Strategic Segmentation: The Strategy-Capabilities Link in Services

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DRU-2162-NSF

September 1999

Prepared for National Science Foundation
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August 12, 1998

Abstract: Current arguments on the drivers of business performance in the service economy focus on investments in information technology, investments in human resources, and investments in developing customer-oriented business processes. This paper advances a new approach to understanding competitive performance in the service economy. Termed the strategic segmentation perspective, this new approach suggests it is not investments in organizational capabilities alone but the alignment of organizational capabilities with customer segmentation strategies that generates competitive advantage. By aligning organizational capabilities with distribution strategies that recognize the distinct product and service needs of different customer segments, service companies can maximize profits from each customer group they serve. The article draws on case studies of high-performing service companies to show how a strategic approach to distribution strategies can be used to achieve superior service performance.
Introduction

The accelerating pace of economic competition has opened a lively debate among management scholars about how service companies can most effectively move forward in generating competitive advantage. There are currently three main positions in this debate. Each focuses on investments in a different type of organizational capability. One position focuses on the role of information technology in supporting both strategic reach and operational efficiency. Advocates of this position emphasize the power of information technology to collect and analyze customer information, to widely distribute products and services to both new and existing customers, and to reduce costs by automating previously labor-intensive back-office processes.¹

A second perspective focuses on the role of human resource capabilities in generating longer and more profitable customer relationships. Advocates of this position suggest that “customer contact” employees with long-employment tenures, a strong attachment to their company, and appropriate financial incentives will be motivated to provide the kind of superior service quality that contributes to customer loyalty.² They also suggest that broadly trained, empowered employees will be more effective in customizing product offerings that both meet customer expectations and generate more revenues per customer account.³

A third perspective suggests that it is neither investments in technology nor in human resources alone but rather the effectiveness with which these capabilities are integrated into customer-oriented sales and service processes that drives superior service performance. Proponents of this position suggest that redesigning work processes to eliminate redundancies, integrate tasks, and achieve a clear focus on customers can improve the quality, timeliness and efficiency of service delivery. The process
integration perspective focuses on the performance enhancing effects of process reengineering initiatives, the use of case managers, and the effective use of cross-functional employee teams.\textsuperscript{4}

Drawing on several years of research into the drivers of competitive performance in the service economy, this paper advances a fourth position on the drivers of superior service performance. This position is called the strategic segmentation perspective. Like the process integration perspective, this perspective suggests that it is the integration of technological and human resource capabilities, not the capabilities alone that drives service performance. The strategic segmentation perspective goes beyond the process integration perspective, however, in suggesting that service companies need to use these capabilities to develop distinct sales and service distribution processes for each major customer segment served.

In an increasingly competitive service economy, competitive performance depends on developing a broad range of sales distribution strategies matched to the product and service needs of distinct customer groups. Achieving a strategic fit between organizational capability development, sales distribution strategies, and the product needs of different customer segments allows a service company to maximize profits from all the customer groups it serves.\textsuperscript{5}

**The Service Value Chain**

For information service providers, the value chain is deceptively simple. It hinges on the design of distribution strategies. Banks, insurance companies, financial service companies, travel service providers and to a lesser extent transportation companies and telecommunications companies create value not primarily by building physical products
but through the exchange of information with consumers. It is how these companies use sales and service distribution strategies to develop, maintain, and deepen relationships with customers that is the key driver of competitive performance.⁶

Sources of competitive advantage traditionally used by manufacturing companies to improve market performance (e.g. product innovation or supply chain management) are not as relevant to information service providers. Information-based products do not require significant investments in design and development and can be easily replicated, making it hard to add value through product innovation. Providers of information services are considerably less dependent on backward linkages to suppliers and vendors than their counterparts in manufacturing industries, making it hard to use effective supply chain management to improve competitive performance.

The design of sales and service distribution strategies revolves around the accomplishment of three value-adding activities. These are:

- Assessing customer product needs
- Managing customer involvement in the selection and production of products
- Managing two-way flows of information in post-sale service activities.

Traditionally, each of these value-adding activities was performed in a series of iterated and labor intensive steps.⁷ Marketing with the help of the sales force generated and managed information about customer product needs. Sales representatives involved customers in product development and selection. Back-office support employees used customer information generated by the sales force to produce products. A different set of support employees based in the front-office were responsible for all post-sales service activities. There was little differentiation between customer groups in the way key valuing-add steps were performed.
When service industries were stable and regulated, service companies could get away with this one-size fits all approach to distribution. With the acceleration of economic competition in the service sector, companies are now being forced to become more strategic in their use of distribution strategies. To remain competitive they need to take advantage of advances in information technology and to harness management techniques favoring a shift to cross-functional organizational design to develop a broader range of distribution strategies that are uniquely tailored to the product and service needs of different customer segments.

