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Building Trust - The Most Important CRM Strategy?

by

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Abstract: Currently there is a battle for customer relationships observable in many B2C and also in B2B markets. Most customer relationship management (CRM) strategies are built on the assumption that once a customer is locked in, it will be easier to charge premium prices in the future for specially tailored solutions, i.e. individualized bundles of standardized product components, due to increasing switching costs for the customer over time. In light of the foreseeable development of appropriate applications, customers are more and more able to organize their personal data environment on their own, temporarily allowing corporations to use these data to be able to tailor solutions according to individual customers' needs. Taking into account this mega-trend, the author argues that switching costs will drop dramatically and the current business model of acquiring customers today with high investments and utilizing this relationship in the future will emerge not to be profitable. Hence, if customers can switch suppliers at virtually comparably low direct and indirect costs, trust – in all its different dimensions – will become key in order to successfully compete in the markets of the future. Special consideration is devoted to the arising opportunities in the financial services industry.

Keywords: Trust, Customer Relationship Management, Switching Cost, Customer Lifetime Value, E-Commerce, Personal Data Environment

1 Introduction

One of the most used buzzwords in the last years has been that of “Customer Relationship Management” (CRM) – or eCRM, emphasizing the need for information technology (IT) as an enabling technology to manage and maintain valuable customer relations (for an assessment of the MIS research in CRM see [15]). The real battle for the customer relationship has just began and companies are investing billions of dollars in order to individually service their customers according to their needs and objectives. In literature an uncountable number of different definitions of CRM can be found, which puts the discussion on CRM concepts and strategies on some fuzzy ground. In the remainder of this paper we will refer to CRM as individually and professionally manage customer accounts by keeping “economically valuable” customers and repelling and eliminating “economically invaluable” ones.

A lot of companies currently already pursue or recently announced a strategy where the customer and his preferences, needs, and objectives is put in the center of interest and all processes are aligned around the customer. Such strategies are based on the believe that if a customer learns how to deal with the corporation and, even more important, the corporation learns how to best individually service its customers, the customer will maintain a long-term relationship with this company. Due to this relationship, it is believed that corporations will be able to charge premiums on their specially tailored solutions which often consist of a bundle of standardized product components (on mass customization see e.g. [16], [17], on individualization see e.g. [19]).

Due to the technological development and the changes in the affinity towards new technologies in the society, especially in the younger generation which is the customer base of tomorrow, in this paper the general sustainability of the business model of such CRM strategies – investing in customers now, lock them in with CRM strategies in order to utilize them later in their life cycle – will be challenged. The author argues why companies should rethink their IT investments, anticipating the shift or power towards the customer and what strategy seems to be a promising response with regard to this likely evolution.

The remainder of this paper is organized as follows. In the next section, CRM and customer lifetime value concepts will be discussed in more detail and the main underlying assumptions for such strategies will be assessed. Section 3 will present the changing environment and the coming shift of power to the customer with its consequences with respect to state of the art CRM strategies. A discussion of a potentially successful strategy focusing on trust building activities will be laid out in section 4. Here, in light of the analysis special attention will be drawn to the opportunities that arise in the financial services industry. The paper concludes with a brief summary of the findings and an outlook in section 5.

2 CRM Strategies and Underlying Assumptions

Currently billions of dollars are invested in CRM tools and a reorganization of processes around the customer – and this trend is believed to even intensify. For instance for 2000 the expenses for CRM tools and applications is estimated to have reached US$ 3,7 billion and they are expected to soar to US$ 16,8 billion in 2003 [14]. In order to be able to generate solutions that can be offered to the customer at the right time and using the appropriate communication channel, sometimes even trying to guess what the customer might need without him knowing about his latent needs. Appropriately applied, a CRM strategy should generate the following effects among the customer base of a corporation:

- Increasing customer satisfaction, loyalty, and trust.
- Increasing share of wallet.
- Qualitatively better tailored solutions with respect to the customer's specific needs. (For an application in the financial services industry see e.g. [1], [3], [10].)

Figure 1 depicts the expected cash flows based on successful CRM. Obviously, after a costly acquisition of a customer, constantly increasing positive cash flows are assumed (for a discussion of shareholder value implications of a customer lifetime value strategy see e.g. [20]). The cash flow is believed to increase due to several effects, such as utilization of cross selling potential, recommendation effect of satisfied customers, cost reductions on the side of the supplier, and an anticipated price insensitivity on the side of the customer.

