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COMMUNITY-BASED STRATEGIES IN ACTION: BUILDING AND SUSTAINING A PRODUCT DIFFERENTIATION ADVANTAGE

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Abstract

An important reason why individuals join groups or communities is to satisfy their needs for identity. Firms might exploit this societal tendency to gain a competitive advantage. Using the strategic approach adopted by Kiehl's, a U.S. cosmetic producer and retailer, as a source of inspiration and illustration, this paper develops a novel theoretical framework to investigate how firms interact with communities to access privileged customers' information, from which they can build a product differentiation advantage. We argue that by adhering and supporting a well-defined set of values, Kiehl's both achieves community membership and strengthens the sense of identity that its target communities provide to their members. These investments prompt reciprocal community member behaviors, which the company channels into its customer knowledge development process. Finally, this article describes how firm–community interactions can protect the differentiation advantage by turning products into symbols of the communities to which its customers belong.

Key words: product differentiation, customer knowledge development, communities, case study

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> *Each of us is committed to serving our customers and* ***communities*** *alike through the highest service standards.*
> —Kiehl's mission statement

INTRODUCTION

Perceived membership in a social group, henceforth a community, offers a sense of identity to individuals who see themselves as part of that group (Tajfel and Turner, 1979). Social identity theory postulates that, as a consequence of this perceived membership, individuals adopt behaviors that are consistent with the stereotypes associated with the group identity (Shih et al., 1999). As leading philosophy, sociology, and psychology scholars suggest (e.g., Castells, 2000; Gergen, 1991; Kumar, 2005; Lyotard, 1984; Vattimo, 1992), communities, i.e. social groups, have recently gained greater prominence as alternative sources of identity in an epoch characterized by a certain degree of incredulity about traditional values and greater demand of heterogeneous sources of meaning.

Firms have not remained mere observers of this trend. Companies increasingly participate in diverse actions – such as corporate giving, strategic philanthropy, social sponsoring, corporate citizenship – aimed at interacting with the communities they affect or are affected by (Lakin and Scheubel, 2010; Marquis et al., 2007), as communities not only exert institutional pressures on firms (Calvano, 2008; Julian et al. 2008; Marquis et al., 2007) but also offer intriguing opportunities for establishing and defending a competitive advantage.

Building on these premises, this paper aims at developing a novel theoretical framework to study how firms might create and appropriate value by interacting with communities. We refer to "community-based strategies" (henceforth, CBS) as the set of actions and activities that a focal firm undertakes to establish its connection or relational link with one or more communities, with the goal of building a competitive advantage. Specifically, we shall focus on the interaction with those communities to which a firm's customers belong. Thus, an implicit assumption of our research is that a firm's customer base (or part of it) is intentionally or unintentionally formed by individuals who belong to communities from which they derive group identity. Grounding on this assumption, we investigate how the interaction with communities improves the process of customer knowledge development (Cooper and Kleinschmidt, 1995), which involves the transfer of relevant information from customers to the firm’s production site. Such information is crucial for the success of new product development (NPD) projects, because it enables the firm to tailor its product portfolio to its customers’ needs and expectations. Moreover, more precise information about customer preferences reduces the cost of product failures, which account for a significant share of the overall NPD budget.

Our proposed model of product differentiation depicts firm investments in community interactions as a starting point. Because these actions align the firm’s and the community’s values and help strengthen the firm’s role as an identity provider, community members come to recognize the company as part of their group and express greater willingness to reciprocate the benefit of receiving this identity. We argue that firms can leverage this reciprocity mechanism to access privileged information about community members’ preferences and thus achieve a competitive advantage. By employing this information, firms develop products that not only match customers’ expectations but also become symbols of the community that manifest its underlying values. This particular relationship of product–symbol–community increases both customers’ fidelity and their willingness to pay, and thus guarantees the long-term sustainability of a firm’s competitive position.

We use a case study describing Kiehl’s, a U.S. cosmetic producer and retailer, to inspire, motivate, and illustrate our proposed framework. As our aim is to develop a theoretical model, the case study cannot, and should not, be read as an empirical test, but rather as a theory enabling mechanism (Danneels, 2003; Daneels, 2010). Indeed, since the phenomenon under scrutiny, i.e. CBS, is both complex and emergent, its investigation requires a more holistic perspective. Case study research allows for the development and extension of theoretical concepts (Yadav, 2010; Eisenhardt, 1989) and thus provides the ideal basis for our goal. Kiehl's embraces a unique strategic differentiation approach that we posit reflects its CBS. The company began as a small pharmacy located in the East Village of New York; now it is a multinational company and part of the French group L'Oreal, with more than 200 shops in 34 different countries, that has become one of the world leaders in beauty and health products.

This study contributes to the following research streams. First, this paper develops a novel framework to address a key research question in the strategy field: the sources of competitive advantage of companies. It illustrates how firms can develop rare and difficult-to-imitate resources by establishing a commitment or relational link with those communities to which their customers belong. This engagement with communities has led Kielh's to both develop a more focused and efficient product pipeline and increase its customers' willingness to pay for its products. A better understanding of these mechanisms helps dig deeper into the origin and sustainability of a differentiation advantage.

Second, this paper adds to the recent literature on customer co-creation (Ernst et al., 2010). Building upon von Hippel's work on user-driven innovation (e.g. von Hippel, 1998), this research stream suggests that the firm-centered paradigm that views NPD as a fully internal process has been gradually replaced by a model in which empowered customers take a more active role in the NPD process (O'Hern and Rindfleisch, 2009). In this way, new product ideas can be generated that are more likely to be valued by consumers, thereby increasing the likelihood of new product success. For instance, Fuchs et al. (2010) show that the integration of customers into NPD processes generates psychological effects on consumers' product demand; that is, just because the customer has participated in the product selection process he/she assigns higher value to the product. In this paper, we present a novel complementary mechanism through which such participation is triggered—the reciprocal response in exchange for the provision of community identity; this elicits a different explanation for why firm products that respond to community needs command a higher price margin. Most importantly, our level of analysis is the community and not the individual consumer. We believe that this different level of analysis and the key role played by group identity are the main differences between our model and the current literature on customer co-creation.

