

# **A SIX PACK PORTFOLIO MODEL: LINKING CUSTOMER PROFITABILITY, COMMITMENT AND GROWTH POTENTIAL TO RELATIONSHIP STRATEGY**

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## **ABSTRACT**

The paper develops a three-dimensional portfolio model which distinguishes between six different categories. Based on assessments of customer profitability, customer commitment, and growth potential, the positioning of a given customer relationship in the portfolio allows to develop appropriate customer relationship management strategies. Therewith, the suggested portfolio model contributes to firms' customer base optimization efforts. Some initial results from applying the portfolio model are reported and managerial implications and future research are discussed.

**Track:** Relationship value and portfolio management

**Keywords:** relationship profitability, commitment, sales potential, relationship strategy

**Paper:** WIP paper

The notion that business relationships can be managed with a portfolio approach has long been attractive to practitioners and academics (e.g. Fiocca, 1982; Johnson & Selnes, 2004; Olsen & Ellram, 1997; Turnbull, 1989; Turnbull & Zolkiewski, 1997; Yorke & Droussiotis, 1994, for a recent review see Corsaro et al., 2013). The portfolio approach tries to offer a categorization of objects in order to decide on appropriate strategies for these objects. With regards to a firm's customer relationship, a customer portfolio should enable strategizing, i.e. determining an appropriate relationship strategy for a given customer relationship. Overall, the objective of portfolio approaches is to optimize customer relationship management efforts in order to maximize profitability.

While common sense states that customer differ in their ability to generate profits for a firm (also called supplier-perceived customer value), it is surprising that the notion of customer value has not been applied in customer portfolios to a large extent (Corsaro et al., 2013). Thus, one contribution of this paper is to explicitly include customer value as a dimension of a customer portfolio.

In addition, the long-standing discussion of customer commitment is rarely included in customer portfolio as portfolios often display different profitability dimensions (e.g. price vs. cost to serve, Rangan, Moriarty & Swartz, 1992). Alternatively, authors have developed specific models to capture customer relationship parameters as, e.g., "the development stage of a relationship" (Ford, 1980; Dwyer, Schurr & Oh, 1987), "the dynamic interaction" between firms (Freytag & Clarke, 2001), or the cooperation-competition matrix (Wilkinson & Young, 1993). This paper suggests an integration of customer commitment with customer profitability in one portfolio model in order to capture simultaneously the supplier's interest in the customer (its contribution to profitability through value creating potential) and the modus operandi of the relationship (extent of rational vs. cognitive commitment).

Finally, we wish to consider a future oriented dimension in the portfolio as well. We suggest to capture customers' ability to increase their spent with a firm, also called additional sales potential. This critical issue is ever so often overlooked when developing strategies and making budget and forecasts.

Overall, the paper contributes to existing customer portfolio models by combining dimensions not integrated into one portfolio model before. The paper is organized as follows: First, the three dimensions are defined. Thereafter, the 6-pack portfolio is developed. Then, some empirical examples are presented. Finally, managerial conclusions and further research questions are discussed.

## CUSTOMER VALUE AND CUSTOMER PROFITABILITY

Customer profitability is the contribution of a customer to a supplier's profits. Many firms focus on margin and volume in their calculations of customer profitability driven by accounting data from enterprise resource planning systems (like SAP, Baan, Microsoft Dynamics). While calculations of various margins are extremely important, a customer has much more ways of contributing to a supplier's business success. This perspective is normally developed under the

relationship value literature (for reviews see Gummerus, 2013; Lindgreen & Wynstra, 2005) but seldomly integrated into customer portfolios (Corsaro et al., 2013). The relationship value radar (Ritter & Walter, 2012) suggests eight areas of potential contributions:

- Payment: value is created through high margins and fast payments;
- Volume: value is created by higher volumes of a product (volume per product), larger width in purchased product portfolio, and longer-term contracts (volume over time);
- Quality: value is created by demanding the right products in relation to supplier's competencies (thus avoiding waste of high-value resources on low-value demands);
- Safeguard: value is created by short notice supplies of excess capacity or low quality products.
- Innovation: value is created by developing new products and new markets.
- Information: value is created by providing insights about the customer firm, customer market developments, and technological advances.
- Access: value is created through references to new customers, access to industry associations, and contact to important players both in the political system, the technology arena, and the business system.
- Motivation: value is created by using the customer to motivate employees – either by public status of the customer or access to unique resources.

Based on this understanding of customer profitability, a customer is profitable when the customer contributes sufficiently in at least one value dimension. Unprofitable customers do have a negative contribution (e.g. when customer handling costs outnumber contributions). For the suggested customer portfolio, we initially suggest a division into profitable-not profitable customer relationships as this eases the use of the model. However, this dimension can also be used as a scale stretching from very unprofitable to very profitable.