[Figure 1 about here]

**Strategic Design of Distribution Channels**

In the emerging service economy, there are four classes of distribution strategies that hold particular promise in helping companies generate competitive advantage. These four strategies are automated service delivery, mass customization, simple relationship management, and team-based relationship management. Each strategy combines the key valuing adding activities in the service value chain in a unique way to produce a different mix of product customization, product bundling, and personalized service support (Figure 1). The different mixes of product and service outputs allow distribution strategies to be tailored to the revenue potential of select customer groups. The four strategies are illustrated below with examples of service companies that are using a strategic approach to distribution to improve their business performance.
Automated Delivery

Automated service delivery improves the profitability of low-margin customers with limited and standard product needs by substituting technology for labor throughout the service value chain. Service companies using automated delivery do not use direct customer contact to assess product needs, but draw on large volumes of customer billing and purchasing data to create predictive models about customer product usage. Customers “inform” service providers about their product needs through past purchasing behavior. There is also no direct contact to customers for product selection, product production, or follow-on service support. Direct mailing campaigns and technology-based delivery channels (e.g. the Internet, automated telephone programs, electronic service kiosks) replace a sales force as the main means of producing and distributing products. Service support is, similarly, delivered through direct delivery technologies, with customer service employees handling only those service inquiries that customers have difficulty negotiating automatically.

An automated service delivery strategy creates a vehicle for service companies to compete in commodity market segments. Automation of customer assessment, product provisioning and production, and service support significantly reduces the overall costs of service delivery. From the customer’s point of view, automation leads to improved speed and convenience in the delivery of standard product and services. Wells Fargo’s is using an automated delivery strategy to transform the personal banking market in California. The bank’s automated service delivery strategy is based on moving mass-market customers with simple and standard product needs from expensive branch-based forms of distribution to self-service, mini-branches in supermarkets and drugstores. The mini-branches are outfitted with ATM machines and telephones which are directly linked
into service call centers to allow customers to self-provision products (e.g. opening deposit and checking products or applying for consumer credit) and to complete standard service transactions (e.g. transferring funds) quickly and conveniently.

In the first business regions to adopt the mini-branch concept Wells Fargo was able to cut annual operating costs by as much as 20% while expanding its customer base and improving customer satisfaction. Data mining activities to determine customer behavior and product usage were integral to the success of the mini-branch concept. Wells Fargo collected and analyzed 18 months of data collected on customer use of products and services at branch outlets to identify customers that were most receptive to being shifted over to the mini-branch concept. Those customers that were that were frequent users of ATM’s at branches or were using tellers for simple service transactions were contacted and informed about conveniently located mini-branches and the hours that bank personnel would be available to help them navigate technology at these mini-branch stations.

AT&T offers another successful example of an automated delivery strategy. When the long-distance market turned into a commodity market segment, AT&T found itself needing to move away from a direct sales force to find ways to more cost-effectively identifying customer product needs and deliver products. It devised an automated service delivery strategy in which product needs determination and product development are driven by predictive modeling and in which product provisioning and follow-up service support is managed through production-oriented call centers.

The telecommunications giant made large investments in information systems that allowed it to integrate billing and purchasing records from its 80 million residential customers and then mine this vast quantity of data to come up with targeted sub-segment
strategies for its long-distance customers. The more targeted approach to customer assessment allowed AT&T to add up to a million new customers per year through much of the 90s while dramatically improving the productivity of its marketing dollars. At the same time, AT&T shifted almost all of its service support activities to specialty vendors with the technological capabilities (e.g. call center automation, scripting) needed to all but automate provisioning and routine service support. This shift allowed AT&T to reduce by as much as several hundred dollars per account the administrative costs of account servicing.

**Mass Customization**

Mass customization encourages stronger and more profitable relationships with customers that have standard but broad product needs by cost-effectively developing and delivering bundled packages of standard products. Mass customization builds on the technological infrastructure of automated delivery to create cost-efficiencies. Product selections are standardized and product production is automated. Direct delivery technologies are the main vehicle for completion of routine service transactions. While building on an automated delivery strategy, mass customization also makes use of broadly trained case managers that provide end to end sales and service support to customers. These case managers do not normally have dedicated customer accounts, but do act as a single company contact point insulating customers from the complexity of internal business processes and minimizing the need for multiple service calls.

