Customer relationships and the heterogeneity of firm performance

Kaj Storbacka and Suvi Nenonen
Hanken School of Economics Finland, Helsinki, Finland

Abstract

Purpose — The purpose of this paper is to examine how, taking customer relationships as the unit of analysis, the heterogeneity of customer relationship performance influences the heterogeneity of firm performance, and how firms can balance the heterogeneity of customers, customer relationships, and customer portfolios by differentiated business models.

Design/methodology/approach — The approach to the topic is one of theoretical analysis and conceptual development.

Findings — Value capture is defined as the discounted present value of all future economic profit from the relationship. Three sources of value capture heterogeneity are identified: the customer, the relationship with the customer, and the interdependence between customers in a customer base. Relationship performance can be improved by investing in business model differentiation, in order to facilitate controlled adaptation to specific customer relationships and/or customer portfolios. Firms have to manage parallel business models and a central capability is the ability to create internal fit between the elements of a specific business model.

Research limitations/implications — The research presented relates to business-to-business customer relationships. Some of the conceptual thinking will not be applicable in consumer relationships.

Practical implications — A firm should have an optimum mix of customer relationships in its customer base, in relation to firm goals and strategy. Management needs to recognize the heterogeneity of customer relationship performance, and manage customer portfolios accordingly. In order to deal with the heterogeneity, it may be necessary to manage parallel business models. This will necessitate new capabilities, such as customer insight generation, account management, modularized production platforms, and relationship performance control.

Originality/value — For a scholarly audience the paper contributes to the discussion on how marketing improves firm performance by assuming responsibility for increasing firms’ market value. For a practitioner audience it offers ideas for genuinely customer-centric management.

Keywords Buyer-seller relationships, Organizational performance

Paper type Conceptual paper

1. On the heterogeneity of firm performance

A key ingredient of a theory of the firm is its ability to explain performance heterogeneity among firms — an issue that has been in the focus of strategic management research over the years. There have been many different approaches to explain heterogeneity. Early work in strategic management discussed both internal strengths and weaknesses of the firm, as well as external issues related to opportunities and threats in the market space (Ansoff, 1965).

The competitive strategy school (Porter, 1980) seeks to explain the differences in performance by looking at industry structures and the firm’s positioning in the industry. This school of thought implicitly assumes resource homogeneity and resource mobility among competing firms in an industry. This means that firms cannot build competitive advantage based on controlling strategically relevant resources as all firms will acquire the resources necessary to execute the selected strategy from factor markets.

Wernerfelt (1984) introduced the resource-based view of the firm (RBV), which focuses on characteristics of firm resources that contribute to performance in the form of competitive advantage. Researchers have argued that resources that are valuable, rare, inimitable, and non-substitutable, create the foundation for sustainable competitive advantage (Barney, 1991; Conner and Prahalad, 1996; Peteraf, 1993). Hence, RBV assumes resource heterogeneity between competing firms, and further that these resources are not mobile, which makes long term, sustainable competitive advantage possible based on internal configuration of strategically relevant resources. Priem and Butler (2001) note that the value of any firm resource is ultimately determined by demand-side characteristics. This indicates that the effectiveness of the firm’s strategy will be dependent on exogenous factors – primarily customers.

A shortcoming in the RBV literature is that it “views the firm as the primary unit of analysis” (Dyer and Singh, 1998, p. 660), and seldom acknowledges that “a firm’s critical resources may span firm boundaries and may be embedded in inter-organizational practices”. The value of relationships has been recognized by researchers within the industrial marketing and purchasing group (IMP). Håkansson (1987) argues that relationships are one of the most valuable resources that a firm possesses. Ritter et al. (2004) conclude that they provide benefits in terms of the functions they perform and the resources they help create and provide access to, including knowledge and markets.

The role of customers and customer relationships in value creation is accentuated as we move from a production-dominated, “inside-out”, value chain paradigm towards a
knowledge-intensive, collaborative value network paradigm where firm boundaries, as well as industry and country boundaries, are becoming increasingly permeable, fuzzy and fleeting (Day, 1994; Dyer and Singh, 1998). Simultaneously, the liquification of resources (Normann, 2001) makes reconfigurations of business operations much easier, not only enabling rapid change but rather emphasizing that the ability to understand changes in the value network logic and reconfigure the firm in relation to the network actors will become a competitive advantage.

These reconfigurations will ultimately manifest themselves as redefined offerings to the customers. Firms are increasingly building offerings that require totally new relationship patterns, linkages, and continuous adaptations of firm and customer processes (Cannon and Perreault, 1999), called “partnering” (Anderson and Narus, 1991), or collaborative relationships (Day, 1994). In this context relationships will become a source of performance heterogeneity. Hence, the focus of analysis has to be expanded from the firm as the unit of analysis to the firm’s relationships with suppliers, alliance partners and customers as the units of analysis.

This article will focus on the relation between a firm and its business customers. The customers’ role is changing in fundamental ways, and this may require a total redefinition of how we view the firm, even change the theory of the firm (Conner, 1991; Dyer and Singh, 1998; Priem and Butler, 2001; Slater, 1997; Woodruff, 1997). The argument is that previous theories suffer from myopia in that they do not sufficiently acknowledge the role of the customer, nor the relationship to the customer as a resource and as a supplier of resources, and, furthermore, do not recognize the importance of the capabilities related to managing customer relationships in the increasingly dynamic market environment.

