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Relationship Capital: A new management currency for a changed world

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A New Management Currency for a Changed World

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Introduction

At 28 December 2007, Merrill Lynch's "Goodwill and other intangible assets" was valued at just over US$5 billion. By 26 December 2008, that number was just over USD2.6 billion. A reduction of a staggering USD2.4 billion, in the value of a single company.

A key component of the "intangibles" that constitute goodwill and so, the value of organizations, is the value of business relationships. The events of 2008 taught many companies a harsh lesson in valuing relationships. As one banker commented to us: "We thought we had strong client relationships, but when times got hard we had some nasty shocks. Clients who had been with us for many years simply walked away."

The banks were the first to feel the impact, but in the new business environment, organizations across all industries recognize the growing need to refocus their efforts of evaluating and managing relationship strength.

Going forward, organizations will focus a greater degree of attention on evaluating and managing the quality of their business relationships – what we term their relationship capital.

This paper introduces the concept of relationship capital: a new management currency for a changed world.

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At 28 December 2007, Merrill Lynch's "Goodwill and other intangible assets" was valued at just over US$5 billion. By 26 December 2008, that number was just over USD2.6 billion. A reduction of a staggering USD2.4 billion, in the value of a single company.

The innocently named "Goodwill and intangibles" covers a variety of intangible asset valuations which Merrill's financial statements acknowledge contain "certain subjective and complex judgments" before stating that "fair value is measured based on the market approach, using market-multiple analyses." Principal among these intangible assets is the valuation of proprietary know-how and proprietary systems and processes. Another significant constituent is the value of relationships. As an example,

"In connection with the acquisition of First Franklin in 2007, Merrill Lynch recorded identifiable intangible assets of $185 million. In response to the deterioration in the sub-prime mortgage markets, Merrill Lynch reviewed its identifiable intangible assets for impairment and recorded impairment charges of $107 million and $53 million related to mortgage broker relationships of First Franklin in the third and fourth quarters of 2007, respectively. At December 28, 2007 the entire amount of mortgage broker relationships has been written off."

Merrill Lynch Annual Report, 2007, p 125.

What is clear, is that organizations place a huge value on their relationships – and they are right to do so. There is an adage in business that "People do business with people." Organisations do not typically do business at the organisation level. What the events of 2008 have taught businesses is that many businesses, particularly in banking and finance were relying on relationships that were built on very shaky foundations.

Going forward, organizations will focus a greater degree of attention on evaluating and managing the quality of their business relationships – what we term their relationship capital.

Relationship Capital comes of age.

More than 20 years ago, Harvard's Theodore Levitt[1] introduced the term "relationship marketing" to suggest that establishing long-term relationships with customers and clients was preferable to transactional marketing.

Levitt reflected that the difference between transactional and relationship marketing is to the difference between a marriage and a one-night stand. "The sale, then, merely consummates the courtship at which point the marriage begins," wrote Levitt. "The quality of the marriage determines whether there will be continued or expanded business, or troubles and divorce."

In the intervening years, numerous studies have established the benefits of creating and maintaining strong customer relationships. Strong relationships equate with greater customer loyalty and retention, which ultimately result in higher sales, market share, and profits[2,3].

Equally, numerous studies have focused on the factors, both behavioural and attitudinal, that

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1 Levitt, Theodore, (1983) "After the Sale is Over", Harvard Business Review.
2 Crosby, Lawrence A., Kenneth R. Evans, and Deborah Cowles (1990), "Relationship Quality in Services Selling: an Interpersonal Influence Perspective," *Journal of Marketing*, 54 (July), 68-81.
3 Morgan, Robert M. and Shelby D. Hunt (1994), "The Commitment-Trust Theory of Relationship Marketing," *Journal of Marketing*, 58 (3), 20-38.

underpin relationship strength and have demonstrated a link between these factors and relationship strength. From a behavioural perspective these include factors such as duration of the relationship, frequency of contact/order, regularity of contact/order and monetary value[4]. From the attitudinal viewpoint variables such as satisfaction, trust, commitment to stay with the supplier/provider and the perceived costs of switching to an alternative provider/supplier, are considered[5,6].

Surprisingly though, while the value of strong customer/client relationships is widely accepted, the measurement and management of the value of such relationships remains an underdeveloped science. Indeed, despite the huge investments made by organizations in customer relationship management systems (CRM's), or perhaps because of them, the human touch is more absent from business relationships today than it was more than 20 years ago when Levitt introduced the notion of relationship marketing. As Kirsten Sandberg, executive editor of Harvard Business School Publishing, commented in 2006: "The snazzy technology was supposed to make one-to-one interactions with customers a reality, but experts say all it has done is enable companies to disappoint their customers faster and more efficiently – anytime and anywhere. Customer loyalty hasn't increased. Companies still can't target their most profitable customers, and their data-mining and sales processes are still as convoluted as ever."[7]

Clearly, something has gone wrong.

