CHAPTER 12

Managing *Relationships* and Building *Loyalty*
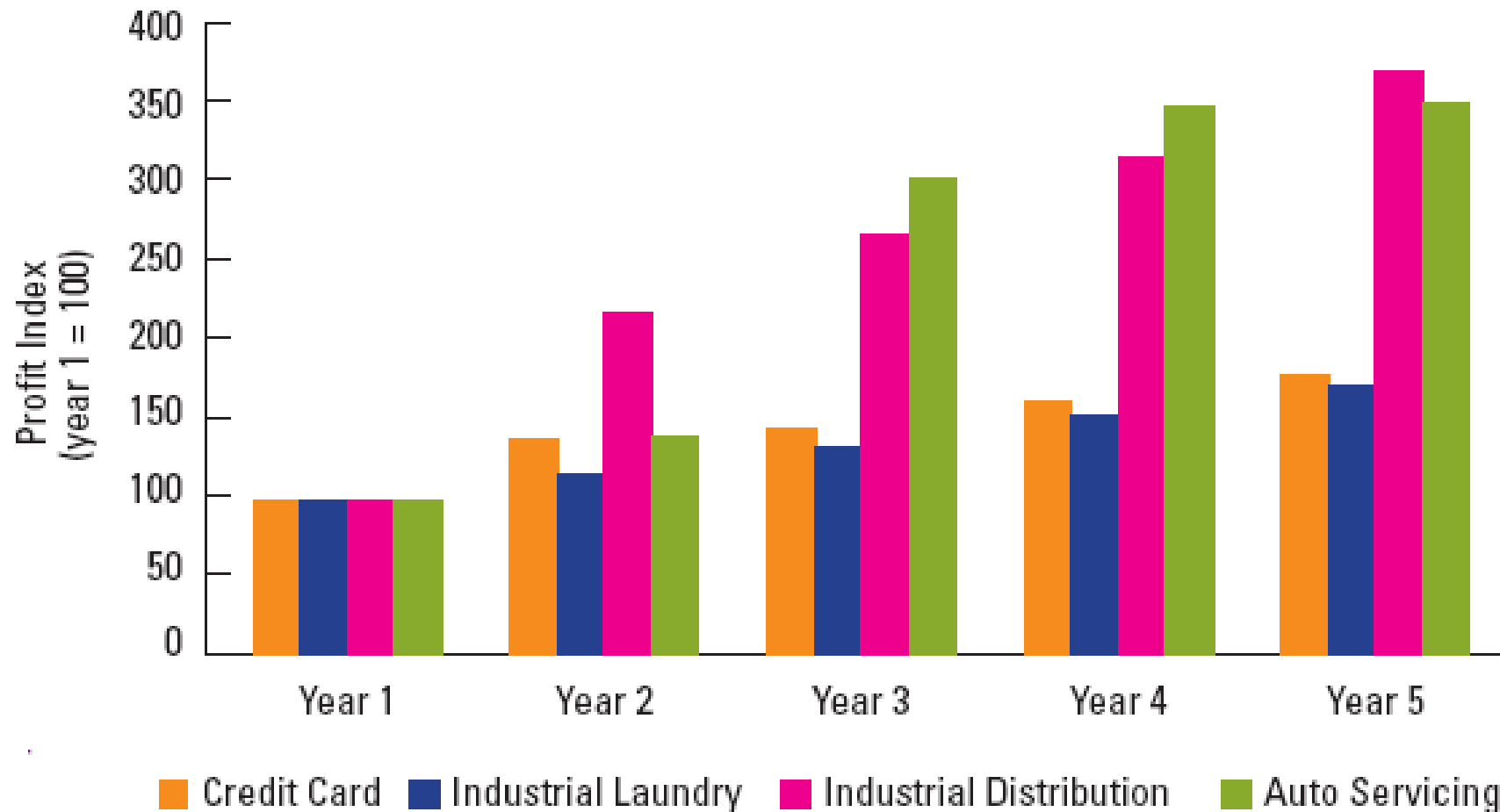
Overview of Chapter 12