Purpose
This article examines customer relationships as drivers of firm performance. The purpose of the article is twofold. First, we take customer relationships as the unit of analysis and focus on understanding how relationship performance heterogeneity influences firm performance heterogeneity. As suggested by Dyer and Singh (1998), Storbacka and Lehtinen (2001), and Storbacka (2006), dyad or network routines and processes could be an important unit of analysis. The analysis is primarily dyadic, but dyads are also parts of networks. Hence, the process, the value and the heterogeneity of the dyad may be influenced by chains of activities involving more than two firms, and constellations of resources controlled by more than two firms (Anderson et al., 1994). We claim that an under-investigated source of performance heterogeneity is the firm’s ability to build and manage a set of customer relationships (i.e. a customer base) in order to support the effectiveness of the selected strategy, and, hence, firm performance (Dyer and Singh, 1998).

Second, we argue that firms can actively manage the heterogeneity of customers, customer relationships, and customer portfolios with differentiated business models. Business models are defined as configurations of interrelated capabilities, governing the content, process and management of exchange in customer relationships.

2. Relationship performance: dyadic co-creation of value
In order to understand how customer relationships influence firm performance, we examine the content and logic of relationship performance by defining how value is created in customer relationships.

Firms use their resources and capabilities in order to create value. Drawing on Barney (1991), Daum (2002), Edvinsson and Malone (1997), Eisenhardt and Martin (2000), Kalafut and Low (2001), and Morgan and Hunt (1999), a firm’s resources are the physical (e.g. specialized equipment, geographic location), human (e.g. skills and knowledge), structural (e.g. routines, practices and processes), and relational (e.g. relationships to suppliers, partners, alliances and customers) assets that can be used to implement value-creating strategies. Day (1994, p. 38) defines capabilities as “complex bundles of skills and accumulated knowledge, exercised through organizational processes, that enable firms to coordinate activities and make use of their [resources]”. Drawing on this and on Morgan and Hunt (1999), we define capabilities as a firm’s ability to utilize its resources effectively (to achieve goals).

Central to the service dominant (S-D) logic, proposed by Vargo and Lusch (2004), is a focus on the value-creation process that occurs when a customer consumes, or uses, a product or service, rather than when the product is manufactured. Vargo and Lusch (2004) articulate this in their sixth foundational proposition by claiming that “the customer is always a co-creator of value: there is no value until an offering is used – experience and perception are essential to value determination”. Grönroos (2000) argues that it is the customer that creates value and that this value creation is supported by interaction throughout the relationship with the supplier. He adds that focus should be on the customer's value-creating processes.

With this definition follows that the customers are not to be viewed as passive recipients of value created by the firm. Prahalad and Ramaswamy (2000) describe the evolution of customers from “passive audiences” to “active players”. Firms do not exist in order to distribute value along a value chain, but rather to support customers in the value-creating process (Day, 1994; Normann and Rafael Ramirez, 1993; Storbacka and Lehtinen, 2001).

Building on the above discussion and on Payne et al. (2008), we define customer relationships as longitudinal social and economic processes for the co-creation of value. Business-to-business customer relationships consist of three main processes (Figure 1): the customer value-creating process, in which the customer organization applies its capabilities on its resources in a series of activities and management practices to achieve particular goals (Woodruff, 1997); the firm value-creating process, in which the firm applies its capabilities on its resources in a series of activities and management practices to improve firm performance; the encounter process, in which dyad actors use relational capabilities in collaborative activities and practices of interaction and exchange for the co-creation of value.

Ulaga (2003) claims that measurement of value creation in buyer-seller relationships is still in its infancy. Recent research (Flint and Mentzer, 2006) argues that business customer value can be viewed in several ways. Pardo et al. (2006) have
identified three categories of value in an account management context: exchange value, which is the value originating in activities by the firm and being consumed by the customer; proprietary value, being created and consumed only by the firm as it creates and operates its account activities for its efficiency or effectiveness exclusively; and relational value, the co-produced value (for firm and customer) that emanates from being party to a relational constellation embedded in collaborative and co-operative activities.

We define relationship performance as the total value formed during the interaction between firm and customer over time. An essential managerial aspect of relationship performance is to determine how this value is shared between the firm (value capture) and the customer (value creation). Blois and Ramirez (2006) argue that although firms exist to help customers and organizations create value they can only do so in order to capture part of that value for themselves. However, it is important to note that long-term value capture is not possible if the customer does not perceive that the relationship creates value. Value creation is hence a prerequisite for long-term value capture (e.g. Gosselin and Bauwen, 2006).

3. Aspects of value capture heterogeneity

The resources and capabilities to perform value-creating practices are heterogeneous among customers. Customers’ willingness (and/or a firm’s ability) to engage in encounter processes that create value also varies. Hence, relationship performance heterogeneity will play a significant role in determining the heterogeneity of firm performance.

Matching the heterogeneous need in the market (by segmenting) with the heterogeneous resource base in a firm has been explored already by Alderson (1957, 1965), and more recently by Priem (1992), Hunt (1997, 2000), and Hunt and Morgan (1995). Many previous studies approach heterogeneity by examining the heterogeneity of customer attributes, and creating segmentation models based on this. Central to our research has been to understand heterogeneity on a dyad level, based on process thinking, and specifically focusing on value capture heterogeneity.