Third, this work is also related to the existing literature on brand communities (see, among others, Muñiz and O'Guinn, 2001; McAlexander et al., 2002), but differs from it in two important aspects. First, as explained in greater detail below, we refer to communities as providers of identity in broader terms. Such communities can exist independently of the focal firm or brand. Thus, our theory can be applied in domains in which the grounds of identification are not represented exclusively by brands. Second, our focus is not on how relationships within communities originate and evolve, but rather on how firms contribute to, interact with and ultimately benefit from communities (Schau et al., 2009). Thus, community formation remains in the background of our model (i.e. it is taken as exogenous) while we attempt to explain how firm community engagement can lead to a sustainable competitive advantage.

The paper is organized as follows: section 2 reviews the literatures on NPD and communities; section 3 explains our methodology; sections 4 and 5 develop our theoretical framework; and section 6 concludes by discussing the implications of our research.

BACKGROUND LITERATURE: NPD AND COMMUNITIES

Accessing customers' information to improve NPD strategies

Our theory finds its natural setting in those sectors in which differentiation advantage plays a major role. Firms gain a differentiation advantage when they can increase customers' willingness to pay for their products (or services) beyond the cost of the investment required to create the differentiated offering (Porter, 1996). A standard differentiation advantage stems from supplying products that fit customers' needs better than do competitors' offerings (Villas-Boas, 2009). Thus, a successful NPD strategy must attain information about the segmentation of the market (Sanchez and Mahoney, 1996), including the number of product segments and which segments can support a sustainable business model due to their willingness to pay or size (Yahaya and Abu-Bakar, 2007). Such information normally resides within a firm's (potential) customer base, because customers know (or should know) their specific needs and circumstances. The NPD process therefore inevitably contains uncertainty, because the firm possesses only a subset of the relevant information. As a result, many product launches suffer unsuccessful results (Ding and Eliashberg, 2002).

To improve NPD success rates, a firm must access customers' information and use it in a process known as customer knowledge development (Cooper and Kleinschmidt, 1995). This process is complex for several reasons (Joshi and Sharma, 2004). First, firms must identify their ex-ante potential customers before launching a product, which creates customer selection biases. Second, customers might have an unclear idea of their needs, which prevents them from identifying product characteristics they might desire (Simonson, 2005). Preferences generally result from a process of trial and error and continuous feedback (Loch et al., 2008); only by testing several products can customers identify those that best fit their idiosyncratic needs. However, information about the feasibility of potential products resides with the firm or its production unit. In short, "it is not easy to transfer 'sticky' customer preference information from a customer to a producing company" (Franke et al., 2009: 104).

Marketing literature has analyzed several mechanisms to move information from customers to production, though all of them suffer from costs and measurement errors (Franke et al., 2009). Prelaunch surveys and questionnaires can collect information about desired product features, unsatisfied consumer needs, and willingness to pay, but these costly techniques do not resolve the uncertainty about ex-ante customers' selection and their "real" preferences, which makes them noisy and biased (Simonson, 2005). Alternatively, the firm can gather suggestions and other related information from customer satisfaction surveys, but this option entails an ex-post correction of extant production decisions and likely induces high costs associated with adjusting the product portfolio and time to market delays. Finally, Bhattacharya et al., (1998) suggest that to cope with uncertainty about consumers' preferences companies should run several NPD projects simultaneously, develop only those that succeed, and cull the others (Sorenson, 2000). However, as we noted previously, learning about customer preferences in the post-launch phase entails higher costs, as well as strategic risks and firm reputation concerns derived by product recalls (Cooper and Kleinschmidt, 1995).

Differently, innovation literature has suggested that the locus of problem solving might move from the production site to users (von Hippel, 1998). That is, the firm could transfer its problem-solving knowledge to its customers, then task them with creating prototypes or customizing product features to meet their specific needs. However, such open innovation approaches move valuable knowledge outside firm boundaries and increase the risk of imitation by competitors (Laursen and Salter, 2006).

Inspired by von Hippel's work on user-driven innovation, a recent stream of the literature has developed around the notion of customer co-creation, that is, *"a collaborative NPD activity in which consumers actively contribute and select various elements of a new product offering"* (O'Hern and Rindfleisch, 2009: 4). Our work falls within this research line, and extends it by proposing that information transmission from customers to the firm is channeled through the firm-community interaction. As such, we do not analyze consumers individually but as member of communities from which they derive identity.

Communities as providers of identity: Values, symbols, and reciprocity

Broadly speaking, a community is any group in which members share common conditions (Calvano, 2008; Hillery, 1955), such as specific needs, shared interests, or common geographical locations.[4] Many communities serve as identity providers, such that members seek to belong to them to satisfy their needs of identity. In this paper, our definition of community is borrowed from social identity theory. We define a community as a social group in which perceived membership offers a sense of identity to individuals who see themselves as a part of that community (Tajfel and Turner, 1979). When an actor participates in community activities, he or she implicitly or explicitly verifies the values associated with that community and thus derives an identity (Rowley and Moldoveanu, 2003).[5] As social scholars note, this form of identity provision has become the main *raison d'être* of many communities (Dunham et al., 2006; Fosfuri et al., 2009; Penn and Zalesne, 2007). The increasing role of communities as identity providers may relate to contemporary transformations in

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[4] "A community is made up of its member entities and the relationships among them. Communities tend to be identified on the basis of commonality or identification among their members, whether a neighborhood, an occupation, a leasure pursuit, or devotion to a brand" (McAlexander et al. 2002: 38).

[5] Tajfel and Turner (1986) describe the process of group identity formation through categorization, identification and comparison. Categorization occurs when an individual chooses to participate into groups with particular characteristics that help defining her self-image and self-perception. Identification is the process of identity formation through active group participation. In-groups are the groups we identify with, whereas out-groups are those ones we do not identify with. Finally, through comparison an individual compares and exploits group membership to derive social differentiation.

Western cultural and social lives (Gergen, 1991; Kumar, 2005; Lyotard, 1984; Vattimo, 1992). That is, the demand for new and more varied forms of identity by society (Gergen, 1991; Inglehart, 2000) has produced an eruption of identity fragmentation, as is well documented by empirical researchers (Ger and Belk, 1996; Smith Speck and Roy, 2008).