- **The Search for Customer Loyalty**

- **The Wheel of Loyalty**

- **Building a Foundation for Loyalty**

- **Strategies for Developing Loyalty Bonds with Customers**

- **Strategies for Reducing Customers Defections**

- **CRM: Customer Relationship Management Systems**

The Search for Customer Loyalty

How Much Profit a Customer Generates Over Time (Fig 12.2)

Profit Index (year 1 = 100) vs **Year 1, Year 2, Year 3, Year 4, Year 5**

Legend: Credit Card ■ Industrial Laundry ■ Industrial Distribution ■ Auto Servicing ■

SOURCE

Based on reanalysis of data from Reichheld, F.R., Sasser Jr., W.E., (1990). Zero defections: quality comes from services. *Harvard Business Review*, 68 (September–October), pp. 105–111.

Why Is Customer Loyalty Important to A Firm's Profitability?

- **Customers become more profitable the longer they remain with a firm:**

  → **Increase purchases and/or account balances**

    - **Customers / families purchase in greater quantities as they grow**

  → **Reduced operating costs**

    - **Fewer demands from suppliers and operating mistakes as customer becomes experienced**

  → **Referrals to other customers**

    - **Positive word-of-mouth saves firm from investing money in sales and advertising**

  → **Price premiums**

    - **Long-term customers willing to pay regular price**

    - **Willing to pay higher price during peak periods**

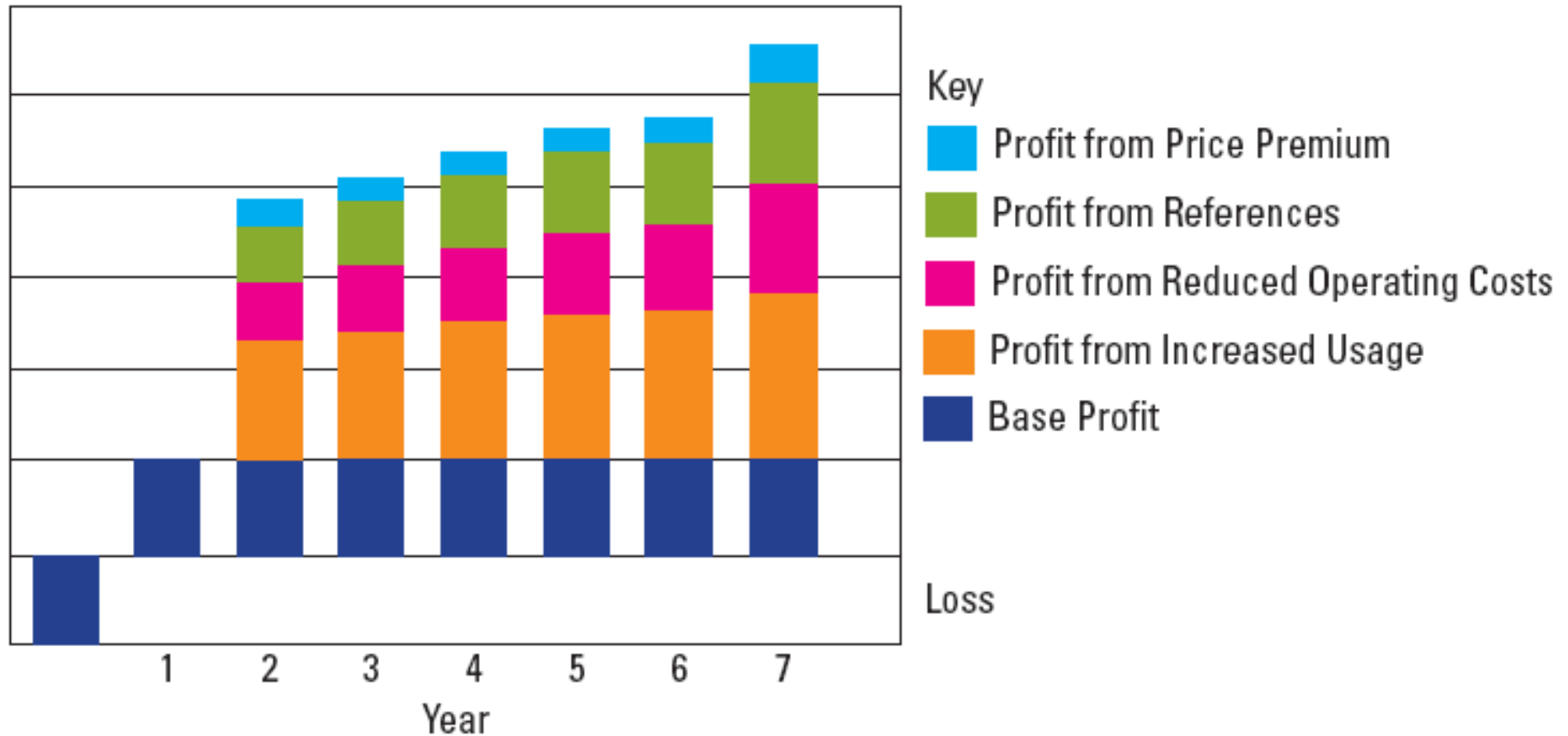# Why Customers Are More Profitable Over Time (Fig. 12.3)