Building a bridge between value capture and shareholder value

In order to understand how relationship performance and the value captured influence firm performance we need to find an agreement on how firm performance is measured, and how practices in customer relationships contribute to favorable development of these measures.

Improving a firm’s financial performance is acknowledged by various researchers as the main objective of marketing (Day and Fahey, 1988; Srivastava et al., 1998; Doyle, 2000; Zou and Cavusgil, 2002; Kumar and Petersen, 2005). Vargo and Lusch (2004) emphasize the need to create new objectives and metrics for marketing strategies that are linked to financial performance: “Marketing practice accepts responsibility for firm financial performance by taking responsibility for increasing the market value rather than the book value of the organization as it builds off-balance-sheet assets such as customer, brand, and network equity” (Vargo and Lusch, 2004, p. 14).

Firm performance is ultimately judged by the shareholders of the firm. Thus, it can be argued that optimal firm performance is reached when long-term shareholder value is maximized. Hence, an appropriate way to measure value capture of a customer relationship is to measure its contribution to the development of shareholder value.

Shareholder value can be measured by capital market based and accounting based measures. Examples of capital market based measures are: market-to-book ratio (Hogan et al., 2002), Tobin’s q, which is the ratio of a firm’s market value to the current replacement costs of its assets (Tobin, 1969; Lewellen and Badrinath, 1997; Anderson et al., 2004), and MVA, market value added, which is the difference between a firm’s market value and its capital employed (Stewart, 1991; Griffith, 2004). Accounting based measures are for instance discounted future cash flows (Black et al., 1998; Rappaport, 1998), return on investment (Buzell and Gale, 1987; Jacobson, 1988, 1990), sales (Dekimpe and Hassens, 1995), price (Boulding and Staelin, 1995), cost (Boulding and Staelin, 1993), and economic profit of economic value added (Stewart, 1991, Kleiman, 1999).

Eggert et al. (2006) conclude that the focus of marketing metrics is shifting from aggregated measures like market share, profit, and sales, towards performance indicators on the individual dyad level: relationship performance. Accounting based measures have major advantages as they enable analysis on an individual dyad level. One of the most commonly used accounting based measures, customer profitability (i.e. accounting profit per customer per annum), has been shown to vary significantly between customers (Mulhern, 1999; Kaplan and Narayanan, 2001; Storbacka, 1997; Storbacka et al., 1999). Thus, the heterogeneity of annual profit per customer is a driver of the heterogeneity of firm performance.

However, the retrospective and cross-sectional (legal accounting based) analysis has significant weaknesses. First, it does not take into account the capital invested in order to serve customers. Selden and Colvin (2003) call for the use of economic profit, while Ryals and Knox (2005) propose the calculation of risk-adjusted customer value that is based on customer revenue, risk and cost forecast, and also exposed to the weighted average cost of capital in net present value calculations. In this article it is suggested that economic profit should be used as a starting point for measuring shareholder value creation. Economic profit defines the net operating profit after tax (NOPAT) and subtracts the cost of capital for the economic book value of firm’s assets used in the customer relationship under analysis. Thus, the key components of economic profit on a dyad level are: revenue from the relationship, total cost incurred by the relationship (defined as
Second, legal accounting is cross-sectional, whereas customer relationships should be viewed on a longitudinal basis, focusing both on the history of the relationships (over several financial years) in order to understand longitudinal heterogeneity as well as migration effects, and also on estimating the future development of revenue (growth) and economic profit. In the current marketing literature, the customer lifetime value (CLV) is most often proposed as the measure for estimating longitudinal customer profit (e.g., Dwyer, 1989; Blattberg and Deighton, 1996; Hogan et al., 2002). Most CLV models are built around three main components: expected profit generated by the customer, the firm’s retention rate and a discount rate.

Based on the above discussion, we suggest that value capture can be measured by the discounted present value of all future economic profit that the customer relationship generates, and that this can be used as a proxy for the shareholder value creation. Discounted future economic profit combines several attractive features for effectively assessing value capture: in addition to the traditional accounting profit, it takes into account the capital costs, allows analysis on an individual customer relationship level, and takes a longitudinal view on customer relationships. Also, empirical evidence has shown that positive economic profit leads to an increase in shareholder wealth (Bacidore et al., 1997; Kleiman, 1999).

Sources of value capture heterogeneity

Variations in customer relationship economic profit can be caused by four different factors: revenue, total cost to serve, capital invested, and risks. Based on the model in Figure 1 and on Storbacka (2006) we conclude that there are three sources of value capture heterogeneity: the customer, the relationship with the customer (or the encounter process), and the interdependence between customers in a customer base that may influence the encounter process.

First, there is customer intrinsic heterogeneity, which relates to the magnitude and relevancy of customers’ extant resources, and their propensity to apply these resources in their supplier relationships. It is evident that customers with larger value creation potential are more valuable than customers with a low potential. There are risks associated with customers, and these relate partly to customer specific issues (resources and capabilities) and partly to the industry or geographical areas where the customer is active. Some industries are more risky than other, but regardless of the industry there may be differences among customers, as to their ability to execute their strategy and sustain their growth.