The target customers for a mass customization strategy are those with standard but broad product need across a number of product lines. This could be a retail banking customer with deposit, credit, and investment needs or it could be a small business
customer with telecommunications needs spanning local, long-distance, cellular and network services. Case managers help service companies develop longer and deeper relationships with these customers in a couple of ways. Through their direct contact to customers they are able to recognize product needs and product synergies that would not appear in back-office datamining activities. This allows them to more effectively cross-sell products. Case managers also draw on their broad product knowledge and ability to provide end-to-end service support to provide a higher level of service quality to multi-product customers. This higher level of service quality is an important element of retaining the customers that chose to consolidate multiple accounts with a single service provider. \(^{12}\)

Citibank is using a mass customization strategy to better serve the market segment for young professionals with moderate levels of assets at their disposal but a range of financial service needs. Citibank has integrated sales of deposits and checking products, consumer credit and basic investment vehicles into a branch-based Personal Banker position. Personal Bankers work to cross-sell customers across retail banking product lines and provide integrated account servicing to improve quality for multi-product customers. To keep the costs of product development and provisioning down, the number of products Personal Bankers offer customers is limited to 15-20 off-the-shelf products across all product lines. Customers have access to Personal Bankers for complicated questions but are incented to use direct delivery technologies for their routine transactions. The first Citibank branches to adopt the mass customization strategy were able to significantly increase the number of multi-product customers under management by 20% and the revenue generated from each customer account by 12%.
Southwind Travel, a specialty provider of travel services to South America, offers another example of the successful application of the principle of mass customization. Southwind targets value conscious customers that want a tailored vacation rather than a pre-packaged tour but cannot pay top dollar for fares and accommodations. The company keeps up-to-date information on a limited and manageable number of travel offerings in South American, including information on discount fares, local accommodations, local transportation, tours and outdoor adventures. Southwind’s travel agents work individually with customers to mix and match elements of their standard travel offerings to create a customized bundled of services that undercut the prices of larger competitors by 10-15%. Southwind’s strategy of providing tailored but cost competitive travel packages has helped the firm to grow at a 30% annual rate for the past several years.

**Simple Relationship Management**

Simple relationship management allows service providers to earn comfortable margins on customers with sophisticated but limited product needs by using highly-trained, dedicated account personnel to perform each valuing add step in the service value chain. All products delivered through a simple relationship management strategy are highly customized. Product selection, product production, and service support are all uniquely tailored to the individual needs of each customer account.

The simple relationship management strategy involves pairing a dedicated relationship manager and customer service assistant to each customer account. The relationship manager is a product expert. The relationship manager works to understand customer product needs and to develop customized products to meet these needs. Customer service assistants do much of the paperwork involved in producing customized
products. They are also responsible for providing personalized post-sales service support to each customer. Unlike the case managers in the mass customization strategy, product experts and customer service representatives in the simple relationship management strategy need an intimate understanding of each customer account. To provide customized products and personalized service support, they need a detailed understanding of each customers unique product needs.

The simple relationship management strategy can be used to generate competitive advantage from customers that want individualized attention and advising from a service company and are willing to pay a premium for this higher level of service. Humanic Design, a provider of Enterprise Resource Software for the Human Resource Function, has used a simple relationship management strategy to sustain a 20% year-on-year growth trajectory in the rapidly consolidating market for Enterprise Resource Planning (ERP) software.

A high-end provider of Enterprise Resource Software, Humanic Design focuses on customers willing to pay up $100,000 for a customized human resource management system. The costs of product development and production represent just a fraction of the overall pricetag. What the customers are paying for is a high-level of personalized support. Each human resource software package is customized to the software and network needs of individual users. The high-end strategy is supported by pairing each company with a relationship manager who has expertise in human resource software systems and client-server technologies. The relationship manager acts as single point of contact and takes the lead identifying customer requirements, developing a strategy for customizing the system, and coordinating on-going service support.
The Los Angeles Independent Bank\textsuperscript{13} has used a simple relationship management strategy to gain competitive advantage in the market segment for small middle market business customers (i.e. firm customers with $5\text{-}$25 million in annual sales). Because these customers are not the largest in the middle market, most commercial banks do not make sufficient effort to get to know the needs of each customer's specific account. They used standardized off-the-shelf products, keep customer caseloads too high and incent their relationship managers to transition to larger accounts, leading to high levels of account officer turnover.