A survey of the relevant literature underscores three key features of communities: values, symbols and reciprocity. Communities that are primarily a source of identity to their members emerge from a kernel of shared values that help members forge their personal sense of self (Hitlin, 2003; Taylor, 1989). People participate in communities because they recognize the communal values as their personal ones and internalize them to shape their identity (Smith, 1991). For example, by participating in an association that fights cancer, members identify with values such as solidarity and patient care. Thus, values are crucial to enable the process of categorization, a key component of group identity (Turner and Tajfel, 1986). Values also help establish the boundaries of a community (Rowley and Moldoveanu, 2003), and therefore sustain the process of identification (Turner and Tajfel, 1986). Members of communities often use symbols to reassert and recognize their community identity, because symbols represent expressions of the community's core values and confer cohesion in terms of their representation. Wearing a plastic bracelet with a slogan identifies the wearer as a member of a particular association, which has specific values shared by all its members. Other symbols such as slogans, products, and rituals also serve to define the community's boundaries and differentiate members from nonmembers. The greater the differentiation in symbols, the stronger is the identity that the community can provide its members (Rowley and Moldoveanu, 2003).

Whereas values and symbols explain identity formation in a community, through categorization and identification, reciprocity guarantees its functioning and long-term survival. Reciprocity indicates that members of a specific community exert personal effort and engage in non-stipulated actions to reciprocate the community's provision of identity (Anthony, 2005; Heckathorn, 1996; Turner and Tajfel ,1986). Members reciprocate because they expect other actors to take actions that reinforce the community identity or because they believe they must reward others for contributing. Donations to and participation in community events offer archetypal examples of reciprocal behaviors by community members.

Finally, identity, values, symbols, and reciprocity are highly interrelated. Those communities that provide greater identity to their members (through their values and symbols) are characterized by a higher degree of reciprocity, which triggers their effort, participation, and commitment, which in turn contribute to strengthen the community values and thus reform or reinforce the shared identity. We will use these constructs as lens to interpret Kiehl's case and develop our theoretical framework.

METHODOLOGY

Case study selection and data collection

As our methodological approach, we use data gathered from an in-depth case study to conceptualize and extend existing theory. This is particularly appropriate in our context as we attempt to study a phenomenon that is both complex and emergent, and for which a holistic theoretical framework has not yet been developed in the extant literature (Yadav 2010; Eisenhardt 1989). The underlying process consists of examining relevant literature, confronting it with data we collect, identifying gaps and flows, and finally extending prior theory (Danneels, 2003; Danneels, 2010).

We focus on the cosmetic and toiletry chemical sector because key success factors in this industry are new product proliferation, the discovery of new market niches and the construction of the best product portfolios (Jones et al., 2006). The worldwide market is estimated at around 200 billion dollars (*PR Newswire,* 2009) and is characterized by a group of large competitors and several specialized minor players. From the Osiris dataset, we identified 137 companies listed under the SIC code 2844, with the three largest, L'Oreal, Colgate-Palmolive and Avon, accounting for about 50 billion dollars revenues in 2008, a quarter of the worldwide market. The rising segment of this industry, with double digit growth rates, is the so-called "cosmeceutical" that is formed by cosmetic products with biologically active ingredients purporting to have medical or drug-like benefits (*Advertising Age,* 2005). Cosmeceutical constitutes an appealing setting for our research as segmentation uncertainty is high and competitors are increasingly hitting the market with new products that try to spot and conquer all profitable niches. We then chose Kiehl's as our case study subject because it is one of the market leaders in cosmeceutical, and it has developed an efficient process of customer knowledge development that supports its successful NPD strategy. We argue that by leveraging its customers' needs to belong to communities and confirm their identity, Kiehl's engages in investments, strategic choices, actions, and activities that expose how CBS can create a differentiation advantage.

First, we gathered firm data and information from several secondary sources.[6] An important part of our information comes from Kiehl's Web site, including the historical development of the company, product information (e.g., releases, price changes, and termination), and its strategy. We used an Internet archive (http://www.archive.org) to gather information from older versions of the site and therefore have monthly up-dated data from 2005, the year Kiehl's first published a Web site, through 2009.

Second, we gathered data from PROMT (formerly Predicast), a data set that reports on several categories of events, classified by industrial sectors, taken from trade journals, magazines, and other specialized press media. We downloaded all articles with the name "Kiehl's" in the text from 1999 (first year available) to 2009. For the 523 resulting articles, we classified and read the information according to the type of content, such as firm history, corporate social responsibility announcements, marketing, financial or production descriptions, and human resources events. The most common journals that appeared in this search were *Women's Wear Daily (WWD)*, *Cosmetic International*, *Product Alert*, and *Advertising Age*.

Third, during the period October/December 2009, one of the authors has repeatedly participated in Kiehl's blogs and social networks (e.g. Facebook, Twitter) analyzing and classifying the different interactions and information exchanges between the firm and its customers. At the end of each session, memos containing the main insights the researcher achieved during her participation to the blogs and social networks were generated. This activity ended when new memos did not bring any additional insight.

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[6] Kiehl's was not publicly traded before its adquisition by L'Oreal and the French conglomerate does not publish disaggregated information, thereby we cannot count on financial statements and stock market data for our analysis.

Finally, to assess how the broader public perceives Kiehl's image and strategic positioning, we used Search Engine Google Blogs (blogsearch.google.com) to search blog contents on the Internet. This allowed us to compare the frequency with which some keywords appeared in blog posts in conjunction with the name "Kiehl's" *vis-à-vis* the names of some other firms in the cosmetic sector.

Second, these secondary data sources were supplemented with 6 semi-structured interviews with managers and shop assistants at two different Kiehl's store locations in Milan, Italy, and one in Madrid, Spain, from September to December 2009. The interviews followed a questionnaire that contained 34 open-ended questions, divided in four main sections: personnel selection, training, relationships with customers, and community and values. One author first created this questionnaire independently, then the two other authors revised it autonomously and sequentially. The revision process ended when all three authors reached a consensus about the questions. All interviews were preceded by several emails exchanges, they lasted around an hour, and were recorded (available upon request).