The value of individual customers is always relative. A customer can be more valuable to one firm (or business model) than to another. The value has to be related to the firm’s strategy and objectives. Therefore, the value of a customer can be analyzed in terms of the fit between the strategic objectives of the utilized business model and the resources of the extant customer base. It is important to note that value capture dimensions should not be analyzed in isolation. A customer that may not be valuable from a cash flow perspective may bring resources to the firm that can be used to develop new technologies or offerings, or help the firm enter new relationships or markets (Ford et al., 2003; Varadarajan and Cunningham, 1995). Morgan and Hunt (1999) argue that firms can get access to critical resources through partnerships, and by combining such resources with its own resources a firm can produce a competence that results in competitive advantage.

Second, there is customer relationship heterogeneity, which relates to the characteristics of the relationships the firm has been able to build for its customers. Although a customer may be very valuable, and have a major growth potential, the firm might not be able to create a relationship that helps it to tap into this growth opportunity (in terms of, for instance, share of wallet). The central determinant of customer relationship heterogeneity would be the business model used to manage relationships: what is the strategy used to attract customers, what is the competitive advantage, what are the value propositions, how are the customer relationships managed, how much cost is incurred by the exchange process, what retention mechanisms are used, etc.

A particularly interesting viewpoint, when analyzing the customer relationship heterogeneity, is longitudinal heterogeneity. This relates partly to the volatility of economic profit over time (Stahl et al., 2003). Another key ingredient of longitudinal heterogeneity is the loyalty or retention of the customer. Wernerfelt (1984) suggests that customer loyalty is an attractive resource as it builds resource position barriers that can act as entry barriers. Liljander and Strandvik (1995) and Storbacka et al. (1994) have suggested that there are bonds present in all customer relationships that influence the longitudinal development of the relationship. To reduce customer relationship heterogeneity, bonds can be analyzed, planned and managed (Storbacka and Lehtinen, 2001).

The third way of analyzing value capture heterogeneity relates to the interdependence between customers in a customer base. Groups of customers, as in portfolios, can be reviewed in order to understand the correlation and concentration of customers and customer relationships (risk and the synergies between customers and customer relationships). It is important to understand these linkages, and to locate the source of correlation or concentration. If the source is an external factor, such as geo-political situations, currencies or industries, firms need to reduce its magnitude by allocating resources to less risky customers or portfolios. If the source is internal, it can be actively managed or “hedged”, depending on the capabilities of the firm.

Selden and Colvin (2003, p. 7) suggest that firms should be viewed “not as groups of products or services or functions or territories, but as portfolios of customers”. Nenonen and Storbacka (2007) have used empirical data to create relationship portfolios based on the cross-sectional economic profit of the relationships. Based on this evidence there is major heterogeneity in how customer relationships generate profit to a firm. Most firms will need to group customer relationships based on value capture heterogeneity in order to be able to manage the need for differentiation between the relationships.

4. Balancing value capture heterogeneity with business model differentiation

Sirmon et al. (2007) argue that in order to capture value, firms must structure their resource portfolio, bundle

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resources to build capabilities, and leverage capabilities to exploit market opportunities. In this article it is suggested that the firm’s use of its resources and capabilities, and thus the relationship performance and the balance between value creation and value capture, is determined by the firm’s way of conducting business operations, i.e. its business model.

Business models have traditionally been discussed in an internet context (Afuah and Tucci, 2000; Osterwalder, 2004). Increasingly the business model concept is used as a general construct explaining how a firm is interacting with suppliers, customers and partners (Zott and Amit, 2003). Several business model definitions have been proposed (Afuah, 2003; Amit and Zott, 2001; Chesbrough and Rosenbloom, 2002; Magretta, 2002; Osterwalder et al., 2005; Storbacka, 2006). Building on these, and Miller (1996), business models are defined as configurations of interrelated capabilities, governing the content, process and management of interaction and exchange in customer relationships (i.e. the business model defines the content, process and management of the interaction and exchange process in Figure 1). Content of exchange refers to the resources applied in the exchange. Process of exchange refers to the structure and activities of the encounter process (parties involved, ways and channels of interaction, and relation to firm and customer value-creating processes). Management of exchange refers to how the dyad actors control and coordinate the allocation of resources during the exchange process.

There is, as shown in the discussion in the previous section, considerable value capture heterogeneity among customer relationships in a customer base. This heterogeneity relates to the customer’s extant resources and talent in using them, to the aptitude of the customer relationship to generate economic profit, and to different kinds of elements that influence the longevity of relationships and volatility of economic profit over time. It has also been suggested that this heterogeneity can be controlled by grouping customers into portfolios.

In order to balance this heterogeneity, and improve the firm’s performance, the business model of the firm cannot be homogeneous across customer relationships or portfolios. Hence, one way to improve the overall relationship performance is to invest in business model differentiation, in order to facilitate controlled adaptation to specific customer relationships and/or portfolios of customer relationships.

There is an abundance of opportunities for business model differentiation; the literature discusses issues like “partnering” (Anderson and Narus, 1991), moving “from products to integrated solutions” (Brady et al., 2005; Davies et al., 2008), “moving downstream in the value chain” (Wise and Baumgartner, 1999), “transitioning from products to services” (Oliva and Kallenberg, 2003). Whatever the differentiation logic is, it will ultimately aim at redefining the content, process and management of interaction and exchange in customer relationships.