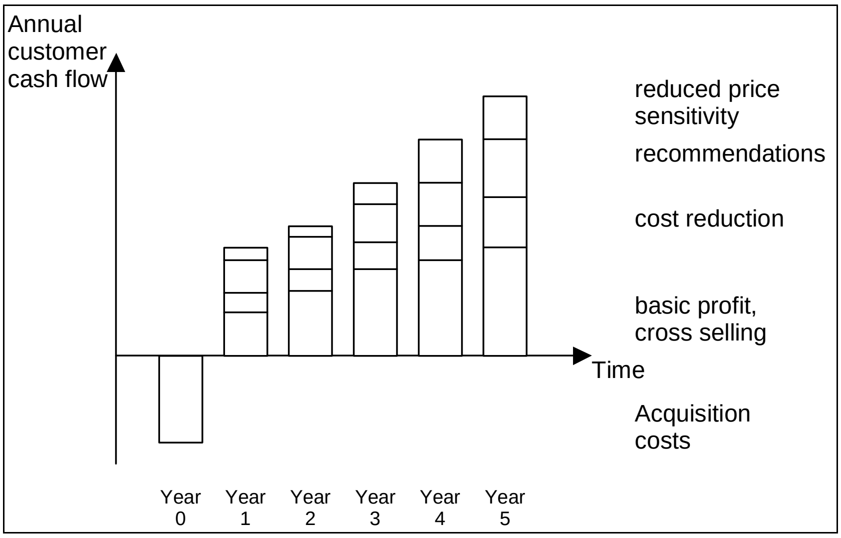

Figure 1: Customer Life Time Value (See e.g. [18])

Certainly, this sounds like an appealing concept and many customers would already be quite happy if their service or product supplier would at least deliver the solutions they have been asking for. But this approach neglects some important features of human nature:

- First, a lot of people want to be able to compare their purchases with purchases of their peers. With individualized products and services this becomes increasingly difficult.
- Second, a lot of people ever more worry that companies which have a lot of information about them may misuse these data [12].
- Third, a lot of people exhibit variety-seeking-behavior, i.e. looking for variety inherently contains utility for the customer [5],[9].
- Fourth, changed income circumstances induce customers to switch a supplier [5],[9].
- Fifth, customers might not like to realize the fact to be locked-in, i.e. making a switch to a different supplier a costly venture for the customer.

Talking about the last issue, this is one of the basic underlying assumptions of current CRM strategies. The acquisition costs upfront to win a new customer relationship has to pay off over time. Building up high switching costs is one of the profit sources for companies pursuing such a strategy.

Switching costs can come in a variety of dimensions which are gathered in Table 1. (For the term switching costs see also [2].)

Dimension	Example
Economical	Opportunity costs of providing a company with address information.
Psychological	Positive emotional relationship towards supplier based on trust, tradition or image [9].
Social	Integration of the customer into corporate processes focusing on personal human relations [9].
Legal	Contractual long term agreements.
Technological	Proprietary interface for data exchange.

Table 1: Dimensions of Switching costs

In the next section, we will discuss, why trust may become key in the future considering the changing market environment and hence dramatically dropping switching costs.

3 Trust as Vital Component of Switching Costs

Though the idea of companies serving their customer base according to their needs and really focusing on what the customer wants is appealing, customers are getting increasingly aware that the information about themselves is a highly valuable asset. But not only customers do recognize that these data are worthy assets but also analysts tend to value companies in the Information Age according to their number of customer relationships instead of their tangible assets (see [20] and references therein).

3.1 The Customer – An Information Broker?

Coming back to the customers view, it is highly questionable whether customers will accept in the long-run that companies are getting a highly valuable asset – personalized data – for “free”. Of course, customers also benefit by providing corporations with personalized information. They might save time, since they do not have to fill out address fields over and over again or they might get better tailored solutions for their problems, but it is doubtful whether this utility outweighs the asset they are giving away for “free”. The exchange rate is unbalanced and already back in 1997, Hagel and Rayport announced what they call "The coming battle for customer information" [6]. With software tools becoming available and an increasing technological affinity, it can be expected that customers will start keeping their own profiles and selling access to certain parts of these profiles (temporarily) to companies.