We used the extended case method approach to move back and forth from the theory to the data. This process consists in many cycles of confrontation between data and theory, which lead to the search of new data as the research unfolds, and the development of new concepts and theories (Danneels, 2010).

Kiehl's history

In 1851, John Kiehl established a small apothecary in the East Village in New York, preparing and selling classical drugs and more exotic cures (e.g., virility creams, baldness treatments) onsite, in response to clients' demands. In 1921, Irving Morse, a former apprentice at Kiehl's with a pharmacology degree, bought the firm and transformed it into a modern, full-scale pharmacy with a more structured line of proprietary products. His son Aaron created the modern Kiehl's identity when he took the helm in 1961; he geared the company toward natural health-care products, some of which (e.g., Blue Astringent, Musk Oil) quickly became famous in the East Village. As the company's mission statement indicates, Aaron Morse regarded improving the quality of life of his East Village community as critical. He transformed the shop by adding a small library, coffee shop, and makeshift museum featuring photographs, tools, and objects to attract consumers' attention.

Aaron's daughter Jami and her husband Klaus, who took charge in early 1990, separated the production laboratory from the shop and started introducing products for sport customers (Klaus was a professional skier). From 1995 to 1999, as the East Village became a fashionable address that attracted actors, novelists, rock stars, and athletes, demand for Kiehl's products grew dramatically, as did the company's production and logistics bottlenecks. These problems motivated it to enter into a 2001 deal with the French company L'Oreal, which acquired Kiehl's for US$80–150 million.

After the acquisition, L'Oreal's strategy for Kiehl's consisted of three main points: (1) maintain the independence of Kiehl's, its product heritage, and its philosophy; (2) support Kiehl's production and logistics through L'Oreal's resources; and (3) replicate and scale Kiehl's model to an international level and open shops in several big cities, first in the United States and then abroad. Today, Kiehl's is a multinational company with a presence in more than 30 countries and more than 200 shops. Some of the downsides of this growth strategy are discussed in the final section.

MOVING THE LOCUS OF INFORMATION

In order to facilitate the reading of the case, we anticipate here the four-step model of a customer knowledge development that emerges from our research (Figure 1). It depicts how firms can move the locus of information from customers to their production units by investing in values that provide identity to community members and leveraging their reciprocal behavior.

[FIGURE 1 ABOUT HERE]

As an underlying assumption, our model holds that a significant fraction of (potential) customers of a focal company are members of communities that provide them with a shared identity. This association might result from coincidence, such as when several members of a given community happen to purchase from the focal firm, or it might reflect a deliberate decision by the company to include community members within its target market. Kiehl's was initially located in the East Village and thus almost unintentionally appealed to the crowd that populated this specific area of Manhattan.[7] Later though, its choices and investments targeted specific communities and the values on which they built their link through a shared identity. As one of the shop managers we interviewed noted, "it is very important to create a *neighbor* spirit where the shop is located."

Table 1 provides some evidence consistent with the notion that the engagement with communities is more critical for Kiehl's than it is for some of its competitors. We confront Kiehl's with three large brands in general cosmetics (Clinique, Shiseido and Givenchy) and with three small firms specialized in cosmeceutical (Nuvilex, Wellquest and Nia 24). Indeed, this table shows that during the period 2007-2009 22,4% of all blogs in which the name "Kiehl's" appears at least once, we can also find words like "Community", "Group", "Family", "Friend", "Belong", "Identity", "Unity" (and variations of them). This share is instead less than 17% for any other competitor.

[TABLE 1 ABOUT HERE]

Investment in values to interact with communities

According to Figure 1, the first step for a company that wants to interact with a community is to gain recognition as a "member" of that community. To do so, it must engage in actions that align with the values of the community. Our various sources of information suggest three general values that represent Kiehl's investment targets: (1) equality and human rights, (2) health care issues, and (3) environmental awareness. To support these values, the firm undertakes two types of strategic actions, namely, sponsorship of charity events and campaigns to donate sales proceeds to socially responsible causes. These actions are communicated through several means like, for instance, posters in Kiehl’s shops, the company web site, Twitter, Facebook.

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[7] Starting in the 1960s, the East Village began attracting artists and hippies and became the center of a liberal, postmodern counterculture; it also has a reputation as the birthplace of artistic movements.

First, in the defense of equality and human rights, Kiehl's has raised money for Heritage of Pride, a nonprofit group that organizes lesbian, gay, bisexual, and transgender pride activities in New York. In 2007, a fundraising event at the flagship store featured cocktails, music, and a kissing booth with models. Since 2004, Kiehl’s has organized the Bad-Water Ultramarathon to attract funds to support the Challenged Athletes Foundation, a charity that provides grants directly to athletes with physical disabilities. Finally, in 2008, the company collaborated with Sandy Lam, a Chinese singer, to support the Watchdog Early Learning and Development Centre in Hong Kong, with the aim of providing a preschool program for developmentally delayed children under the age of six years.

Second, with regard to health issues, on Worlds AIDS Day in 2005, Kiehl’s organized a two-hour shopping event, marked by speeches and advertising about AIDS prevention. All sales proceeds during the event were donated to nonprofit organizations dedicated to AIDS awareness. Other examples of initiatives in which Kiehl’s donates a fixed share of its product revenues to a particular organization include its Grapefruit Cleanser and YouthAIDS (this initiative has donated more than $300,000 to the AIDS prevention organization) and Suncare Cream and the Breast Cancer League.

Third, Kiehl’s is a paradigm of an environmentally committed firm. In 2006, it cooperated with and sponsored the Natural Resource Defence Council’s efforts to raise awareness about global warming through civil actions and demonstrations. In 2009, together with YAWA, a Malaysian youth foundation, Kiehl’s launched the “Save Our Rare Earth” Biodiversity Eco-Camp in an attempt to instill environmental awareness in young people. Currently sales of Kiehl’s Aloe Vera Biodegradable Liquid Body Cleanser invoke donations to JPF Eco Systems, an environmental organization supported by Brad Pitt.