**Content – value proposition, offering, and earnings logic**

The content of exchange refers to the resources applied by both parties in the dyad. The parties co-create value by integrating their resources – a process that requires exchange to ensure access to resources that help the dyad actors reach their goals. The content of exchange can be further understood by describing the value proposition; the structure of the offering, and the earnings logic used by the firm. We will next discuss these aspects separately.

Frow and Payne (2008) have described the development of the value proposition concept, from a managerial, rather mechanistic “delivery of value” concept towards more interactive, experiential and relationship-based theoretically central construct. According to Vargo and Lusch (2004), firms can only make value propositions: since value is always determined by the customer (value-in-use), it cannot be embedded through manufacturing (value-in-exchange). In a similar vein, Lanning (1998) defines a value proposition as: “the entire set or resulting experiences, including … price, that an organization causes some customers to have”. Anderson et al. (2006) suggest that is useful to divide the elements of the value proposition into three types:

1. points-of-parity elements, with essentially the same performance or functionality as those of the next best alternative;
2. points-of-difference elements, that make the supplier’s offering either superior or inferior to the next best alternative; and
3. points-of-contention elements, about which the supplier and its customers disagree regarding how their performance or functionality compares with those of the next best alternative.

We define a value proposition as the firm’s suggestion to the customer on how its resources and capabilities, expressed as artefacts (goods, service, information, and processual components, such as experiences), can enable the customer to create value (Anderson et al., 2006; Flint and Mentzer, 2006; Normann, 2001; Storbacka and Lehtinen, 2001). Thus, value propositions can be seen as resource integration promises – firms suggest ways to enhance value creation by providing resources that “fit” into the practice constellations of customers (Korkman et al., 2008).

The usage of the constructs “value proposition” and “offering” are overlapping in literature, indicating that there is a need for further clarification of the differences. We suggest that whereas the value proposition can be viewed as an idea or a promise, the offering can be viewed as a description of the resources or components needed to co-create the promised value. Normann (2001, p. 114) defines offering as “artefacts designed to … enable and organize value co-production”.

One approach is to articulate offerings as providers of service, as Gummmeson (1995, p. 251): “customers do not buy goods or services: they buy offerings which render services which create value”. Storbacka and Lehtinen (2001, p. 5) claim that “the traditional distinction between goods and services is meaningless” (see also Araujo and Spring, 2006) and argue that the offering will consist of a mixture of goods, services and information components and that offerings need to be viewed as processes. Pekkarinen et al. (2008) presents an analysis of the various conceptualizations of the offering construct in literature and conclude that elements such as technology, information, capabilities, financial elements, quality, benefits and sacrifices, risk sharing, and even image have been suggested.

A key capability in designing value propositions and offerings relates to the determination appropriate earnings logic, i.e. how the value created in the exchange is shared...
between the customer and the firm. The earnings logic is
either based on the value of the resources provided by the
firm, or based of the impact that the exchange has on the
customer’s business process, and, thus, on its ability to
effectively achieve its goals. If the logic is based on the
resources provided pricing can be cost-plus based or market-
value based. A key ingredient in designing earnings logic
relates to the choice of price carrying elements in an offering
does all elements carry a separate price, or are some elements
expected to subsidize other elements), and to the degree of
price bundling, i.e. the relation between price carrying and
only cost carrying elements in an offering (see Storbacka,
2006; Stremersch and Tellis, 2002).

Process – the encounter process and relationship
practices
The interest in understanding processes related to external
stakeholders is increasing as the locus of value creation
increasingly extends traditional firm boundaries. According to
Vargo and Lusch (2004) even customers that want only
discrete transactions are not freed of relational participation,
as they are active participants in the exchange process. “What
precedes and what follows the transaction as the firm engages
in a relationship (short- or long-term) with customers is more
important than the transaction itself” (Vargo and Lusch,
that customers view a solution as a set of customer-supplier
relational processes comprising:
• customer requirements definition;
• customization and integration of goods and/or services;
• their deployment; and
• post-deployment customer support.

The complexity of the encounter process will be dependent on
the strategy, and the value proposition of the firm. Encounter
processes can be analyzed and described on a continuum
ranging from purely transactional to purely collaborative
(Anderson and Narus, 1991). The process of exchange will
vary dependent on the type of relationship: from thinner to
thicker information, from distributive to integrative
negotiations, from routine to extensive problem solving,
from mechanistic to organic coordination, and from unilateral
to joint adaptation, as relationships become more
collaborative (Narus and Anderson, 1995).

Möller and Törrönen (2003) have suggested a framework
for categorizing capabilities required to conduct value-
creating (encounter) processes, based on a relational value
continuum where the extremes are “low relational complexity
combined with current time orientation” and “high relational
complexity combined with future orientation”. The argument
is that moving towards relationships that are more focused on
future value creation potentials, and thus involves more
complex encounter processes, requires a more complex set of
capabilities. Examples of such capabilities could be a
“relational capability” (i.e. working key account
management, qualified technological support personnel,
committed personnel with team working skills, ability to
view things from the customer’s perspective, organization-
wide relational orientation, sharing of proprietary
information, making propositions that enhance the
customer’s business processes, and information systems
integration), a “networking capability” (i.e. organization-
wide network player orientation, key personnel share and
support the achievement of joint goals, and mobilization and
maintenance of multilevel and multifunctional contacts
between several actors), or a “capability of mastering the
customer’s business” (i.e. track record of understanding the
business logic of the customer, track record of proposing
major suggestions leading to business improvements or new
business concepts, and capability of offering “externalization”
of some key business processes or complete business).

