in it without a very clear idea of how they are going to measure the return on that investment. Given the current tight economy, companies have no choice other than to focus increasingly on financial measures, especially ROI. The ROI analysis should consider intangibles (i.e., outcomes beyond tangible cost savings and revenue growth).

Simply stated, ROI is calculated as returns divided by investments. When assessing the total cost of ownership of CRM, it is important to add ongoing costs such as annual software licensing fees, software maintenance (e.g., modifications and fixing bugs), and continuous employee training, as well as one-time costs, such as the software base license, consulting fees, hardware, initial employee training, and so forth.20 On the other hand, when figuring out the returns, the matter is considerably more complex, because there are many tangible and intangible benefits. Tangible benefits include cost savings and revenue growth that would be achieved by improvement in sales force productivity, increased cross-selling, and an increased customer retention rate. Intangible benefits might be an increase in customer satisfaction, improvement of market predictive ability, and product development in accordance with customers’ needs. Although these benefits are difficult to quantify, they can be measured with appropriate benchmarks.21


The paramount cause for difficulties in calculating ROI, however, is that the benefits of CRM need to be measured on a long-term basis. CRM programs take some time to bring benefits to the company, and it is hard to define the proper period of time for such results to materialize. Recently, considerable research has been undertaken in the field of “Marketing Return on Investment,” which pursues the optimal allocation of marketing resources.\(^\text{22}\) Thus, the concept of ROI will become more sophisticated in the near future.

**Privacy Concerns**

The recognition of privacy has increased in today’s society, and companies should handle personal information with extreme care. “Adequately addressing privacy concerns will be a top business priority,” Scott Nelson, vice president and research area director for Gartner, has said, continuing that: “This is going to require rethinking of how information is gathered, how customers can access and control that data and how enterprises can safeguard it from parties that might want it but shouldn’t have it.”\(^\text{23}\) Although personalization and customization are the key features of CRM, companies need to balance these attributes with privacy.

On November 8, 2004 the *Wall Street Journal* gave an account\(^\text{24}\) of the new customer approach of Best Buy Co., Inc., the top company in the United States in the consumer-electronics retail industry. This account said that it “estimates that as many as 100 million of its customer visits each year are undesirable,” and Brad Anderson, CEO of the company “wants to be rid of


these customers.” These figures were true and derived from actual data; nevertheless the company should have given careful consideration to the effect of these kinds of sentiments being disclosed in public. The week after this article appeared, the Wall Street Journal published letters from angry consumers, and Dell, one of the Best Buy’s main competitors, ran an advertisement in The New York Times, which said “At Dell, We Love All Customers. Even the Ones Best Buy Doesn’t.” In this case, Best Buy did not infringe on the law, but they certainly made privacy advocates nervous.

Japan

In Japan, CRM has gradually become accepted, and software has been sold mainly to large companies. As of now, the market size for CRM in Japan is still small, only about 1/20th as large as in the United States.

But, in 2006, Microsoft entered the market, aiming at small and medium-sized companies. Thus, the market will be expanding before too long. Total revenues have already increased dramatically and are expected to continue to do so for the foreseeable future (Fig. 5).

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25“Minding the Store.”
CONCLUSION

Is CRM a Panacea?

In consideration of the pitfalls noted in Chapter 2, are all companies putting CRM to practical use? The answer is “No.” In fact, there is one exceptional case for implementing CRM.

The essential qualification for implementing CRM is a high “frequency of customers’ purchases.”28 Without frequent interaction, it is difficult for company to maintain a dialogue with its customers in order to persuade them to buy more of its products. For instance, a construction company that builds large bridges that have useful lives of 100 years or more does not need to implement CRM.

Company Strategy and Organization

At the end of this paper, I would like to mention one more issue. It is important to adopt CRM that is appropriate to a company’s strategy and organization. According to the business consultants Michael Treacy and Fred Wiersema, there are “three value disciplines, [which refer] to the desirable ways in which companies can combine operating models and value propositions to be the best in their market.”29

The first is “Operational Excellence,” which means “providing customers with reliable products or services at competitive prices, delivered with minimal difficulty or inconvenience.”30 The second is “Product Leadership,” which means “providing products that continually redefine


30Treacy and Wiersema 32.
the state of the art.” And the third is “Customer Intimacy,” which means not delivering “what the market wants, but what a specific customer wants.” Companies with these qualities should cultivate relationships with their customers, and they will be optimal candidates for implementing CRM. Even if a company chooses “Operational Excellence” or “Product Leadership,” it should maintain threshold standards on other dimensions of value. That is to say, these companies can also take advantage of CRM.

**Closing Remarks**

Let me mention again that CRM is not a system, but a philosophy. If it is utilized it with care and attention, it will have a positive effect on a number of organizations.

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31 Treacy and Wiersema 40.
FIGURES

Figure 1

How Well Are CRM Programs Meeting Expectations?

Source: National Retail Foundation (April 2004)

Figure 2

What is Your Expectation for CRM Technology Spending in 2004 vs. 2003?

Source: National Retail Foundation (April 2004)
Figure 3

Usage Rates of Management Tools in 2004

<table>
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<th>Usage</th>
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<td>CRM*</td>
<td>75%*</td>
</tr>
<tr>
<td>Benchmarking*</td>
<td>73%*</td>
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<tr>
<td>Outsourcing*</td>
<td>73%*</td>
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<tr>
<td>Customer Segmentation*</td>
<td>72%*</td>
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<td>Mission and Vision Statements*</td>
<td>72%*</td>
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<td>Core Competencies*</td>
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<td>TQM*</td>
<td>61%*</td>
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<tr>
<td>Change Management Programs*</td>
<td>59%*</td>
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<tr>
<td>Balanced Scorecard*</td>
<td>57%*</td>
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<tr>
<td>Supply Chain Management</td>
<td>56%</td>
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<td>Scenario and Contingency Planning</td>
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<tr>
<td>Activity-Based Management</td>
<td>52%</td>
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<tr>
<td>Economic Value-Added Analysis*</td>
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<td>Loyalty Management*</td>
<td>40%**</td>
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<td>Price Optimization Models*</td>
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<td>Six Sigma*</td>
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<td>Offshoring*</td>
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<td>Open-Market Innovation*</td>
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<tr>
<td>Mass Customization*</td>
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<td>RFID*</td>
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*Significantly above the overall mean
**Significantly below the overall mean

Source: Bain & Company (April 2005)
### Figure 4

**CRM Software Worldwide License Revenue Market Size and Forecast (Millions of Dollars)**

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<th>2005</th>
<th>2006</th>
<th>2007</th>
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<tr>
<td>Revenue</td>
<td>3,386</td>
<td>3,505</td>
<td>3,715</td>
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</table>

Source: Gartner Dataquest (August 2004)

### Figure 5

**Japanese CRM Software License Revenue Market Size and Forecast (Millions of Yen)**

<table>
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<th>Year</th>
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<th>2005</th>
<th>2006</th>
<th>2007</th>
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<tr>
<td>Revenue</td>
<td>9,510</td>
<td>9,720</td>
<td>13,810</td>
<td>19,800</td>
<td>27,000</td>
</tr>
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</table>

Source: Yano Research Institute (February 2006)
BIBLIOGRAPHY


National Retail Federation and Ogden Associates, “CRMretail Study 2004.”