These initiatives establish, in most cases, the first contact between Kiehl’s and the potential customers and signal its role as a contributor to and member of those communities that embrace the specific values supported. Thus, Kiehl’s interactions with its target markets involves adherence to the values on which its (potential) customers' communities build their shared identity and, as a result, the company gains identification as a community member. It is worth noting that the three general values Kiehl's embraces are not in conflict; communities that care about civil rights improvements and equality often are concerned about environmental and health care issues too. Communities focused mainly on one of these values should be sympathetic toward and support and recognize the other values as well. In this sense, according to a Kiehl's store manager, "Local fashions and idiosyncrasies can influence a shop's management practices, but they never condition Kiehl's values…. They are universal.… They are shared by different communities around the world.... They are a *fil rouge* [common thread] that links America, Europe and Asia."

In short, our data show that Kiehl's investments do not target one community but rather a group of values. These values then attract communities that perceive them as representative of their membership. The values are sufficiently differentiated that they appeal to several communities, but they align enough that they do not create tensions, such that support of certain values would generate hostility and discrimination among customers who belong to other communities.

Reciprocity and information revelation

When a firm signals that it is a member of a community by implementing initiatives that support and strengthen community values, it becomes a positive contributor to the identity that the community provides to members (Fireman and Gamson, 1979). In turn, community members are willing to reciprocate because they receive the benefits of a well-defined identity. According to Figure 1, a focal firm can exploit this willingness to enhance its customer knowledge development process.

First, as community members, consumers tend to be more responsive to the firm's questionnaires or surveys and exert more effort to offer their best approximation of their needs and expectations about products, because they consider the firm part of their community. Due to a sense of reciprocity, they try to provide more and more refined information to the company. Second, firms might exploit reciprocity by asking their customers to test products and provide additional feedback about new product ideas. In this case, reciprocity plays a fundamental role, because revealing information is costly for the customer, insofar it requires effort and time. A customer who enters a Kiehl's shop likely identifies the company as a supporter of his or her community and feels obliged to contribute by revealing preferences, consciously or not. "When you become part of the Kiehl's world, automatically you become a client.… Most customers take their friends to our stores to enliven the same experience…. If someone helps the individual, he feels integrated in the community.… We try to extract the largest amount of information from our customers concerning the product offer" (shop assistant).

Table 1 provides some numbers that suggest that reciprocity plays a greater role for Kiehl's than it does for other firms in the same sector. Indeed, this table shows that during the period 2007-2009 the share of all blogs in which the name "Kiehl's" appears in conjunction with words such as "Reciprocity", "Give back", "Feedback", "Contribute", "Suggest", "Mutual", "Propose" (and variations of them) is 0.244. This share is instead less than 0.11 for any other firm reported in Table 1.

Shops become crucial information gatekeepers, and many elements of Kiehl's strategy attempt to facilitate the communication process between customers and the firm. From our data analysis, we identify three complementary investments that facilitate this process: (1) shop assistant training, (2) architectural designs, and (3) free product sampling. These elements are carefully considered and planned, according to vice-president and general manager Kristin Armstrong: "We are in complete control of our environment, our service level, our education" (*Flare,* 2004: 94).

Shop assistants undergo a three-week training course to learn how to "diagnose" their customers. Nearly 10% of Kiehl's compensation budget goes to training (*Fast Company,* 2005).[8] The employees adopt an almost medical approach, focused on providing solutions to customers' problems. The shop assistants usually wear white medical coats and "talk to each customer as an individual, working to recommend the products that are best fitted for their needs and preferences"

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[8] In Italy, one week of intensive training was followed by four weeks of on-the-job training, during which the employee was constantly supervised, tutored, and advised. Furthermore, "Most of our assistants were Kiehl's customers before becoming assistants" (shop manager).

(*Business Wire,* 2008: 8). By "hugging the customer," the employees gain an understanding of each customer's problems, create a one-to-one relationship, and aim to provide the best solution with "honest and straightforward products" (*Advertising Age,* 2004: 34).[9]

The architectural design of the shop also functions to support the information gatekeeper role. The shops are even called "laboratories which allows [Kiehl's] insight into customers, and give back to [Kiehl's] community. [Kiehl's] offers a place to come and hang out, to keep the social aspect of the neighbor alive" (*WWD,* 2003: 11). Most shops feature a motorcycle to make male clients more comfortable, chairs and couches, free magazines and coffee, and relaxing music. Moreover, they are usually located in informal, central, popular locations that resonate with the original East Village experience, so "it is extremely important for us to find the proper location" (*WWD,* 2003: 11). Shops show images and posters of recent sponsored events, which constantly remind Kiehl's customers of the founding values of the company.

Finally, Kiehl's offers massive amounts of free product sampling in shops. For every item, Kiehl's provides a trial-sized version that customers can and are strongly encouraged to try (*Drug Store News,* 2001). The "try before you buy" philosophy is an important component of the company's strategy to include customers in the evaluation and improvement of each product. Kiehl's gives away more than 12 million packets of product a year (*Fast Company,* 2005), in line with its belief that "Sampling is a way to address [customers'] distinctly individual skin, hair or face care needs" (*The Wall Street Journal,* 2002: 17).

While these types of investments are not new in marketing strategy, what is novel in Kiehl's approach is the focus on the values and ultimately on the communities associated with those values. Indeed, these investments are meaningless without the reciprocity triggered by the provision of identity. Kiehl's customers are cooperative, willing to reveal information, and happy to spend time in the shops—especially men, who stereotypically are reluctant to dedicate time to shopping-related activities (men represent almost 40% of Kiehl's customer base, *Forbes,* 1996). Shops also provide meeting points for community members, such that the perception of shared values and the power of its symbols become stronger, because the community values get evoked across a broader set of situations, and the symbols gain greater visibility (Laraña et al. 1994).

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[9] This task is also carried out through its page in Facebook and Twitter where customers ask for specific products for particular needs and Kiehl's answers with suggestions and recommendations.

Compared with traditional approaches to extract customer information, CBS offer two key advantages. First, the information tends to be less noisy and more representative of the overall customer base, because the ex-ante investments in particular values prequalify potential customers using unbiased criteria. The choice of values that constitute the core of a community usually creates an endogenous selection of the potential members. With less variance in the information extracted, firms can reduce the probability of errors in interpreting and using this information. Conversely, if it simply pays random testers for their feedback, the firm runs a severe risk of gaining feedback from consumers who self-select and emphasize features that are not critical to most of its customer base. Second, customers who help the company because they feel obliged to reciprocate for the identity they receive are more likely to identify product features that interest the community they represent. That is, they consider the community, not just themselves as an individual.

