Poor service actually a strategy to deter unprofitable customers
March 8th, 2007 @ 10:04 am by Andy

(This item is adapted from a news tip by my colleague Julia Ann Easley last week.)
The next time you get frustrated with a business for being a bit sluggish with its service, you might be playing into its strategy, according to Hemant Bhargava, a management professor at the UC Davis Graduate School of Management.

Bhargava says that companies wanting to deter unprofitable customers will intentionally create setbacks that impair the quality of service for those users. Netflix, America Online and FedEx have used this strategy, and it is common in the technology industries where firms offer all-you-can-eat pricing menus.

Bhargava explains that this business model, known as the “damaged goods strategy,” keeps high-end users from getting too much from a service. He published an article detailing this strategy in Electronic Commerce Research and Applications in October 2004. But the strategy has become more prevalent and publicized in recent months.

Netflix, for example, has been in the news with revelations, and even a lawsuit, about this practice. With their monthly rate for unlimited rentals, Netflix would rather not have customers who rent upwards of, say, 20 movies a month, explains Bhargava. In such cases, Netflix will specifically route these customers orders to more distant warehouses to delay delivery time, or will send movies that are not at the top of these customers lists, he added.

“Targeting these customers with a system thats modified to be inefficient appears expensive in the short term and damaging to the quality of Netflixs service,” says Bhargava. “But eventually it benefits the company by causing the unprofitable users to take their business elsewhere, which they couldnt do just by raising the monthly fee.”

Another prime example of the damaged goods strategy, and one that Bhargavas article focuses on, is
America Online’s requirement of a connection manager.

AOL required this proprietary software, which was incompatible with many other Internet applications and slows down the connection speed. It discourages “power users” who would take advantage of its flat-rate unlimited usage plan, but does not affect lower-end users.

Bhargava says these tactics can be seen in the way that a courier service offers various levels of speed of delivery. For example, he says, research has shown that FedEx will often delay a package with standard shipping, leaving it in a warehouse for a couple of days in order to maintain the value of premium delivery.

***Andy adds: Basil Fawlty was ahead of his time.

“Basil Fawlty, a frustrated, angry, short-tempered, super-snobbish misanthrope, is the very antithesis of the sort of person who should run a hotel, where a calm demeanour, winning smile, patience and a desire to make guests feel at home are the required attributes. But run a hotel Basil does....”

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One Response to “Poor service actually a strategy to deter unprofitable customers”

1. Ms. Clark Says: March 9th, 2007 at 2:32 am
   
   I don’t know why but the Fed Ex example seems really egregious. I would never have joined AOL not at any time, it’s just had a bad reputation for me, so that one doesn’t surprise me. I would think that netflix could make it less “all you can eat” by putting a limit of 15 or whatever they think is the maximum profitable number of DVDs, better than trying to trick their customers.

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