At LA Independent Bank each small middle market corporate account is managed by a relationship manager with expertise in both credit and cash management products. The bank supports it simple relationship management strategy by keeping the number of customer accounts per manager at 20\% below the industry average of 50 and expecting relationship managers to have personal contact with each customer at least four times a year. With many small middle market customers looking for better customer care, the use of the simple relationship management strategy has allowed First Business Bank to thrive at a time when many regional banks of its size have been absorbed or gone bankrupt in the recent waves of consolidation in the California banking market. The bank has used its simple relationship management strategy to earn net revenues that are up to 20\% higher per employee than other banks serving the same market segment.

**Team-based Relationship Management**

Team-based relationship management encourages stronger and more profitable relationships with customers that have sophisticated and broad product needs by using a team of trained experts to manage all steps in the service value chain. The team-based
relationship management approach is like the simple relationship management strategy in using dedicated account personnel to uniquely tailor product selection, product production, and post-sales service support to the individual needs of each customer. It is different than simple relationship management in focusing on building bundles of customized service products.

The strategy brings together a relationship manager, product and functional experts, and customer service support individuals to provide for the comprehensive needs of each customer account. The relationship manager is responsible for overall management of a customer account. Relationship managers work to involve customers in a dialogue about product need and to help customers select a package of service products that meet their unique needs. Product and functional experts are responsible for product production. They work to customize the individual product lines or services that are included in the bundled of services negotiated with a customer. Service support employees do much of the paperwork involved in product production and are responsible for post-sales service activities.

Union Pacific is using a team-based relationship management strategy to maximize the revenues earned on selling railroad transportation services to its larger and more significant customers. The company has six main lines of transport business -- industrial equipment, cars and car parts, coal, chemicals, agriculture products, and trucking containers. In each business area, client relationships are managed by a cross-functional team which includes an operations manager, a financial manager, a sales representative and dedicated customer service workers. Team members work together to provide a comprehensive and customized service offering to meet each clients entire rail transportation needs. In putting together these packages, the team may vary transit
schedules, financing options, the number of rail cars per train, and all other aspects of service offerings to meet a customers unique needs.

At Harris Bank, a team-based relationship management strategy is the key to the way the bank interfaces with its middle-market clients. The bank has a special lending group which focuses on building long-term relationships with firms that have annual sales of $50 million or more. Most banks use a simple relationship management strategy to serve this customer group -- relying on a credit expert as the main interface with each customer account. At Harris Bank each customer is managed by a team consisting of a relationship manager, a credit expert, and a number of product specialists (e.g. cash management, trusts, international banking products). At the outset of a new relationship, the team analyzes a company’s product needs and selects an appropriately tailored bundle of products. The credit expert and product specialists offer customized options for their products and the relationship managers works to pull together the various product lines into an integrated bundle. The team-based relationship management strategy has allowed Harris Bank to significantly outperform its competitors, with revenues earned per employee 25% higher than the industry average.

**Picking the Right Approach**

Each of these four distribution strategies creates different opportunities for improving a service company’s earning potential. To find the appropriate distribution strategy or mix of distribution strategies for their customers, service managers need to ask themselves three questions:

- Do we have a strategy for “adding value” to information?
- Will my customers’ pay for value-added information delivery?
• How strong are our technological and human resource capabilities?

[Figure 2 about here]

The way these questions are answered should lead to different decisions about strategic design (Figure 2).

Selecting an “Information” Strategy

Service companies have traditionally been geared to earn profits through control of information. Assymetric control of information allowed service providers to charge price mark-ups out of activities that involved nothing more than the transmittal of information. Increasingly, advances in information technology have eroded control of information as a source of profits. The growth of proprietary and open electronic networks now gives customers easy access to new source of information on product offerings and pricing (e.g. from other consumers and other service providers) once controlled by service companies. The growth of these networks takes the margin out of activities that involve merely transmitting information.

In commodity market segments, advances in electronic communication means that competitive advantage comes to depend on the cost-effective and speedy transmittal of information. Service companies that do not add value to information transmitted to customers need to become the low cost provider of information by investing in direct delivery channels that reduce prices and maximize customers convenience in gathering
product information and completing service transactions. Profitability for these service providers depends on earning a very thin margin on a large number of mass-market customers. By making ATMs and telephone banking available in supermarkets and drugstores, Wells Fargo's is attempting to attract the large number of banking customers who view their financial service transactions as an errand no different than shopping. They are not looking for a financial service advisor but a convenient place to keep their money and to be able to write checks.

To move out the commodity position, service companies need to develop a strategy for adding value to information. That is, they need to interpret, present, or explain information to consumers in a way that that information becomes more valuable than if it is presented in a purely electronic medium. Adding value to information in a way that consumers are willing to pay for allows a service company to charge a price mark-up over the mere costs of transmitting this information. There are two main strategies that service companies can pursue to add value to formation.