Key
- Profit from Price Premium
- Profit from References
- Profit from Reduced Operating Costs
- Profit from Increased Usage
- Base Profit

Figure 12.3 Why customers become profitable over time.

Assessing the Value of a Loyal Customer

- **Must not assume that loyal customers are always more profitable than those making one-time transactions**

  - → Large customers may expect price discounts in return for loyalty

  - → Revenues don't necessarily increase with time for all types of customers

- **Tasks:**

  - → Determine costs and revenues for customers from different market segments at different points in their customer lifecycles

  - → Predict future profitability

- **Acquisition revenues less costs**

  → **Revenues (application fee + initial purchase)**

  → **Costs (marketing +credit check + account set up)**

- **Projected annual revenues and costs**

  → **Revenues (annual fee + sales + service fees + value of referrals)**

  → **Costs (account management + cost of sales + write-offs)**

- **Value of referrals**

  → **Percentage of customers influenced by other customers**

  → **Other marketing activities that drew the firm to an individual's attention**

- **Net Present Value**

  → **Sum anticipated annual values (future profits)**

  → **Suitably discounted each year into the future**

- **Customers stay loyal when we create value for them**

- **Value can be created for customers through**

  → **Confidence benefits**

    - **Confidence in correct performance**

    - **Ability to trust the provider**

    - **Lower anxiety when purchasing**

    - **Knowing what to expect and receive**

➔ **Social benefits**

- Mutual recognition and friendship between service provider and customer
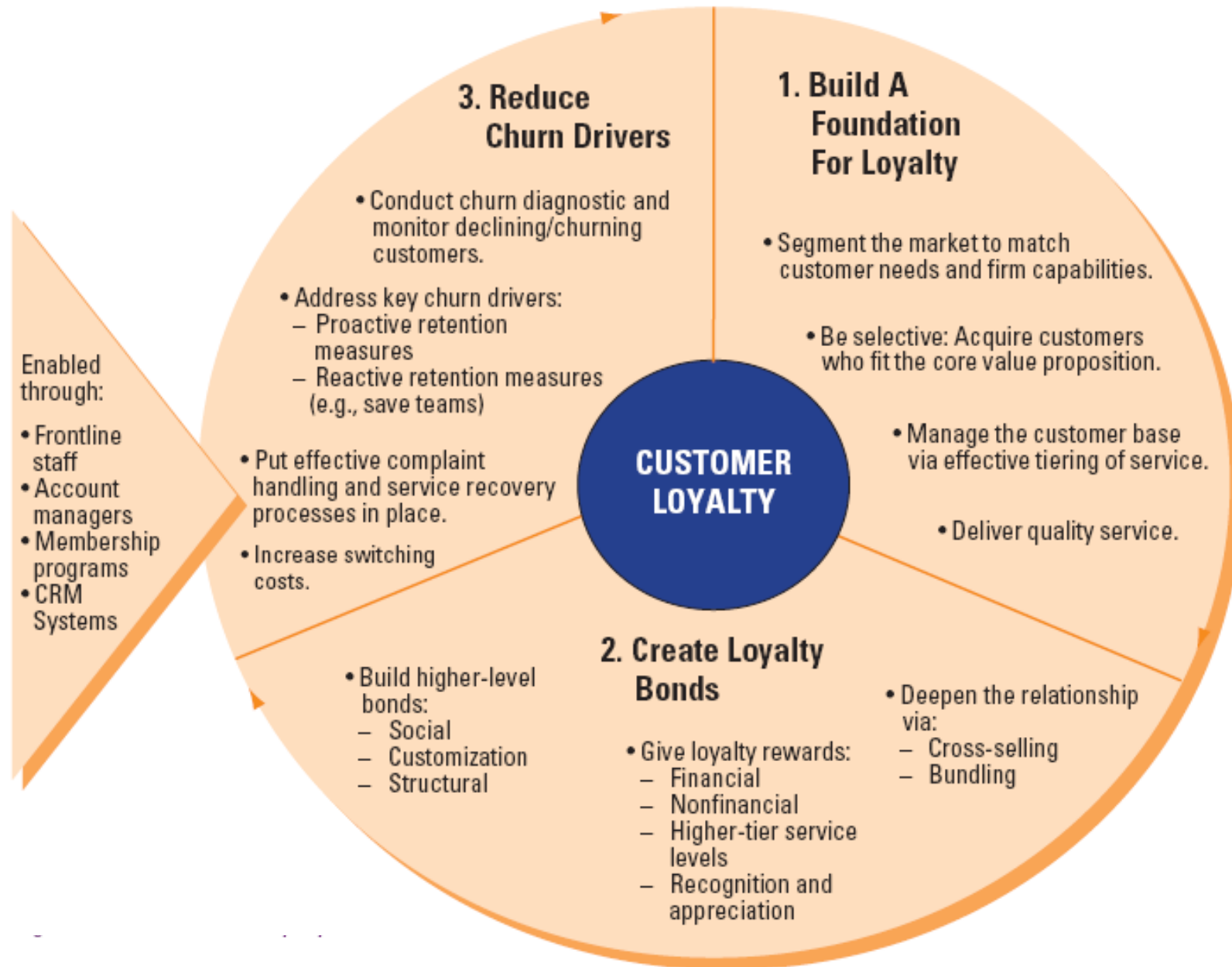
➔ **Special treatment**

- Better price

- Discounts not available to most customer

- Extra services

- Higher priority when there is a wait

The Wheel of Loyalty

The Wheel of Loyalty (Fig. 12.5)

CUSTOMER LOYALTY

1. Build A Foundation For Loyalty
- Segment the market to match customer needs and firm capabilities.
- Be selective: Acquire customers who fit the core value proposition.
- Manage the customer base via effective tiering of service.
- Deliver quality service.

2. Create Loyalty Bonds
- Deepen the relationship via:
  – Cross-selling
  – Bundling
- Give loyalty rewards:
  – Financial
  – Nonfinancial
  – Higher-tier service levels
  – Recognition and appreciation
- Build higher-level bonds:
  – Social
  – Customization
  – Structural

3. Reduce Churn Drivers
- Conduct churn diagnostic and monitor declining/churning customers.
- Address key churn drivers:
  – Proactive retention measures
  – Reactive retention measures (e.g., save teams)
- Put effective complaint handling and service recovery processes in place.
- Increase switching costs.