In the drive to define business management as science and systematize sales and customer interactions, firms have lost focus on a key principle of good sales and customer management:

People buy from people. Organisations do not typically buy from organisations.

Of course there are situations where organizations buy from organizations. Where the brand name is so strong, that purchases are made without strong personal contact. If nothing else, the events of 2008 taught us that blindly trusting brand names, especially in banking (that historically most conservative and "relationship" oriented business), is not necessarily wise.

The events of 2008 also taught many companies a harsh lesson in valuing the strength of relationships. As one banker commented to us: "We thought we had strong client relationships, but when times got hard we had some nasty shocks. Clients who had been with us for many years simply walked away."

The banks were the first to feel the impact, but in the new business environment, organizations across all industries recognize the growing need to refocus their efforts of evaluating and managing relationship strength.

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[4] Liljander, V. and Strandvik, T. (1994), "The Nature of Relationship Quality", EIASM Workshop on Quality Management in Services IV, Proceedings-Part II, Mame-La-Vallee, France, May 12-13, 1994.
[5] Schijns, Jos M.C.and Gaby J. Schröder (1995), "Segment Selection by Relationship Strength", University of Limburg, Maastricht.
6 Tracey S. Dagger, Peter J. Danaher and Brian J. Gibbs (2009), "The Interplay of Contact Frequency and Relationship Duration in Customer-Reported Service Relationship Strength", Journal of Service Research 11 (4), 371-388.

7 Berger, James T, (2006), "Thoughts on Relationship Marketing", The Wiglaf Journal.

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Taking this a step further, attributing value to the cumulative and inter-connected relationships of all the people in an organization; both internally (with colleagues) and externally (with customers, clients, suppliers and broader contacts) reflects an organisation's relationship capital.

The time is right for a renewed recognition that people do business with people – and in an environment where trust in corporates (and many public figures) has been undermined, a re-examination of the strength and value of relationships is critical to valuing the overall strength of a business and its future prospects.

What Relationship Capital is; and what it isn't.

We define Relationship Capital as:

The value of all relationships that all people within an organisation bring to that organisation

Further, Relationship Capital is calculated as:

The sum of the strength of each individual's relationships with other parties, with respect to each other party's degree of power and influence.

These can be relationships with suppliers, partners, ex-employees, nodes (people with high influence not necessarily associated with any organisation), or other functions within your organisation.

Factors to consider in calculating Relationship Capital include:

- power and influence of the other party
- type of relationship
- strength of relationship
- number of touch points on both sides

In accounting terms, Relationship Capital constitutes a key element of "goodwill" or intangibles. Goodwill reflects the difference in the valuation of organizations between say, their share price, and the value of their physical assets and current revenue streams. This difference in values is often explained by intangibles such as the value of the brand name; copyrights and patents; employees knowledge and skills and proprietary systems and processes.

Terms such as intellectual capital and human capital[8] have become a part of the every day corporate lexicon. Relationship Capital will surely follow.

Relationship Capital is not to be confused with social capital. According to Wikipedia, social capital has many interpretations: "Social capital is a sociological concept used in business, economics, organizational behaviour, political science, public health and the social sciences in general to refer to connections within and between social networks." While there are similarities with Relationship Capital, social capital typically derives from a social relationship (i.e. a non-work originated contact) and social capital is often characterised by the number of relationships as opposed to the quality of relationships.

[8] Schultz, Theodore W., (1961) "Investment in Human Capital", American Economic Review.

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Relationship Capital vs Social Capital

	Relationship Capital	**Social Capital**
Value ($) of relationship	High	Low
Type of relationship	Typically long-term	Typically short-term (transactional)
Depth	Deep	Shallow
Time and $ invested by both parties	High	Low
Physical contact	At some point	Not necessarily

Similarly, Relationship Capital is not related to Guanxi (meaning relationship in Chinese). The core concept of Guanxi in Chinese is "a personal connection between two people or a group of people (a network) in which one is able to prevail upon another to perform a favour or service, or be prevailed upon." As an art of social relationship, Guanxi has generally formed the basis of Chinese social value structure. In business however, it sometimes violates proper business norms and can lead to corruption.