- **Product Advising.** The clearest and most obvious strategy for adding value to information is through product advising. Service firms using product advising to move away from the commodity market position do not just present customer with information on product offerings and product choices, but draw on product experts to help customers choose the right product to meet their individual service needs.

  Product experts bring to the service relationship a knowledge of service products that a customer does not have and cannot readily acquire to educate customers about their product choices. Customer education is important to winning customer's business at all stages of the service value chain. By educating uninitiated customers about new products or new ways of combining products during an initial customer contact, a service company
can increase demand for their products. By being able to answer tough questions as customers begin to use products, a service company can win customer loyalty.

Product advising is particularly important for both the simple- and team-based relationship management strategies. Customers looking for a service relationship rather than a transactional providers of services want to work with product experts with deep and detailed product knowledge. Los Angeles Independent Bank, for example, differentiates itself from competitors by selling customized rather than off-the-shelf products to its small middle market customers. Product experts at the bank bring a knowledge of credit and cash management products that the small business customers themselves do not have in-house and are not interested in acquiring. Customers of LA Independent Bank expect their relationship manager to help them weigh the benefits of different financing and cash management schemes and to be available to answer questions after a purchase has been made.

- **Information Brokering.** A second and distinct strategy for adding value to information revolves around information brokering. Information brokering involves bringing together types of information that are costly for a consumer to assemble. A service company using an information brokering strategy adds value by reducing the time and costs involved in pulling together information on products and pricing. Information brokering is a key source of competitive advantage in the mass customization strategy. It can also play a role in the team-based relationship management strategy.

To see how the information brokering strategy works, go back to the example of Southwind Travel. There is no special knowledge or skills required to bring together the tailored tours that Southwind Adventures develops for its customers. All of the information on flights, accommodations, local tours and outdoor adventures is available
to their customers via the Web or a telephone directory. The customer willing to
download information from the Web, make calls to hotels and tour operators in South
America, and to comparison shop for flights from the US to South America can reduce
the cost of their entire tour package. But to bring this information together has a heavy
cost in terms of the customer’s time. Southwind makes it possible for its customers to
plan a vacation to even exotic and out-of-the-way places conveniently and cost-effectively
by making this hard to assemble information readily available.

Assessing Customer Demand

The next step in choosing a positioning strategy is assessing consumer’s willingness to
pay for value-added information delivery. Adding value to information normally
involves workforce delivery of products and services, raising costs compared with
electronic delivery. There are many service customers that are not willing to pay the extra
costs of adding value to information. These customers are highly price-oriented and tend
to view the services they consume as commodities. They spend time comparison
shopping and are willing to shift service providers to take advantage of price discounts or
special product campaigns.

Price-oriented customers are best served using an automated service delivery
strategy. Investments made in product advising or information brokering are not valued
by these customers and will not be rewarded. Customers move away from a pure price-
orientation when they demand product bundling or product customization.

- **Product Bundlers.** Product bundlers have product needs across a number of
different product lines but choose to consolidate their product holdings with a single
service provider. Product bundlers place a high value on the information brokering
function that a service provider can play. They want to minimize the time and effort it takes them to complete their service transactions. Product bundlers are value-conscious but not overly focused on price. They are willing to work with a service provider that offers reasonable value across a range of products without having to be the lowest cost provider of any of these products.

Identification of customer groups that are interested in product bundling is key to the success of both a mass customization and team-based relationship management strategy. The success of Citibank's mass customization strategy is, for example, based on targeting young professionals customers that lead busy lives and do not have time to continuously pursue the cheapest product offering. These customers value being able to see the universe of their monthly financial service transactions neatly put on a single account statement. They also value being able to have all their financial service questions answered through a single conversation with a Personal Banker.

AT&T is, similarly, moving to identify product bundlers in its personal market segment. By comparing data on customers and product use across previously independent product lines, the company is culling out those customers that may be interested in bundling local, long-distance, cellular, and network services from those just interested in a single product line. Even as it intensifies the development of an automated delivery strategy for mass market customers interested only in cheap, long-distance services, AT&T has begun shift customers interested in product bundling to a mass customization platform that supports integrated service delivery.

The perils of trying to develop a distribution strategy based on product bundling without first clearly identifying customers preferences can be illustrated with an example from J.P. Morgan. Despite years of trying to provide integrated bundles of customized
financial service products to its large commercial customers, J.P. Morgan has never successfully been able to bundle its investment banking activities with commercial lending. Most of J.P. Morgan have internal expertise on credit and financial management. They may turn to a bank for access to credit, but they are not interested in paying for the expertise needed to customize those product to their operations, choosing instead to keep this expertise in-house.