Relationship practices are defined by the encounters needed
for the co-creation of value in a specific business model. These
encounters will be handled by different functions and
on different organizational levels. Price and Schultz (2006)
argue that as one actor/function will be involved in giving
promises that another actor/function is supposed to deliver, a
key issue is to create capabilities to generate a cross-functional
view of the encounter process and to supervise the firm’s
“promises management” process. Matthysens and Johnston
(2006) discuss the resources and information flows between
marketing and sales management processes, and conclude
that cooperation between marketing and sales should be
improved. But also other functions may impact the
relationship practices: production/operations management
often “owns” the physical asset, i.e. production capacity and
may influence the availability of necessary resources, whereas
finance is concerned with financing the differentiation efforts
and in interested in understanding financial returns of various
resource allocation efforts. Improvement of relationship
performance will, hence, require capabilities to coordinate
encounter processes cross-functionally.

The management of relationship performance usually
entails the establishment of retention and/or collaboration
practices (such as account management programs and joint
research and development activities). The differentiation
between “transactional” and “collaborative” encounter
processes, however, generates a need for relationship
practices that are distinctly different from each other. The
capabilities needed to set up an effective strategic account
management program are quite different from the capabilities
needed to create success in channel sales, particularly in the
use of electronic channels. The capability to generate and
disseminate customer insight, however, forms a common
thread for all different types of business models. Customer
insight is generated by combining all available data related to
customer relationships – behavioral, attitudinal, research
based and legacy system based.

When differentiating business models, a firm has to do
trade-offs between standardization and differentiation
(Heikkilä and Holmström, 2006), as an increase in variation
of offering elements typically increases the average unit cost.
The typical outcome of standardization/differentiation
optimization is to create the capability to efficiently
assemble different module combinations (Miller 1996) in
order to create platforms for “repeatable solutions” (Foote
et al., 2001).

Managing interaction and exchange
The differentiation of the content and the process of
interaction and exchange will have an immediate impact on
the organizational structure and management practices used
to govern the customer relationship. Most organizations tend
to have an organizational structure focusing on product and
geography. Galbraith (2002) and Homburg et al. (2000) have done a robust analysis of companies moving from product-focused and geography-focused structures towards customer-focused structures. Adding the “third dimension” i.e. the customer viewpoint raises questions relating to efficiency, complexity and flexibility. Within a product-focused organizational structure sales people are essentially product specialists (Homburg et al., 2000). Improving relationship performance will ask for customer specialists, actors who have the ability to influence the content and the process of exchange. This means that the management of interaction and exchange cannot be confined to the sales or marketing functions, but rather it crosses the boundaries between several functions, product areas, geographical areas, and hierarchical levels.

Hannan et al. (1996 p. 506) suggest that an organizational element is part of the “organizational core if changing it requires adjustments in most other features of the enterprise … coreness means connectedness, elements in the core are linked in complicated webs of relations with each other and with peripheral elements”. Based on this we suggest that the management of the interaction and exchange will be a core element of the organization. This, essentially, means that organizations should be built around the differentiated business models in use.

From a structural point of view the customer-focus issue is only one viewpoint. The organizational challenge is actually part of the fundamental concern for any organizational structure: the capability of a firm to balance exploitation with exploration (March, 1991). The challenge may relate to simultaneously managing the efficiency of a “product” business model and the flexibility needed by a “solution” business model. Or it may stem from the fact that some customer relationships or portfolios are strategic as they enable an efficient utilization of existing resources and capabilities, whereas others may be geared towards exploring for new resources and competencies; for renewal and long term shareholder value.

Organizations are always faced with some degree of conflict (e.g. differentiation versus standardization, transactional versus collaborative) and Gibson and Birkinshaw (2004) suggest that success therefore requires ambidextrous organizations. They propose that structural ambidexterity relates to dual organizational forms, or organizational architectures that are composed of tightly coupled subunits that are themselves loosely decoupled from each other. Tushman and O’Reilly (1997), and Sutcliffe et al. (2000) suggest that within subunits, the tasks, culture, individuals and organization arrangements are consistent, but across subunits, tasks and cultures are inconsistent and loosely coupled. This indicates that business units should be formed around business models: some focus on exploration (adaptation), while others focus on exploitation (efficiency).

A key management capability issue relates to measurement. Firms need to develop their capability to measure relationship performance – both to the firm and to the customer. This could be called “relationship performance controlling”. For finance, the measures relate to value capture: present and future revenue, total cost of delivery, capital invested and risk. The measure may be different for each business model. A “product” business model may need to focus on revenues and efficiency, whereas a “solution” business model may need to focus on profits, investments, share of wallet and longevity of relationships. As customer relationships are long-term investments, it is of particular importance not to rely only on retrospective (“lagging”) indicators of value, but also take a longitudinal view (“developments over periods of analysis”), and identify prospective (“leading”) indicators, such as number of long term contracts, order backlog, work-in-process, or sales funnel size (Storbacka, 2006).

Equifinality and configurational fit
In the previous sections we have shown that in order to balance the heterogeneity of customers, customer relationships and portfolios, firms have to simultaneously develop differentiated business models. Business models are configurations of inter-related capabilities; the success of these models is not defined by individual capabilities but their configurational fit.