Enabled through:
- Frontline staff
- Account managers
- Membership programs
- CRM Systems
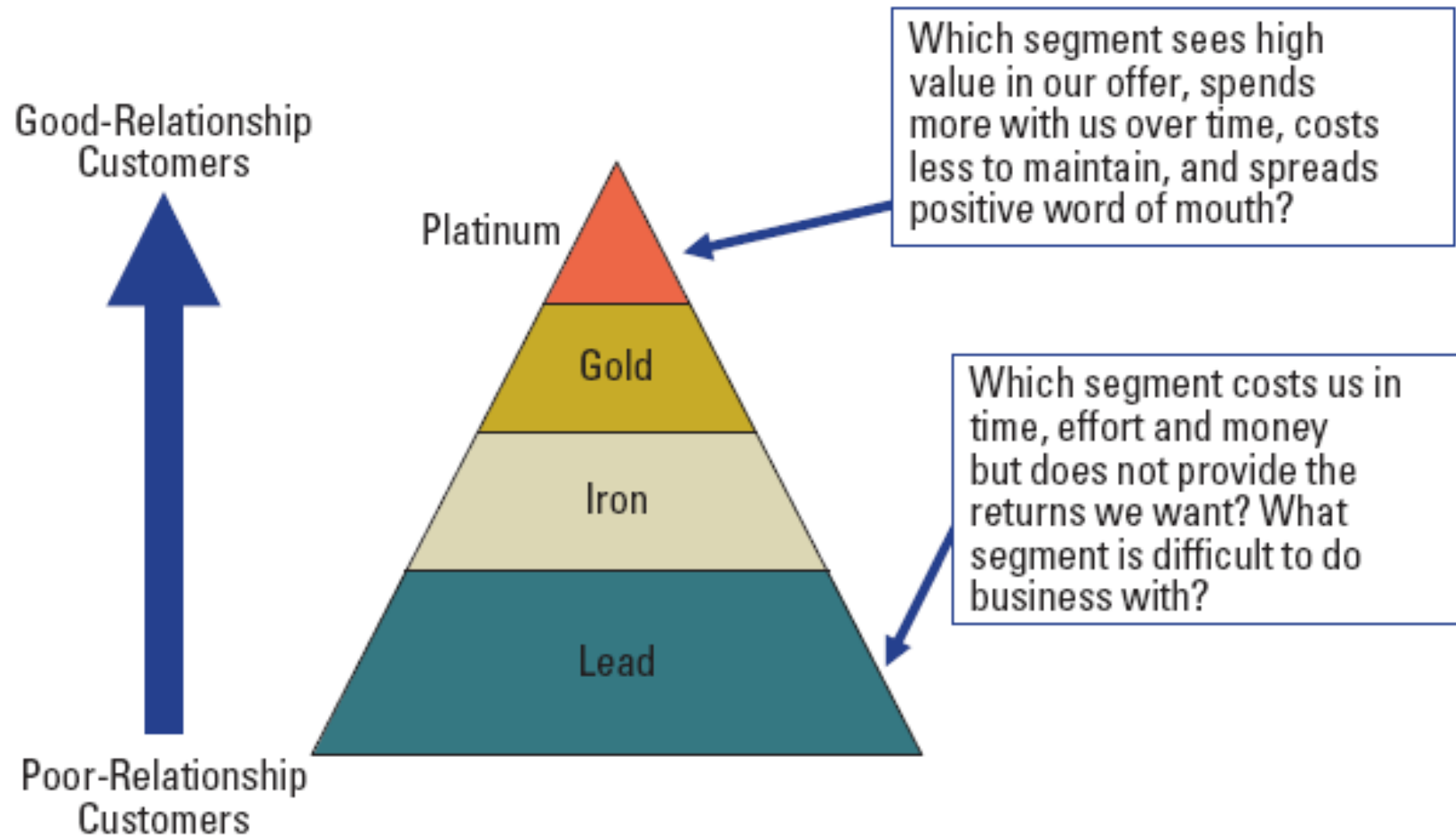
Building a Foundation for Loyalty

Targeting the Right Customers and Searching for Value, Not Volume

- **Target the right customer and match them to what firm can deliver**

  - ➔ **How do customer needs relate to operations elements?**

  - ➔ **How well can service personnel meet expectations of different types of customers?**

  - ➔ **Can company match or exceed competing services that are directed at same types of customers?**

- **Focus on *number* of customers served as well as *value* of each customer**

  - ➔ **Some customers more profitable than others in the short term**

  - ➔ **Others may have room for long-term growth**

- **"Right customers" are not always high spenders**

  - ➔ **Can come from a large group of people that no other supplier is serving well**

Good-Relationship Customers

Poor-Relationship Customers

Platinum

Gold

Iron

Lead

Which segment sees high value in our offer, spends more with us over time, costs less to maintain, and spreads positive word of mouth?