- **Product Customizers.** Customers also move away from a pure price-orientation when they demand product customization. Product customizers want to work with a service provider that tailors products to their exact requirements. They expect and are willing to pay for high levels of individualized attention. The success of both a simple and team-based relationship management strategies depends on identifying customers willing to pay for product customization. Product customizers, for instance, are the target for both Human Design and Los Angeles Independent Bank. Customers for both service providers choose to draw on a service providers expertise in customizing software or credit products rather than develop this expertise in-house.

The difference between product customizers and non-customizers can be illustrated through a comparison of the customers targeted by Wells Fargo and its smaller, California-based competitor First Federal Bank. While Wells Fargo’s is targeting price conscious consumers looking only for a place to keep their money, First Federal targets older, more conservative customers that put a premium on product advising and service quality. First Federal customer’s often have considerable assets to manage but shy away from the risk of investment products. Each customer is assigned to an account executive that can present and discuss options for using traditional banking products (e.g. checking accounts, CDs, and money market funds) to meet a customers personal savings and
liquidity goals. Through the more intensive management of relationships with customers interested in customizing traditional banking products, First Federal has prospered even during the consolidation of the California banking market.

Evaluating Organizational Capabilities

A final step in choosing a positioning strategy is exploring alignment with organizational capabilities. Each of the four service distribution strategies relies on a very different mix of technological and human resource strengths. The automated delivery model is technologically-intensive. It requires high-levels of process automation and the effective management of customer information. At the other end of the spectrum, the simple and team-based relationship management strategies are both human resource intensive. Companies developing either of these delivery strategies need to make appropriate investments in product expertise, stable account management, and effective teams. A mass customization strategy sits between an automated delivery strategy on the one hand and relationship-based strategies on the other. Mass customization builds on the technological infrastructure of automated delivery but also requires investments in broadly skilled case managers.

- **Process Automation.** Both mass-customization and automated service delivery depend on the automation of back-office product development and front-office product delivery. Automating back-office product development allows for improvements in the overall cost-effectiveness of service delivery. In the direct delivery model, back-office automation is accomplished by linking datamining activities forward to direct mailing and direct calling programs. AT&T’s long-distance offerings, for instance, are generated
from direct feeds from modeling activities. Much of the selection, printing, and product mailings are fully automated.

In the mass customization strategy, back-office automation is accomplished through technologies that standardize product development by guiding service employees step-wise through sales and service transactions -- prompting questions, automatically recording and processing customer information. During an initial customer contact, Southwind Travel's information system walks travel agents through a series of information screens with queries on specific elements of a travel package (air travel, local lodging, expeditions and tours) as it builds toward a standard template for organizing each customers travel adventure.

Automation of front-office activities, similarly, supports the cost-effectiveness of service delivery to customers with standard product needs by allowing routine sales and service activities to be completed electronically. In support of its mini-branch concept, Wells Fargo doubled the number of retail outlets equipped with ATM machines from 526 to 1,200 and increased the number of locations with stand alone ATMs from 110 to 275. In developing its mass customization strategy, Citibank built on its early start into the area of home banking. Once it had decided to use electronic delivery to support its push into the high-end retail market, Citibank added as many as 250,000 new home banking customers in a single year by waiving fees and offering free installation for this product.

- **Customer Profiling.** Both mass customization and automated delivery also depend on effective customer profiling. Customer profiling involves the use of technology to collect and interpret customer data in ways that allow product offerings to be generated for specific customer groups. Because service firm's using a direct delivery or mass
customization have limited or no direct contact to individual customers, they need to use technology to create a "virtual" contact point to their customer base.

In the mass customization strategy, customer profiles are generated through information systems available to case managers on their desktop. Citibank, for instance, has developed an information system that gives Personal Bankers a full account history on each customer. By including information on past product purchases, customer service transactions, and current product holdings, the information system gives personal bankers a complete overview of all of the hundreds of customers they may serve. An integrated customer overview allows Personal bankers to offer customers "one-stop" convenience and to more effectively look for potential product cross-sales. In an automated delivery model, these individual customer profiles are aggregated and analyzed in back-office datamining activities -- as for example the predictive models used by Wells Fargo and AT&T.