## CUSTOMER COMMITMENT

The continuity of business relationships has received a lot of interest, often under related labels like “commitment” (Morgan & Hunt, 1994) and “loyalty” (Reichheld, 1993) and “institutionalization” (Håkansson, 1982). Loyal behavior in business relationships has been discussed from many different perspectives (e.g. Parasuraman & Drewal, 2000; Reichheld, 1996), a precise definition of the construct “loyalty” is still missing. The multitude of suggested measures and understandings of customer loyalty documents that this construct is difficult to capture. Loyal customers are often, if not always, regarded as a firm's key asset and are seen as a major key success factor for suppliers' business performance: “The economic benefits of customer loyalty explain why one competitor is more profitable than another” (Reichheld 1993, p. 64). As such, firms are constantly on the search for good measures of their customers' loyalty – which in part explains the great interest in publications like “the ultimate question” (Reichheld, 2006). Most studies focus on specific facets of loyalty and employ partial models and operationalizations of loyalty. Most customer loyalty measures capture customers repurchase pattern, their development of purchase size, customers' referral and feedback/complain activities. Therewith, a loyal customer is defined as a customer who comes back, buys more, talks positive

to others, and offers inputs for improvements. While these are suitable criteria for behavioral loyalty, these items do not explain the motivational drive which makes the customer do just that.

Instead, the term “commitment” offers a better defined and more suitable concept to capture the intention to continue a business relationship. Commitment has been acknowledged in the relationship marketing literature as an important facet of any long-term business relationship (Anderson & Weitz, 1992; Gundlach, Achrol & Mentzer, 1995; Morgan & Hunt, 1994). The discussion of commitment has a long tradition (Wind, 1970). Generally, commitment is described as a kind of lasting intention to build and maintain a long-term relationship (Dwyer, Schurr & Oh, 1987; Moorman, Zaltman & Despondé, 1992). “Commitment to the relationship entails a desire to develop a stable relationship, a willingness to make short-time sacrifices to maintain the relationship, and a confidence in the stability of the relationship” (Anderson & Weitz, 1992, p. 19). “The essence of commitment [...] is stability and sacrifice” (Morgan & Hunt, 1994). In other words, commitment indicates that a customer’s trade-off between the short-term sacrifices and the long term benefits turned towards a preference for the long-term development because the expected advantages of the long-term relationship justify short-term sacrifices. As such, we define high commitment as a cognitive state of the customer which implies a relational approach between the supplier and the customer. Opposite, low cognitive commitment implies a lack of relational bonds between the supplier and the buyer. The exchange between the actors is arm’s length and transactional and based on rational arguments, such as product quality, availability and convenience.

We operationalize commitment in the portfolio as existing vs. non-existing. This rough distinction offers initial insights but can be further refined by using a scale from purely transactional, low commitment relationships to integrated, high commitment relationships (for such scales, see e.g. Day, 2000; Wilson, 2000).

## GROWTH POTENTIAL

Growth potential is defined as the customer’s ability to increase business transactions with a supplier. Some customers do already buy everything they can from a given supplier, in terms of volume depth in single source purchasing agreements and in terms of volume breadth across the product portfolio. These customers have no further sales growth potential, their potential has been realized. Alternatively, customers may currently purchase only a fraction of their demands (multi-supplier strategies) or only a fraction of the product portfolio. Such customers have growth potential.

We again suggest a growth-no growth distinction as an initial step but acknowledge the additional value to employ a scale ranging from no growth potential to very high growth potential.

## SIX-PACK PORTFOLIO MODEL

The three dimensions (profitability, commitment, and growth potential) span a portfolio of six categories (Figure 1) because the distinction between high and low growth potential for unprofitable customers does not add to managerial decision making.



Figure 1: Six-pack customer portfolio

*True loyalists:* True loyalists like doing business with a given supplier; they do all their business possible with this supplier. As they buy as much as they can, there is no further sales potential left; all sales possibilities are utilized. Firms need to maintain relationships with true loyalists in order to secure continued business. True loyalists are the prime target for loyalty programs – not to waste resources beyond business impact but to appropriately continue business. Actually, most firms can save resources by optimizing their relationship maintenance processes.

*Cherry pickers:* Cherry pickers do only buy from a given supplier what they cannot buy other places. They are not customers out of free will, because they like buying from the supplier. They are customers because the offerings are unique in terms of technology, price or convenience. The likelihood for them to terminate business transactions is very high when alternative suppliers emerge. As the relationship with cherry pickers is based on offering features, the firm has to ensure “best offering” to ensure continued business. The true business driver with cherry pickers is the optimization of pricing (let them pay for the features, do not discount) and the reduction of ill-fated loyalty programs (do not bond, they do not want to).

*Potentials:* Potentials are loyal but have untapped business opportunities – there is potential for growth. As they like interacting with the supplier, potentials represent the low hanging fruits for immediate profitable growth in the customer portfolio. The supplier has contact, goodwill, and suitable products. The relationship strategy for potentials is relationship development towards full supply and move therewith the customer into the true loyalist category.