CREATING AND PROTECTING A DIFFERENTIATION ADVANTAGE

CBS outline a unique avenue for building relationship-based, intangible assets, because they depend on the firm's interaction with the target community(ies) (Wood and Jones, 1995). The resulting intangible assets are idiosyncratic to the particular relationship between the firm and the community(ies) and thus represent a useful construct for explaining performance heterogeneity across firms (Zucker, 1986) as specific, valuable, rare, and difficult to replicate features. In our study context, community members' need to reciprocate confers a first-mover advantage on the firm, because only the firm that develops this intangible, relationship-based asset can access the relevant information on product segmentation. When a firm establishes itself as central to a given community, it becomes very arduous for other firms to displace it and to access the same information. Competitors can access the disclosed information only after the focal firm has started to incorporate it into its product offering.

As we depict in Figure 1, after it accesses the information, the firm needs to implement its product differentiation strategy by launching new products (Step 3). For Kiehl's, the information gathered in the shops moves on to a committee of experts, including L'Oreal's pharmaceutical engineers and academics, who attempt to determine solutions and responses to these customer requests. According to one store manager, "Especially during the launch of new products, when we have feedbacks from the customers, positive or negative, we insert them in a report to pass to the headquarters: it is a bottom up process…. The clients' information regarding a new product is fundamental for us. Their impressions, suggestions and answers are expressed in a monthly report that goes directly to the U.S. headquarters…. We constantly transmit to our clients that their perceptions and opinions about the products are taken into account and are very important for us." Another manager clarified in an interview: "Our mission is to give our customers exactly what they want.… We are always very attentive to our clients needs and develop products that have been specifically required by them." An interesting aspect of this process of information extraction is the weight the company assigns to different sources of information. The highest priority is given to customers' feedback obtained in Kiehl's landmark shop in the East Village. Information from sites located in malls or department stores and that obtained through online channels, like blogs and Facebook, receives lower priority. Occasional customers, who enter Kiehl's shops by chance, are also typically not used as a source of information for NPD.

Kiehl's—or more precisely, L'Oreal—relies on a modular production process to create different products that combine various ingredients. From 2005 to 2009, it employed 132 different basic ingredients to produce 209 different products. The most common 10 natural ingredients (e.g., vitamin E, avocado oil, sesame oil) constitute 35.4% of the overall products. This modular approach has two advantages: It reduces time to market, which enables the company to respond quickly to the needs of its customers, and it keeps production costs low.

Our product dataset reveals that in 2005, Kiehl's offers consisted of 126 different products; in 2009, it had increased to 179 products, for an annual increment of approximately 9.4%. Kiehl's products represent five niches, classified by targets (baby, body, face, hair, and fragrance); each niche comprises several sub-niches that have evolved in the process we depict in Table 2. Kiehl's product offers appear well adapted to its communities and not isomorphic compared with those of competing firms. For example, Kiehl's has no makeup products (cf. Clinique and Shiseido, which offer approximately 100 different makeup products), has introduced only two recent perfumes (cf. Givenchy and L'Occitane, which sell more than 15 fragrances), and embraces deep products lines within the face, hair, and body niches. "Our product offer is completely different to that of our main competitors" a shop manager stated. Kiehl's products target peculiar needs that emerge from the interaction with customers like, for instance, the "Unusually Rich But Not-Greasy-At-All Hand Cream", "Facial Fuel Anti-Wrinkle Cream", "Facial Healthy Bronze". Recently, they have also added some pet products in their offering like shampoos and conditioners for dogs and horses, something unusual for a cosmetic business.

[TABLE 2 ABOUT HERE]

As soon as Kiehl's supplies its products to the market, its information becomes public knowledge, which rivals could use to obliterate its competitive advantage. Two reasons demonstrate why this copycat strategy is not likely to succeed (Step 4, Figure 1). First, customers likely feel obliged to stay with the company, even if other firms offer competitive products, because of their sense of reciprocity. Second, the firm should be able to establish its products as symbols of the community's identity. Selling products that represent identification symbols creates greater fidelity and increases the customers' switching costs, because the act of buying indicates their affiliation with a community and distinguishes them from other consumers. Because community members have provided the product information, once it gets incorporated into the firm's product offer, the resulting products likely provide representations of community values.

Kiehl's generally tries to attach emotional and empathic meanings to its products. As Philip Shearer, the general director of L'Oreal, recognizes, "Kiehl's has the special characteristics of being a cult brand with roots," such that buying from Kiehl's entails an "experience" that "creates excitement" (*Drug Store News,* 2001). Kiehl's products inspire "an almost religious fervor" (*The New York Times,* 2001: 96), including blogs that describe "my excitement when I heard through the grapevine what Kiehl's was creating" (shedoesthecity.com) or "my excitement when I put the Kiehl's bio Peel on my face" (ciao.co.uk). The company has sown "an air of exclusivity to the product assortment and an authenticity in the experience of shopping" (*Drug News Store,* 2005: 12) by "cultivating [customers'] relationships into fidelity" (*WWD,* 2002: 6) and appealing to its loyal clientele. Moreover, to stress the association between products and symbols, products are sometimes linked directly to a particular value (for instance, Biodegradable Liquid Body Cleanser is linked to JPF Eco Systems, an environmental organization supported by Brad Pitt).

As elements of the communities' symbolism, Kiehl's products therefore manifest their shared values. Thus, the firm provides increased support toward communities' identity. It not only invests in the values that give identity and cohesion to the communities but also redefines or reinforces those values by creating physical manifestations of them. In turn, consumers sense an even greater demand for reciprocity, thereby reinforcing the mechanisms that created the firm's sustainable competitive advantage in the first place.