Configurations are, according to Meyer et al. (1993), constellations of design elements that commonly occur together because their interdependence makes them fall into patterns. Miller (1996, p. 509) suggests that configuration “can be defined as the degree to which an organization’s elements are orchestrated and connected by a single theme”. Miller suggests that typical themes could be “innovation” or “efficiency”. It is suggested that business models created around specific portfolios of customer relationships could also be such a theme, around which a pattern or program can be orchestrated (Hui Shi et al., 2004).

Business model elements are interlinked: it is not possible to change the content of exchange and expect that the process and management of exchange will remain the same, and vice versa. Hence, a particularly important aspect of the configuration of the elements is to create harmony, consonance, or fit between the elements (Normann, 2001; Meyer et al., 1993; Miller, 1996).

Elements of a business model interact if the value of one element depends on the presence of the other element; reinforce each other if the value of each element is increased by the presence of the other element; and are independent if the value of an element is independent of the presence of another element. A firm with many organizational elements that reinforce each other is said to have a high degree of internal fit (Siggelkow, 2002). Creating a successful configuration implies that the core elements are reinforcing, so that the overall system is in a state of coherence or consistency (Siggelkow, 2002). Reinforcing elements can be called framing elements as they set the scene and determine the prerequisites for other elements.

Central to success in managing relationship performance is the configurational fit between different sets of capabilities. Johnston et al. (2006) have, additionally, suggested that “fit” could be relevant also in characterizing network structures and interactions, suggesting that firms should focus on intra-organizational configurations.

Ramirez and Wallin (2000) and Blois and Ramirez (2006) have suggested a way to categorize capabilities based on whether the value finally created is internally or externally focused. Internal capabilities aim at improving the efficiency and operational performance of key business processes, such as manufacturing processes. Relational (inter-organizational) capabilities are the firm’s abilities to effectively manage practices related to the content and structure of interaction.
and exchange between and supplier and customer, i.e. referring both to supplier and customer relationships. Building on Ritter et al. (2004), it is suggested that a particularly important driver of relationship performance is the configurational fit between internal and relational capabilities.

Homburg et al. (2002) report that several approaches to key account management are equally successful. This supports the argument often discussed in the configurational approach (Meyer et al., 1993; Miller, 1996), i.e. the idea of equifinality. Equifinality implies that different types of configurations lead to equally good end-results as long as they are configured in such a way that there is internal fit or congruence between the elements. Thus, the central capability in managing relationship performance will not be to find the “best” business model, but rather the ability to develop parallel business models that are internally coherent, and heterogeneous enough to cover the heterogeneity of the selected market.

5. Discussion – customer relationship performance management

Using customer relationships as the unit of analysis, this article has examined how the heterogeneity of customer relationship performance influences the heterogeneity of firm performance, and how firms this heterogeneity by differentiated and internally coherent business models.

We developed a model describing dyadic value co-creation and defined relationship performance as the total value formed in the encounter process during the interaction between firm and customer over time. A central construct of model is value capture, i.e. how much value the firm can capture from the relationship. Firm performance and value capture can be measured by shareholder value and we concluded that the discounted present value of all future economic profit that the customer relationship generates can be used as a proxy for the shareholder value creation.

There are three sources of value capture heterogeneity: the customer, the relationship with the customer (or the encounter process), and the interdependence between customers in a customer base. Variations in value capture heterogeneity may exist in terms of differences in revenue, total cost to serve, capital invested, and risks. It is concluded that one way to deal with the heterogeneity is to create customer portfolios that create more transparency into the sources of heterogeneity.

In order to balance value capture heterogeneity and improve the firm’s performance, the business model of the firm cannot be homogeneous across customer relationships or portfolios. Hence, relationship performance can be improved by investing in business model differentiation, in order to facilitate controlled adaptation to specific customer relationships and/or customer portfolios. Business models are defined as configurations of interrelated capabilities, governing the content, process and management of exchange in customer relationships.

It was concluded that firms have to become ambidextrous and develop parallel business models for different customer portfolios. A central capability in managing relationship performance in a context of multiple business models is not to find the “best” business model, but rather the ability to develop business models in a way that there is internal fit or congruence between internal and relational capabilities within each specific business model.

Building on our review of the content, process and management of exchange in customer relationships as well as on Ramirez and Wallin (2000) and Blois and Ramirez (2006), we propose that a key “meta-capability” in creating and managing differentiated business models is customer relationship performance management (CRPM). Customer relationship performance management can be defined as a relational capability, involving task-dedicated actors, who orchestrate resources and practices of the firm, and its present and future customers, through alignment of business model elements, in order to improve the relationship performance, and ultimately shareholder value creation. Based on the discussion in the article, examples of such capabilities are: customer insight generation and dissemination cross-functionally, collaboration practices such as account management, retention programs and joint research and development programs, modularized production platforms for cost efficient differentiation, earnings logic development (including pricing logic), cross-functional promises management, structural ambidexterity (the ability to organize and manage parallel business models), and relationship performance controlling (including risk management: management of relationship performance volatility).

Further research avenues

The article opens up a number of interesting research avenues relating to relationship performance management and business model differentiation.