*Skeptics:* Skeptics are customers with high risk for churning – the supplier cannot be sure about the future of these customer relationships and needs to invest significantly in order to develop these customers. As such, there is growth potential but this potential is high hanging fruit. Skeptics are either former cherry pickers who are not any longer sure about the advantages of the offerings, or they are customers with former high commitment but who are disappointed about the treatment and as such skeptical about the basis of the relationship. The relationship strategy is either taking the risk (harvest as long as it lasts), or to make significant investments in the next generation of leading products or in the development of the relationship.

*Time Bandits:* Time bandits are those loyal customers who are there all the time but do forget to make profitable business transactions with the firm. These customer potentially come to every seminar, they visit the supplier's trade show stand and drink and dine on the supplier's expenses, they happily talk to supplier's employees – but they do not offer sufficient value in return. As a result, these customers steal time and other resources. The relationship strategy for time bandits is either up or out. Upwards development is often achieved by informing the customer about the low profitability – in most cases, they simply not know that they are a profit pain to the supplier. Because there is a good fit between the firm and the customer, the profitability issue can often be solved by changes in pricing, transacting a different, more standard product portfolio, increased use of cheaper interaction channels. Alternatively, the relationship can be faded out, or actively terminated. Time bandits live a secret life in customer portfolios; they are loyal and pleasant to interact with – so no-one expects harm from them. Thus, a key issue is their identification.

*Cowboys:* Cowboys, at least the wild ones, enter the salon, make a lot of noise, try to get everybody's attention, potentially violate the law – and leave as sudden as they came. But they leave behind a lot of headaches, clean up costs and lost opportunities. In business, cowboys often ask for a full tender, a detailed offer – and suppliers spent lots of resources into such project and business proposals. All of that work is lost because the high potential customer only wanted a price to compare with, or they simply were not ready for their own ideas. An alternative version of cowboys are those who ask for illegal treatments (bribes, deliveries around certain systems, etc.) or for all too low prices. In common they share one characteristic: there is no good business in them. As such, the appropriate strategy is to spot them early and keep them out of the business: do not let them disturb.

## EMPIRICAL TEST

We used the six-pack customer portfolio model with over 50 executives from various firms spreading across many industries. Typically, we introduced the model and asked executives to allocate percentages of customers to each of the six categories based on either number of customers, turnover, or profits.

Most managers had no or only little problems in deciding the numbers for each box. They felt very comfortable with their answers with a variation of plus/minus five percent. This documents the ease of use of the model. The majority also stated the usefulness of the model.

When executives from the same firm of business unit did the analysis without interacting in the process, their numbers were very close to each other – typically only five percent differences. This illustrates the inter-subject reliability of the model.

The actual numbers varied significantly between firms and even between business units within firms. The follow up discussions revealed that an explicit illustration of the differences in the respective customer base was helpful to understand the different challenges faced by the different units.

Furthermore, managers from the same firm used the model to identify typical customers for each of the six categories and thereby also derive good descriptions of such customers. This exercise helped developing real descriptions for each category in order to better spot customer behavior in order to allocate customers in the portfolio, and subsequently to an appropriate customer relationship strategy.

## MANAGERIAL IMPLICATIONS

The developed six-pack customer portfolio model is a useful framework for discussing relationship strategies and for forecasting growth results. The portfolio model makes three contributions:

### *Allocating suitable customer relationship strategy*

Each category has its own relationship strategy implications, i.e. its own agenda what to do with customers in that category in order to improve business results. This leads to immediate improvements in relationship management effectiveness by, e.g., minimizing wasted resources in loyalty programs towards transactional customers, discounts for cherry pickers, or free coffee for time bandits.

### *Defining sales objectives and suitable customer dash boards*

For each category, firms can adapt their internal objectives and relationship dash boards. Giving incentives based on growth for people dealing with true loyalists is a motivation drain – there is no growth in these customers. Not rewarding growth with potentials means underutilizing business potential. Customer satisfaction measures are on many corporate dash boards these days – and most often reported as averages. But time bandits should be dissatisfied if we want them to leave; cherry pickers should be dissatisfied with our prices but very satisfied with product performance. The only cluster where satisfaction really works is the true loyalists.

### *Projecting growth potential*

Projecting business growth is often a difficult task. The executive team promised the owners the usual 10% growth. After analyzing the customer portfolio using the six pack model, they realized

that 10% growth implied 50% growth for potentials and 20% termination of time bandits – numbers which are totally unrealistic. As a result, the firm was able to make concrete sales plans to actually realize the potential they had – but the executive board was also able to communicate with the owners early in the year that 5% growth was ambitious, yet realistic. As such, the tool also contributes to realistic growth projection.

## FUTURE RESEARCH

This paper conceptually develops a six-pack portfolio model and reports on initial empirical evidence from applying the model. While these initial steps are promising, there are a few limitations to be addressed in future research.

The usefulness of the model is not yet documented with real sales numbers over time because such a longitudinal design demands significant time and resources. As such, despite the positive feedback from participating executives, the impact of the six-pack portfolio model has not yet been empirically tested. Future research may collect data over time to evaluate whether or not there is a long-term impact by using the model.

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