There are several indicators of the benefits that the CBS applied to customer knowledge development grants to Kiehl's: sales growth, higher margins, and fewer product culling. Kiehl's has experienced an average growth rate in sales of about 23% annually in the last 5 years; it opened more than 200 shops worldwide in the last 7 years; and 6 years after its acquisition it already represents 8% of L'Oreal business (*Households and Personal Products Industry,* 2008). The CBS enables it to charge higher prices, prompting analyses that note, "This is high-end stuff. A moisturizer fetches $68.50 for 32 ounces; this isn't your ordinary cosmetics line" (*Forbes,* 1996: 74). Cosmetic consultancies estimate its price margins to be approximately 40%, similar to luxury brands like Gucci and Louis Vuitton. According to the Osiris database, during the period 2005–2009, the top 20 health and beauty firms (SIC code 2844) earned profit margins of 11.2% and returns on assets of 12.3%. In Table 3, we also document the evolution of the prices per ounce of Kiehl's products by niche; the mean and dispersion remain quite constant over time, though the body and face niches register the highest values for both statistics.

[TABLE 3 ABOUT HERE]

Moreover, by extracting precise information about demand segmentation, the CBS reduces product culling and its associated costs. According to our dataset, the average annual percentage of new products as a portion of the total product portfolio is 20.1%, and it culls only about 12.9% of its new products. A shop manager commented that “it’s very unusual that we have to retire a product. Every new product launch has been profusely planned and designed following the suggestions of our customers”.

Table 1 reveals that during the period 2007-2009 the share of all blogs in which the name “Kiehl’s” appears in conjunction with words such as “Symbol”, “Ritual”, “Tribal”, “Cult”, “Enthusiasm”, “Excitement”, “Fervor” (and variations of them) is 0.056. This share is instead less than 0.035 for any other firm reported in Table 1.

CONCLUSION AND MANAGERIAL IMPLICATIONS

Inspired by the increasing tendency of individuals to seek identity through participation in communities, we proposed a novel theoretical framework to explain how firms can exploit this societal trend and build a competitive advantage. Specifically, we focused on the interaction between firms and communities as a potential mechanism for obtaining a product differentiation advantage (Porter, 1996; Cooper and Kleinschmidt 1995). By relying on the case study of Kiehl’s, a U.S. cosmetic producer and retailer, we illustrated the importance of investments in values that represent the core of communities to which customers of the firm belong. By adhering and supporting a well-defined set of values, Kiehl’s both achieves community membership and strengthens the sense of identity that communities provide to their members. These investments prompt reciprocal consumer behaviors, which Kiehl’s channels into its customer knowledge development process. Specifically, reciprocity reduces the costs and noise associated with gaining information from customers. Because the products the firm launches are more likely to reflect the expectations and needs of its customers' communities, they become symbols or manifestations of the values that the communities employ to mould their shared identity. Thus, the firm can establish a unique position in the market that competitors would have a very difficult time imitating.

The theoretical framework we propose in this paper suggests several managerial implications. First, we illustrate how CBS generate a competitive advantage that is based on product differentiation through a novel mechanism associated with gaining information that resides in a firm's (potential) customer base. Compared with existing solutions, such as surveys, questionnaires, and multiple product development projects, a CBS approach offers a more structured, coherent portrayal of the customer knowledge development process (Fang, 2008; Kristensson et al., 2004) insofar it generates fine-grained information about potentially profitable product niches while avoiding both the costs of product culling and biased information.

Second, our theoretical framework demonstrates that a CBS supports the ex-ante selection of that portion of the demand that represents the firm's main interlocutor. In fact, the choice of the central values of a CBS leads to the selection of the type of customers that will be the main sources of information and demand. This approach implies that firms have to tackle needs that are endogenous to their decisions and ex-ante investments on values. Firms must anticipate the pressures and requests from the customers, so a CBS generates a competitive advantage because it also creates first-mover advantages and insulating mechanisms. Firms may adapt perfectly to a particular portion of the demand and thereby preclude other organizations to do so.

Third, CBS imply that some areas of the firm should bridge the external environment with the internal organization, in the pursuit of two important goals. First, organizations need to gain recognition as active members of communities that are independent of the existence of the firm. Second, firms should have permeable boundaries to receive a constant flow of information from the external environment. In the Kiehl's case, the retail shops play this important role and act as firm gatekeepers.

Forth, CBS demand greater coordination across the different divisions of the firm, including coherence in its value investments, strategies, marketing tactics, and product development and releases. In turn, this greater coordination requires a continuous flow of information across different departments, which has to occur at a higher level than each of the different tasks. This implies changes in the design of the organization and its human resources practices, as these changes become crucial to guarantee the communication among divisions. As our model suggests, in a CBS approach information on new product niches is first absorbed by the marketing division, it is subsequently passed to the R&D division that conceives the new products, then to the production division, and finally it flows back to the marketing division in the form of a new product to test and sell. Any friction in this information flow, or any lack of coordination can be highly detrimental. For instance, Lululemon, a Canadian clothing company with connections to yoga communities, maintained tight controls over its points of sales but not its supplier network. When media reports indicated that tests had failed to find any trace of seaweed fibers in Lululemon's products, despite its claims to the contrary, fanatical yoga customers started questioning their devotion, and the firm had few options to address their concerns.

Finally, CBS, although a source of unique competitive advantage, might seriously constrain a firm's growth aspirations. By committing to specific values and communities, the firm takes a strong stance on who should be its customer and who should not. The firm cannot sell to customers who belong to communities that share antagonistic values, and would also suffer from stretching too much its customer base as its association with one specific community might be questioned if the company serves the whole market. The relationship between CBS and firm growth strategies is a fascinating area of research that we hope to address in future work.