Hagel and Rayport, however, do not believe that customers will care about their profiles on their own but propose the emergence of an "infomediary" – corporations that act as "brokers of customer information, marketing it to businesses on consumers' behalf while protecting their privacy at the same time" [5]. There are already some prominent examples of infomediary approaches in the market. For instance Microsoft's Passport allows consumers to be able to sign-in at Passport partner firms with just a single username and login without having to fill-in address fields for each company (see www.passport.com). This is just one step in the direction of a personal data environment. MemIQ –founded early 2000 by HypoVereinsbank AG and Vodafone Group plc. – goes one step further: It offers an intelligent electronic storage for personal documents accessible through the WWW (www.memiq.com). Another approach that should be mentioned here is the Platform for Privacy Preferences Project (P3P) by World Wide Web Consortium (W3C), which in an "automated way for users to gain more control over the use of personal information on Web sites they visit" (www.w3.org/P3P/). The first two approaches might evolve as the above mentioned infomediaries, whereas P3P focuses on providing the customer himself with a tool to manage his personal data.

In the following, the question whether we will see an up rise of infomediaries as business entities or whether the customer becomes his own infomediary, will not be the center of interest, but how businesses should alter their current business models in expectation of the shift of power towards the customer increasingly using such tools.

3.2 Dropping Switching Cost

Getting back to the dimensions of switching costs (see Table 1), some predictable trends will cause a sharp decline in switching costs in the future. One of the most prevailing trends is the development in the information technology and more specifically in applications to store and exchange information in a standardized format (e.g. XML may serve as such a standard for data exchange on the Internet).

Figure 2 schematically depicts the different utility curves for a customer who switches his supplier two times. In the traditional CRM approach, the quality and hence the utility of the offered solutions steadily increases over time due to the two-way-learning and communication process between supplier and customer. However, once a customer decides to switch the supplier, this process has to start all over again. In the infomediary setting, the customer takes all relevant data with him and ideally provides the new supplier with all necessary data to carry on at the same level of tailored solutions as the old supplier. Obviously in this scenario it is assumed that the ability to generate optimal solutions based on a given set of data of a customer is the same for all suppliers, which will hardly be true in real world circumstances.

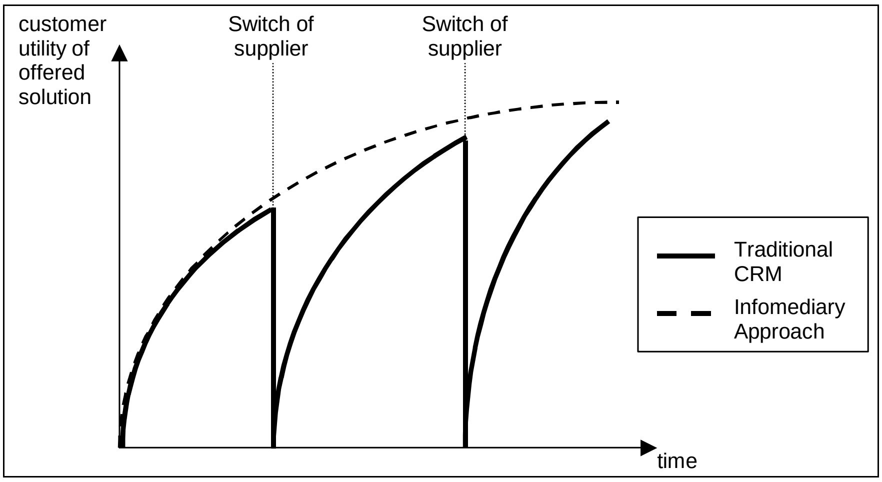

Figure 2: Customer Utility Curves for Traditional and Infomediary Approach

Given the development of user-friendly applications that enable customers to maintain and continuously update their own profiles with relevant data along with the application development sketched above, we will see a significant decline in switching costs in the technological and economical dimensions. Most end-customer to supplier relationships (B2C) are not based on contractual long term agreements, since the purchase of (commodity) products and services such as cars, news, broking, books, generally do not require such long term agreements. Even though, companies try to prevent the commoditization by providing not just the sheer commodity products but packaging them into a bundle of different services coming along with the product itself like delivery time and return policies. Nevertheless, basically just the psychological and social dimensions remain to keep customers.