In order to deepen our understanding of the role of customer relationships as drivers of long-term firm performance, more conceptual and empirical research on longitudinal value capture is needed. The current CLV research needs to be expanded to analyse longitudinal economic profit (not just accounting profit). Nenonen and Storbacka (2007) have done empirical analysis of economic profit creation, but this research was not aimed at forecasting future economic profit. Forecasting the future development of economic profit would create a platform for marketing to enter into the top management agenda, as well as support the enhancement of information provided to the investor community.

The research presented in this paper concentrated more on the value capture from customer relationships rather than on the overall relationship performance or the value creation for the customer. Therefore a more thorough conceptualization and empirical research is needed on, e.g. the drivers of customer’s value creation. Such understanding is needed as a successful business model differentiation leading to a sustainable competitive advantage needs to be based on a thorough comprehension of both value capture and value creation.

The article only briefly touched on the use of customer relationship portfolios as a means for managing customer relationship heterogeneity. The portfolio construct would require further conceptualization. Key issues to explore are among others: how do customer portfolios differ from customer segments; what is the difference between investment portfolios and customer portfolios; and what are
the favourable characteristics of a customer portfolio models targeted at customer relationship performance management?

A promising and still somewhat unexplored research avenue would be the expansion of the business model construct, in order to better understand the possible opportunities for business model differentiation. The elements of a business model (content, process and management of exchange) should be further conceptualized in order to identify sub-elements. An interesting question to investigate is to identify elements that are reinforcing or that are critical in that they set the foundation for configuring effective business models, i.e. are framing elements of a business model. Furthermore, we believe that it is possible to identify other continuums or generic typologies for business model differentiation than the “product versus solution” typology discussed in the article.

This being a conceptual article, an important research avenue is to conduct empirical research on business models and business model differentiation. Anecdotal evidence suggests that firms in business-to-business markets are differentiating their business models, but little research exists as to the types of differentiation implemented (business model typologies), the level of formalization (does differentiation need to be formalized in order to be effective) and the effectiveness of managing parallel business models.

Managerial implications

The present research poses several managerial implications as it indicates that there is major heterogeneity in current and potential value capture between customer relationships. This implies that customer bases should be grouped into portfolios and that firms should be interested not only in their business and product mix, but also in their customer (relationship) mix. This has three implications for a firm aiming at improving its performance. First, the firm has to secure that is has the optimum mix of customer relationships in its customer base, in relation to firm goals and selected strategy. Second, the firm needs to recognize the heterogeneity of customer relationship performance, and create and manage customer portfolios accordingly. Third, in order to deal with the heterogeneity the firm may need to differentiate its business models between relationship portfolios or even between individual relationships and manage parallel business models.

Managing parallel business models requires a new set of management and leadership capabilities. Differentiation increases complexity and puts pressure on managing costs. Hence, a prerequisite for moving in this direction is the establishment of robust measurements. The business models need to be made transparent; people in the organization have to understand the principles that govern the different models and understand the reasons behind the differences (as they in practice may imply lower service levels to some customers and higher to others). A central issue to focus on is promises management: articulating differentiated promises to different customers and securing that the specific functions deliver on the promise.

The findings of this research imply that improving value capture cannot be delegated to any single function in the organization. Genuine differentiation requires the involvement of operations/production management and finance, as success may be dependent on the firm’s ability to create modularized production platforms that enable “mass-customization” and change the fundamental earnings logic of the firm - eventually leading to changed pricing logic. These are strategic issues that cannot be solved by sales and/ or marketing alone; they need to be addressed by all functions of the organization.

A specific issue that may require redefinition is the investment in renewal, research and product development. Increasingly these practices are carried out together with the customer as a part of the encounter process. Firms are beginning to recognize that many investments in product development, new distribution and communication channels, different kinds of collaborative initiatives (such as retention programs and strategic account management programs) and IT solutions are spurred by needs to improve relationship performance, and are, in fact, business model investments.

Traditionally, investments have been regarded as an allocation of resources where the cost associated with the resource is activated into the balance sheet. Hence, the investment is assumed to have an impact not only on the ongoing year, but on future accounting periods as well. However, cost items in the profit and loss statement can also be seen as “investments” from a customer relationship performance management point of view. This view is supported by the fact that certain resource allocations between different customer relationships and portfolios (such as sales and management time, offering and operations development, allocation of physical resources) influence the cost side of the profit and loss statement. These allocations will have a long term impact on the firm’s possibility to create and capture value in the future – even though they cannot be activated into the balance sheet in accordance with current accounting standards.

References


Further reading


About the authors
Kaj Storbacka is Professor of Marketing Strategy at Hanken School of Economics, Finland, and board member of the Strategic Account Management Association, Chicago, Illinois. His main research interests include strategic account management, customer asset management, customer profitability and relationship marketing. His publications have appeared in Journal of the Academy of Marketing Science, Journal of Business Research, Journal of Marketing Management, International Journal of Service Industry Management, European Journal of Marketing, as well as in many conference proceedings. His books include Customer Relationship Management – Creating Competitive Advantage through Win-Win Relationship Strategies and Driving Growth with Customer Asset Management. He is the corresponding author and can be contacted at: kaj.storbacka@hanken.fi
Suvi Nenonen is a doctoral student at Hanken School of Economics and Business Administration. Her thesis examines how customer portfolios can be used in customer asset management in business-to-business context. Her research interests include customer asset management, customer portfolios and market configurations.

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