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Figure 1: Model of customer knowledge development through community-based strategy

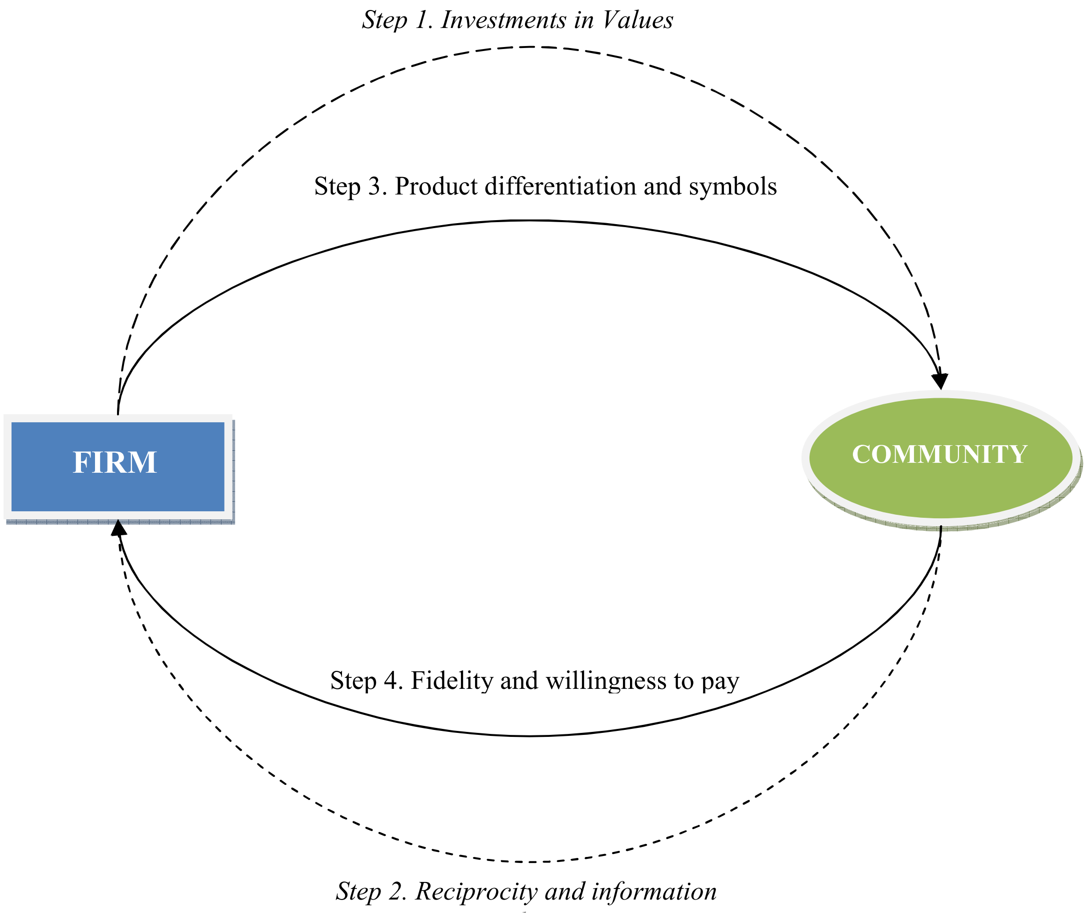
Step 1. Investments in Values
Step 3. Product differentiation and symbols
FIRM
COMMUNITY
Step 4. Fidelity and willingness to pay
Step 2. Reciprocity and information

Table 1: Kiehl’s vis-á-vis some of its competitors

	Kiehl's				
Years	2007	2008	2009	Average	Stand. Dev
Number of posts with the firm’s name	19916	40502	83774	48064	57446
% With Keywords A	0.188	0.241	0.240	0.223	0.235
% With Keywords B	0.207	0.259	0.265	0.244	0.256
% With Keywords C	0.006	0.072	0.090	0.056	0.044
	Clinique				
Number of posts with the firm’s name	98226	177622	324727	200191	234180
% With Keywords A	0.138	0.153	0.164	0.152	0.156
% With Keywords B	0.063	0.074	0.085	0.074	0.077
% With Keywords C	0.004	0.018	0.026	0.016	0.011
	Givenchy				
Number of posts with the firm’s name	67840	158174	271928	165980	198694
% With Keywords A	0.119	0.165	0.216	0.167	0.183
% With Keywords B	0.051	0.056	0.072	0.060	0.062
% With Keywords C	0.024	0.031	0.048	0.034	0.024
	Shiseido				
Number of posts with the firm’s name	44531	75706	169748	96661	114038
% With Keywords A	0.079	0.146	0.162	0.129	0.146
% With Keywords B	0.012	0.035	0.046	0.031	0.038
% With Keywords C	0.004	0.020	0.024	0.016	0.011
	Nuvilex, Wellquest and Nia 24				
Number of posts with the firms’ names	420	699	2554	1224	1492
% With Keywords A	0.205	0.160	0.081	0.149	0.130
% With Keywords B	0.121	0.134	0.060	0.105	0.100
% With Keywords C	0.014	0.016	0.014	0.015	0.001

Notes: Keywords A = “Community” or “Belong” or “Family” or “Friend” or “Group” or “Unity” or “Identity” or “Engagement”; Keywords B = “Mutual” or “Reciprocal” or “Participate” or “Contribute” or “Support” or “Involve” or “Give back” or “Suggest” or “Propose” or “Feedback”; Keywords C =“symbol” or “ritual” or “tribal” or “cult” or “enthusiasm” or “excitement” or “fervor”. Source: Google Search Engine Blogs.

Table 2: Products offered by product niche, 2005–2009.

	Year				
Product niche	**2005**	**2006**	**2007**	**2008**	**2009**
Baby	4	4	4	4	4
Body	32	35	37	39	39
Face	62	71	92	88	100
Hair	27	31	32	32	34
Fragrance	0	0	0	0	2
Total	125	141	165	163	179

Table 3: Price in dollars per ounce by product niche.

	Year					
Product niche	*2005*	*2006*	*2007*	*2008*	*2009*	Mean
			Average price per ounce (dollars)			
Baby	1.35	1.07	1.34	1.34	1.34	1.29
Body	6.23	5.49	5.79	6.06	6.21	5.95
Face	21.02	18.95	21.29	22.39	22.66	21.26
Fragrance					2.14	2.14
Hair	1.54	1.43	1.59	1.44	1.41	1.48
			Coefficient of variation of price			
Baby	0.43	0.35	0.42	0.42	0.42	0.41
Body	1.50	1.42	1.34	1.30	1.26	1.36
Face	1.25	1.31	1.18	1.14	1.21	1.22
Fragrance					0.09	0.09
Hair	0.52	0.49	0.54	0.50	0.47	0.50