Which segment costs us in time, effort and money but does not provide the returns we want? What segment is difficult to do business with?

SOURCE

Zeithaml, V. A., Rust, R. T., & Lemon, K. N. (2001). The customer pyramid: Creating and serving profitable customers. *California Management Review*, 43(4), (Summer), pp. 118–142.
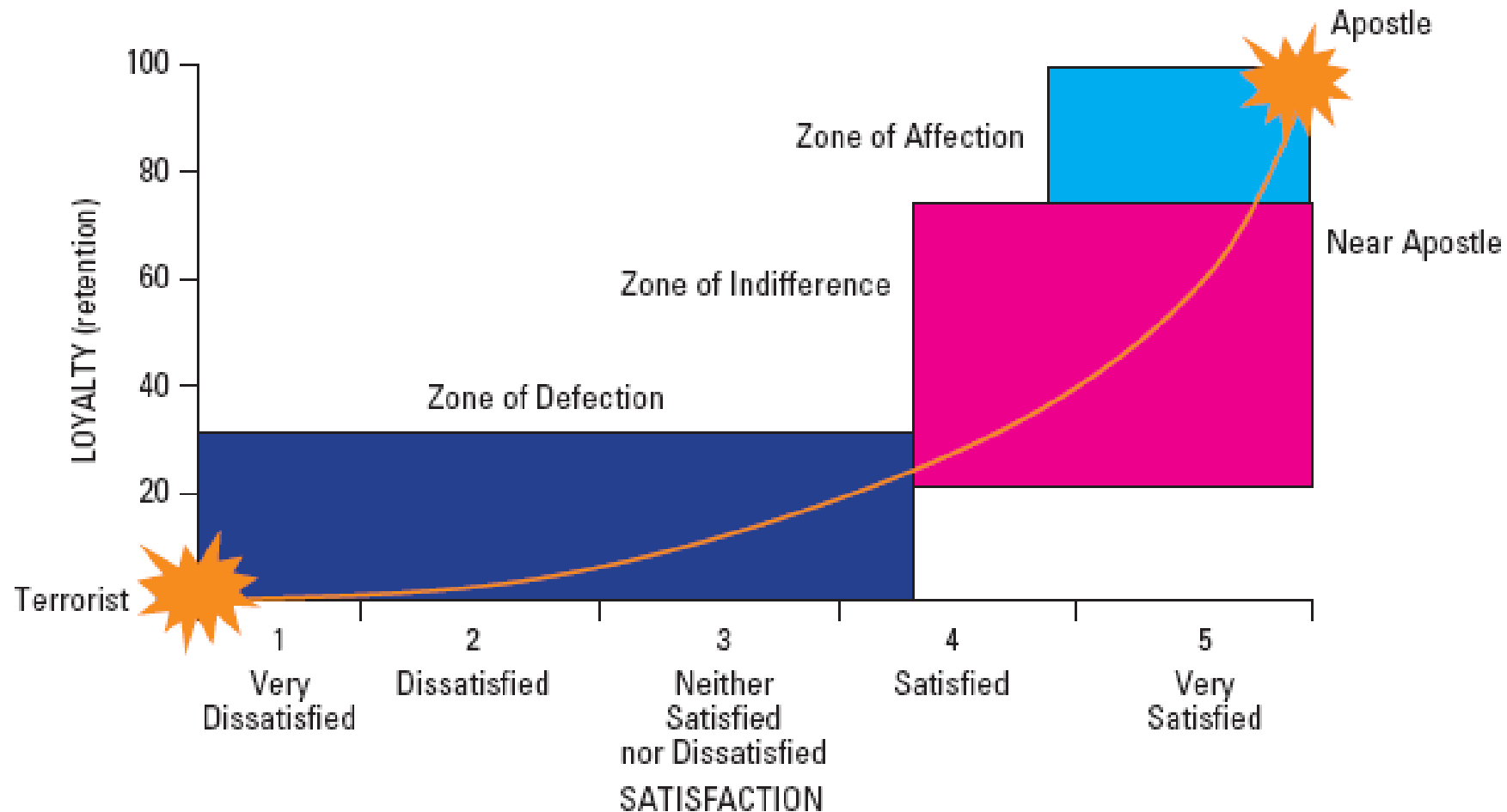
Strategies for Developing Loyalty Bonds with Customers