3.3 The Importance of Trust

The basic argument is, that trust – already one of the most important concepts in doing business – will get even more important and firms should invest heavily in trust building activities to keep and win customer relations. In order to focus on trust building activities, the first step is to understand the concept of trust. Astonishingly, although every business transaction is somehow based on trust of the involved parties, a definition of the interdisciplinary concept of trust can hardly be found. McKnight and Chervany argue in a recent article “Because trust is so broad a concept, and because so many definitions have proliferated, a typology of trust constructs seems appropriate” [4]. Instead of trying to find an overarching definition, the conceptualization links trust influencing constructs and subconstructs together (see Figure 3). (For more literature on trust see e.g. [21], [22], [23], [24], [25], [26], [27], [28], [29] and references in [4].)

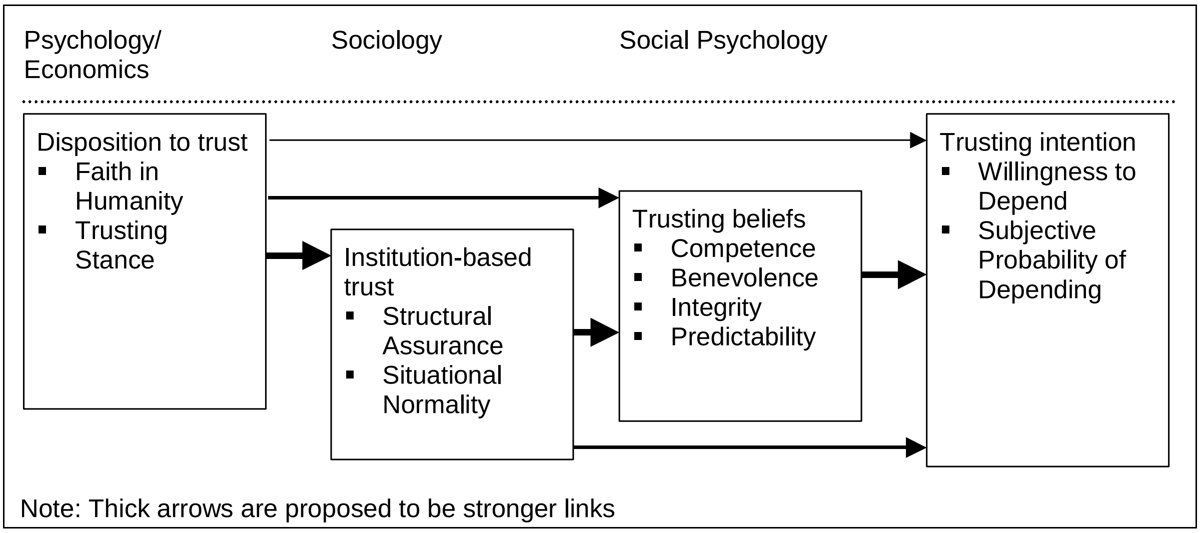

Figure 3: Interdisciplinary trust constructs model [4]

It should be mentioned at this point that trust is not a new concept. No business transaction can be performed without trust [24]. However, particularly with electronic sales channels, like the WWW, trust becomes ever more important – and it is argued that this importance will still increase fundamentally. The specific challenges of trust in electronic channels will be discussed in the next section.

3.4 Trust in Electronic Channels

Trust is already important in interpersonal relationships. With electronic-, mobile- and telephone-commerce – sales channels that are based on the use of information technology – getting more and more a natural way of buying and selling goods in our societies, new challenges of an already complex exchange process are arising: For an end-consumer to decide to place and pay for an order via an electronic channel which often implies trade across national borders, different currencies and legal systems, the consumer must first trust the retailer [28], [29]. Also, particularly on the Internet due to the leveling of distances the number of relevant suppliers for a given product or service has been exploding from the consumer's point of view.

However, since a web store-front can be build up relatively easy compared to a bricks-and-mortar store, it gets very difficult for a customer to decide about the quality of an offered product or service upfront. Moreover, technically it is very difficult if not impossible to build up a personal relationship with a customer in electronic channels [30].

In result we have unsettled customers due to an explosion of relevant suppliers in conjunction with the problem on the one hand to decide about the quality of these suppliers and on the other hand the opportunity to switch suppliers easily. Furthermore, it is difficult to establish personal relationships in an electronic channel. The consequences of these findings are discussed in the next section.