- **Effective Relationship Management.** At the other end of the spectrum, simple and team-based relationship management both require putting a highly skilled and stable workforce in front of customers. Effective relationship management requires two main types of human resource capabilities. The first is product expertise. To customize products to individual customers needs, relationship managers and product experts need to have mastery of their individual product lines. The second is stable account management. To customize products for specific customers, relationship managers and product experts need to develop customer specific understanding of product need and involve customers in co-producing service products. Frequent changing of pairings between customers and relationship managers or product experts breaks down the build up of knowledge between a service company and its customers.
Humanic Design supports its relationship management strategy by recruiting sales representatives that have either a technical background or a fluency in software and network technologies and then continually trains its sales representatives on enterprise resource planning and client-server technologies. The company supports a high degree of continuity in customer relationships by making one service representative the lead on customer contacts for the entire “life cycle” of a customer relationship.

Los Angeles Independent Bank supports its relationship management strategy by hiring experienced lenders and offering them generous performance incentives to keep them put – contingent compensation accounts for up to 25% of base salary. Long years of industry experience give relationship managers the expertise they need to appropriately customize credit and cash management products to customer needs. More seasoned lenders are also not as eager to move from bank to bank which keeps account officer turnover low and allows each relationship manager to develop a detailed understanding of customers. Account officer turnover at First Business Bank is 3% a year or 1/3 of the industry average.

- **Cross-functional Integration.** To bring together bundled packages of service products, both a team-based relationship management strategy and mass customization require effective cross-functional integration. In the team-based relationship management strategy requires cross-functional integration is achieved through cross-training and effective teaming. To effectively customize bundles of service products, individual members of a relationship management team need sufficient understanding of what other team members are doing to integrate their products with the overall package of products. They also need incentives to work with other team members to maximize overall team performance rather than maximize along their individual performance.
At Harris Bank all relationship managers and product specialists go through a common three-year competency development program which combines classroom training and structured work experience. The experience of going through the same training program builds a common base of knowledge and helps the relationship management teams provide more effective bundles of customized services. To further support its team based approach, each product expert has both a functional affiliation and a team affiliation. Specialists are considered members of the relationship management team and incented and rewarded accordingly. At Union Pacific, similarly, each member of a relationship management team has a common set of team performance goals. One element of these common performance goals is based on a customer service index; the other part is based on meetings expectations about revenue and profitability. Having a common set of performance standards encourages all team members to focus on delivering an integrated product.

In the mass customization strategy, cross-functional integration is achieved through the broad training of case managers. The case managers who work within the mass customization framework do not need to be product experts nor do they necessarily need to work with dedicated accounts. But they need product knowledge across a range of product families and the analytical skills necessary to identify synergies between product categories and pull together bundled packages of services. Customers that consolidate multiple service holdings with a single service provider expect a higher level of quality in service delivery than what they might receive from a commodity service provider.

To support their mass customization strategies, Citibank and CalFed each have significantly increased their training investment for branch-based personnel. Rather than
the week of product and service training typical in other retail banks, Citibank spends three weeks comprehensively training its personal bankers in deposit, credit, and basic investment products so that they are able to create bundled packages of services. CalFed has begun licensing its new account representatives in progressively more complicated investment and insurance products. Southwind, similarly, supports its mass customization strategy through investments in broadly training travel agents. The firm typically recruits agents with 3-5 years of experience in the industry and a strong foundation in international travel. Once with the firm, travel agents are given plentiful opportunities to continuously develop their product knowledge. Agents travel at least twice a year to South American and regularly attend conferences in the US to maintain a broad knowledge of travel opportunities.

Integrating Across Distribution Strategies

Having selected the right mix of distribution strategies, a final challenge is to integrate across distribution strategies. For niche service providers this need to integrate across distribution strategies does not arise. Most niche service providers draw on only one of the four distribution strategies to serve their customers. Southwind Travel, for instance, uses a mass customization strategy to serve all of its customers. Humanic Design, similarly, makes uniform use of a simple relationship management strategy.

Diversified service providers that operate in many different types of customer markets, on the other hand, need to draw on multiple distribution strategies. Over the course of their relationship with a diversified service company, most customers will use a number of different distribution strategies. There are two main reasons customers make use of multiple distribution strategies. First, at any given time, the same customer may
use several different distribution channels to meet all their different product and service needs. Citibank's high-end retail clients, for instance, make use of three different types of distribution channels. To purchase new products, modify their mix of products, or seek advice about product use, customers can consult their Personal Banking officer. To conduct routine service transactions, they can use Citibank's on-line banking and telephone-banking services. Those customers that have sophisticated investment needs and want in-depth advising can be referred to one of Citibank's investment specialists.