- **Deepening the relationship**

  - ➔ Bundling/Cross-selling services makes switching a major effort that customer is unwilling to go through unless extremely dissatisfied with service provider

  - ➔ Customers benefit from buying all their various services from the same provider

    - One-stop-shopping, potentially higher service levels, higher service tiers etc
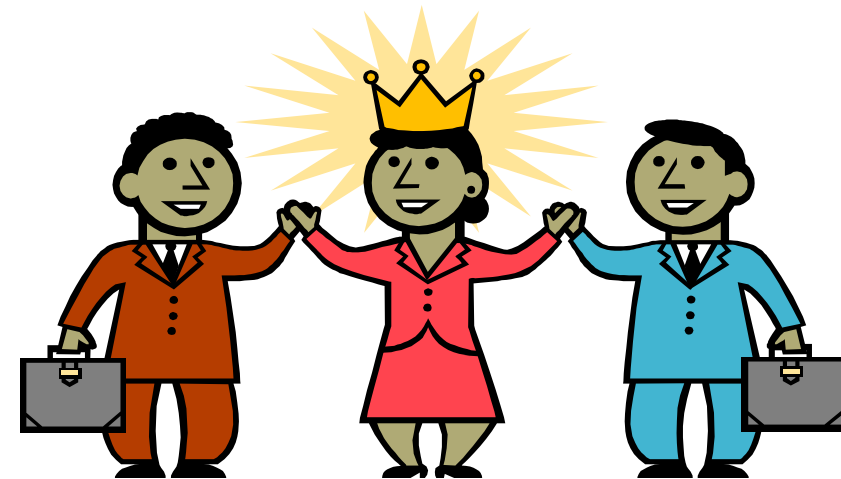
- **Reward Based Bonds**

  → **Can be financial or non-financial bonds or a combination of both**

  → **Financial bonds**

    - **Discounts on purchases, loyalty program rewards (e.g. frequent flier miles), cash-back programs**

  → **Non-financial rewards**

    - **Priority to loyalty program members for waitlists and queues in call centers; higher baggage allowances, priority upgrading, access to airport lounges for frequent flyers**

  → **Intangible rewards**

    - **Special recognition and appreciation**

  → **Reward-based loyalty programs are relatively easy to copy and rarely provide a sustained competitive advantage**

Strategies for Developing Loyalty Bonds with Customers (3)

- **Social Bonds**

  ➔ Based on personal relationships between providers and customers

  ➔ Harder to and takes a longer time to build, but also harder to imitate and thus, better chance of retention in the long term

- **Customization Bonds**

  ➔ Customized service for loyal customers

    - e.g. Starbucks

  ➔ Customers may find it hard to adjust to another service provider who cannot customize service

- **Structural Bonds**

  → **Mostly seen in B2B settings**

  → **Align customers way of doing things with supplier's own processes**

    - **Joint investments in projects and sharing of information, processes and equipment.**

  → **Can be seen in B2C environment too**

    - **Airlines - SMS check-in, SMS email alerts for flight arrival and departure times**

  → **Difficult for competition to draw customers away when they have integrated their way of doing things with existing supplier**