4 Consequences on CRM Strategies

In this section, we will draw some general conclusions for companies which are somehow involved in e-business. Taking the case of the financial services industry as one of the most important industries currently involved in e-business, some more specific recommendations will be discussed.

4.1 General Conclusions

As we have seen, trust instead of high switching costs are key for long-term relationships between suppliers and consumers. So, are all the billons invested in CRM systems wasted money? Certainly most of it is not, but companies should rethink the balance of their investments. Two major issues have to be considered here.

- Firstly, firms should detour some money in trust-building services and marketing activities, instead of passively waiting until consumers are able to switch suppliers at virtually no cost. A nice linking between trust and web vendor interventions can be found in [4]. Issues of interest for a potential investment in are – amongst others – privacy policy, third party privacy seals (e.g. TRUSTe Privacy Program), information disclosure seals (e.g. WebTrust Seal), reputation and brand building activities, guarantees, return policies, reliability seals, security seals (e.g. VeriSign Secure Site Program), and site quality. The handling of private information about specific customers will be an issue of particular interest. Proactively announcing the privacy policy and offering/enabling customers to access their personal profile at the suppliers site might become common in a few years but today it would be a clear first mover advantage that should be exploited. (For different point of view on the importance of privacy statements and seals based on empirical findings see [31].)

- Secondly, and perhaps more important, companies should not rely on cash flow structures as presented in Figure 1. Such a strategy could easily lead to profitability troubles in the long-term. Just imagine companies act on behalf of this cash flow structure: Investing in a relationship with high acquisition costs at the beginning – a decoy offer that does not generate any margin, thus no shareholder value – and expecting constantly increasing cash flows and profit contributions in the future consequently will drive a company out of business. If consumers may switch suppliers at comparably low costs, they might tend to utilize several decoy offers at different companies instead of establishing a long-term relationship with one company. Hence, the initial acquisition costs will never amortize. Thus, focusing on the bottom line for every single deal will become more important in the future.

With these two general conclusions we will now discuss the special case of the financial services industry.

4.2 The Case of the Financial Services Industry

The financial services industry is one of the most important e-business industries and has embraced IT and the opportunities of e-business comparably early. Certainly, the conclusions drawn above are also valid for the companies operating in the financial services markets. However, these companies generally already own a highly valuable asset that might be turned into a profitable business opportunity. Most financial institutions already operate for years in a market where privacy is essential.

A lot of them have built up a good reputation and brand over the years. Since financial services firms have a lot of personal data about their customers due to bank transfers and the portfolio of securities – often even about the whole financial and personal life circumstances of a specific customer – naturally, consumers trust their financial services institutions more than any other company they are doing business with.

In light of shrinking margins, more transparent markets, and an increasing commoditization of financial products, turning this trust into a business opportunity might even become a vital contributor to a banks' profits in the future. Offering trust-based services – like the ones mentioned above of MemIQ – such as digitalization, management, structuring of personal data to form an effective and efficient personal data environment as a service for customers might be in high demand in the future. The potential of such a service shall be clarified by an example:

> *A customer uses the personal data environment services offered by his financial services firm. At the end of the year the annual tax declaration may be performed on a single mouse-click since all relevant documents and data have been gathered in the database throughout the year. This service would save the customer a lot of time and effort or might save him the costs of his tax advisor.*

This visionary example concludes the main body of the paper. In the following section the findings will be briefly summarized.

5 Summary and Outlook

The battle for the customer relationship has just begun and many companies acknowledge, that the customer and his preferences, needs and objectives should be put in the center interest. Effectively applied CRM strategies might help to service the customer better and establish a long-term relationship between the seller and the consumer. However, due to dramatically dropping switching costs these business models will not be sustainable. Focusing on the acquisition of customers with heavy investments at the beginning of a relationship and charging premiums in the future because of the switching costs that have been built up by CRM methods will not be profitable in the long-run.

In this environment the concept of trust becomes vital. Companies – regardless of the industry they are operating in – should proactively invest in trust building activities. Also, taking into account the bottom line of every single deal with a customer will gain importance. The financial services industry is in the convenient position of becoming trusted infomediaries, because of the already established relatively strong trust relationships to their customers.

It remains to be seen whether advances in the IS development are fast enough to allow a customer already in the near future to conveniently manage a highly valuable asset – his personal information – on his own. With respect to the anticipated realizable scale effects, it seems to be more likely that infomediaries may offer their trust-based services successfully.

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