The advent and popularity of social networking web-sites such as Facebook, Twitter and LinkedIn are also sometimes confused with Relationship Capital.

Such sites are proving popular not just with the Y generation and beyond, but with the C suite. People take pride in the number of contacts they have on these sites. It is starting to become almost a definition of one's importance.

The simplicity of such sites, a key reason for their rapid adoption, is also potentially their weakness when it comes to business relationships. They can be used to quantify the number of relationships a person has, but they do nothing to qualify the quality or strength of any relationship.

It is true that such sites do create relationships, but the relationships are typically superficial and socially oriented. Deriving value from these relationships is more difficult. Indeed, the sites themselves, while popular, continue to struggle to monetize their offerings. As Sergey Brin, co-founder of Google noted in late 2007, "I don't think we have the killer best way to monetize social networks yet."[9] One reason may be that while social networks measure the quantity of relationships, they do little to measure relationship quality.

Measuring the quality of relationships

	Relationship Capital	**Twitter**	**Facebook**	**Linked In**
Touch points	Yes	Yes	Yes	Yes
Power of other person	Yes	No	No	No
Influence of the other person	Yes	No	No	No
Type of relationship	Yes	No	No	No
Strength of relationship	Yes	No	No	No

Relationship Capital also differs from Social Capital and Network Capital in that it tends to apply in B2B (business-to-business) environments more than B2C (business-to-consumer), though many of the behaviours that drive successful B2B relationships are equally applicable to B2C relationships.

Relationship Security

If Relationship Capital is the value of all relationships to an organization, then Relationship Security is the extent to which all relationships, or any specific relationships are

[9] Gurley, Bill, "How To Monetize a Social Network", (2009), http://abovethecrowd.com.

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deemed to be secure. Relationship Security impacts the degree to which client/customer accounts are susceptible to attack by competitors and the degree of price sensitivity. Weakness occurs when relationships are either not strong enough; not with the right people; or not with enough people.

Similar to financial security, Relationship Security addresses the degree of risk - the extent to which you are vulnerable to loss e.g. of a customer. The greater the Security, the more secure is your relationship capital e.g. the ability to retain a customer and continue to derive value.

Regular review of Relationship Security allows for remedial action to be taken where security is low, thus preventing, or at least mitigating, the potential for a nasty shock.

The benefits of a focus on Relationship Capital

A focus on Relationship Capital delivers many benefits. These include:

- A better understanding of the organization's business sustainability.
- Early identification of significant accounts where Relationship Security may be weak and therefore the account may be under threat.
- Lower costs of winning work, since, "in general the cost of retention is far lower than cost of acquisition."[10]. Maister et al estimate that the cost of winning work from a new client is 4-7 times higher than winning more work from an existing client.[11]
- More profitable work because customers want to work with people they trust and so are prepared to focus less on price.
- Better matching of people to people e.g. matching sales reps to buyers on the basis of those best able to relate effectively. The better the relationship the more likely you have an environment in which clients/customers will buy from you.
- More word of mouth promotion and referrals.
- Lowering the likelihood of clients/customers switching to competitors. This makes it more difficult for competitors to enter the market.
- Happier customers lead to happier employees; improving staff retention and reducing hiring and training costs.

Given that an understanding of Relationship Capital and a focus on managing Relationship Security has so many benefits, why do so few organisations take the trouble to understand, measure and improve these key indicators of future business success?

First, it is not easy to measure.
Second, to improve takes concerted, organization-wide effort.

In later papers, we look at how to support the change that is required – both in terms of the technology which is now available to measure Relationship Capital and the ways that individuals, teams and organizations can work to improve their Relationship Capital.

10 Gupta, S and D.R. Lehmann, "Customers As Assets" (2001), p11.

11 Maister D et al, "The Trusted Advisor", (2005).

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About the authors

David Lambert and Keith Dugdale are the founders and principals of IOWEU International and co-authors of the best-selling business book *Smarter Selling* (FT-Prentice Hall (FTPH), ISBN 0273 712 462). IOWEU International promotes and manages the global application of the Relationship Capital through a range of training workshops, coaching programmes and consultancy services delivered by nearly 100 certified facilitators in over 20 countries. Contact IOWEU International via info@ioweu.com.

Patrick Boucousis is the founder and Managing Director of Traxor, an Australian company with a revolutionary new approach to Sales and CRM systems. Traxor Relationship Management reflects how business really gets done: person-to-person. It enables organizations to implement people-focused sales and support practices and to see markets and customers, not simply as "contacts", but as real people. Ultimately, Traxor enables organizations to gain the insights necessary to create and grow mutually rewarding business relationships.