The second reason customers will make use of multiple distribution strategies over the course of their relationship with a service provider are changes in life or business circumstances. As these circumstances change, customers product needs may change in ways that require a transition from one distribution strategy to another as their main interface with a service firm. Harris Bank, for instance, has integrated two different distribution strategies to more effectively serve its small and medium-size customers. For most business customers with under $50 million in annual, Harris bank uses a simple relationship management strategy. A single account officer with expertise in credit vehicles is responsible the banks lending relationship with the customer. As needed, this account officer brings in cash management and investment specialists into the customer relationship. As a customer approaches the $50 million in annual revenue size, their changing product needs normally require a shift to team-based relationship management strategy.

• **Integrated Information Management.** Smoothing transitions across distribution strategies requires developing two organizational capabilities. The first is a capability for integrated information management. Customers using automated delivery channels for routine service transactions must have access to the same records as case managers who
help clients with non-routine service transactions. Employees working within different delivery models, similarly, must have access to the same customer information to be able to effectively serve customers as they transition from one delivery model to another. To support the integration of their distribution strategies, both Citibank and Harris Bank have made significant investments in developing a single customer information database that supports employees in all customer segments.

- **Smoothing Customer Hand-offs.** The second element of integrating distribution strategies is to develop a strategy for smoothing customer hand-offs. At Harris Bank, customers with more than $50 million and less than $50 million in annual sales are served at the same lending office to maintain relationship continuity. As the small business customer grows and shifts from a simple to a team-based approach, with new personnel added to the engagement team and a possible transition in the relationship manager, serving the client out of the same office helps reduce dislocation. The senior office managers, the location of the office, the feel of the interaction all remain the same.

Citibank minimizes disruptions in customer relationship by assigning all retail customers with a significant net worth to a single Personal Banker. The Personal Bankers can draw in investment consultants for support in selling investment products but continue to own the relationship.

**Summary**

To remain competitive in an increasingly dynamic economy, companies need to tailor their distribution strategies to the needs of different customer segments. Low-margin customers with relatively limited and standardized product needs can be made
more profitable by using distribution strategies that automate customer assessment, product development and provisioning, and service support. Customers with standardized product needs that span a number of product lines can be made more profitable through distribution strategies that automate product development and routine service support but encourage customer involvement in product provisioning and provide more personalized service support for non-routine service requests. In markets for customers demanding customized products, service companies can earn price premiums by developing relationship-based distribution strategies that draw on a highly skilled and stable labor force and that encourage customer involvement in product selection and provisioning. In developing the right mix of distribution strategies, information service providers need to be careful to align their information strategies with customer demand and organizational capabilities. They also need to make sure that they have a strategy for integrating customer service across distribution channels.

A thoughtful and in-depth discussion of how companies can use information technology to develop and distribute products can be found in J. Rayport and J. Sviokla, "Exploiting the Virtual Value Chain," *Harvard Business Review*, vol. 73, November-December 1995, pp. 75-85.

For a detailed discussion of AT&T's new approach see A. Grant and L. Schlesinger, "Realize Your Customers' Full Profit Potential," *Harvard Business Review*, vol. 73, September-October 1995, pp. 67-68.


In an on-going study of mass customization strategies in 25 leading service providers, close to three-quarters of the companies surveyed cite improved service as the main reason that customers choose to consolidate product holding. Less than a quarter thought that price is a key reason customers choose to consolidate services.

The Los Angeles Independent Bank is a fictional name for a small independent wholesale bank that preferred not to be named.


Figure 1. Four Positioning Strategies

Customized Product/ Personalized Service Delivery

<table>
<thead>
<tr>
<th>High</th>
<th>Simple Relationship Management</th>
<th>Team-Based Relationship Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Automated Delivery</td>
<td>Mass Customization</td>
</tr>
</tbody>
</table>

Product Bundling
**Figure 2. Selecting a Positioning Strategy**

<table>
<thead>
<tr>
<th>Positioning Strategy</th>
<th>Automated Delivery</th>
<th>Mass Customization</th>
<th>Simple Relationship Management</th>
<th>Team-Based Relationship Management</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Information Strategy</strong></td>
<td>Cost-effective and convenient delivery</td>
<td>Information brokering</td>
<td>Product Advising</td>
<td>Product Advising \ Information brokering</td>
</tr>
<tr>
<td><strong>Target Customers</strong></td>
<td>Price-oriented</td>
<td>Product Bundlers</td>
<td>Product Customizers</td>
<td>Consolidating customizers</td>
</tr>
<tr>
<td><strong>Core Organizational Capabilities</strong></td>
<td>Process automation \ Customer profiling</td>
<td>Process automation \ Customer profiling \ Broad skill development</td>
<td>Product expertise \ Stable account management</td>
<td>Product expertise \ Stable account management \ Effective teaming</td>
</tr>
</tbody>
</table>