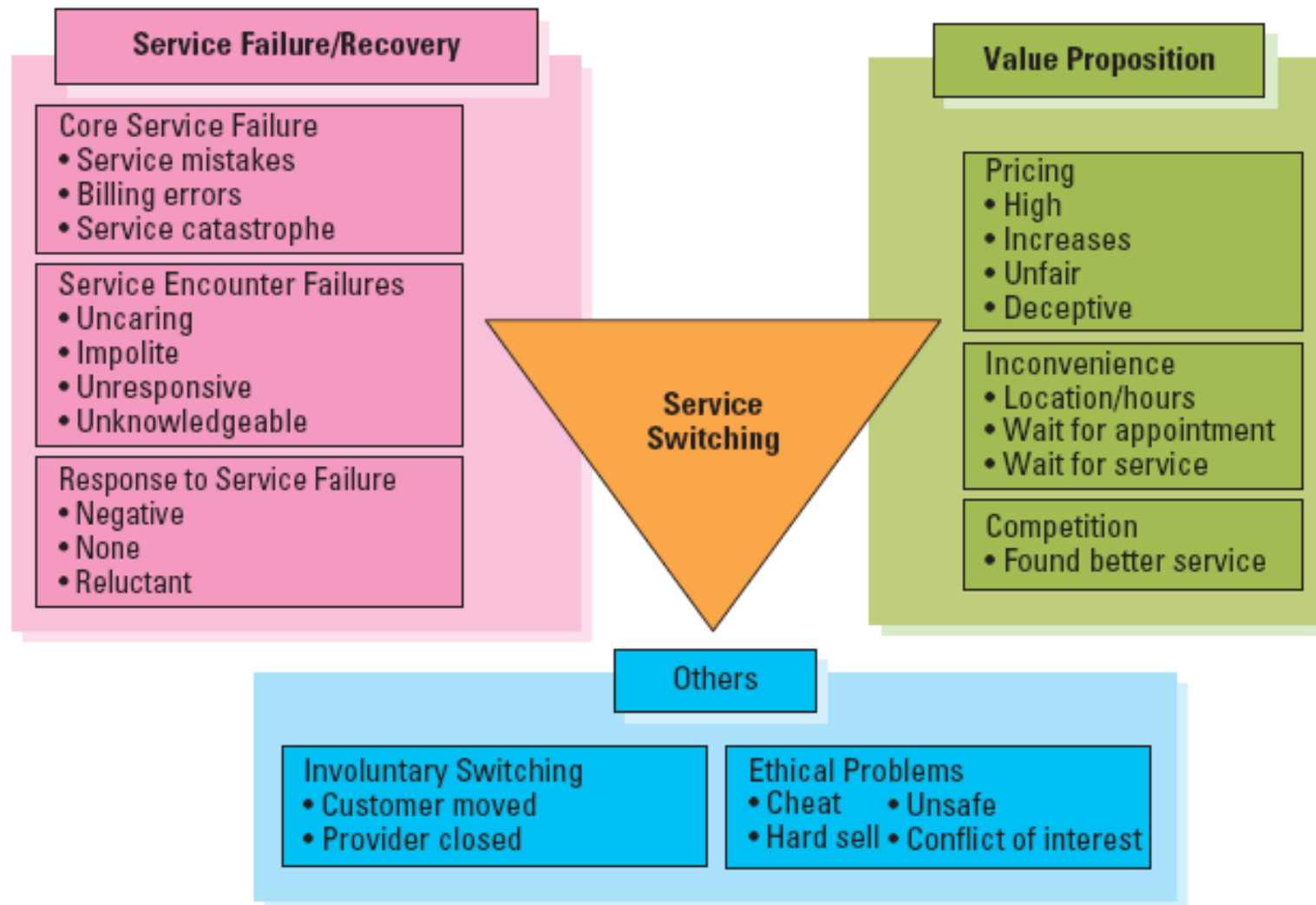# *Strategies for Reducing Customer Defections*

Analyze Customer Defections and Monitor Declining Accounts

- **Understand reasons for customer switching**

- ***Churn Diagnostics* common in mobile phone industry**

  → **Analysis of data warehouse information on churned and declining customers**

  → **Exit interviews:**

    - **Ask a short set of questions when customer cancels account; in-depth interviews of former customers by third party agency**

What Drives Customers to Switch?
(Fig 12.9)

Service Failure/Recovery

Core Service Failure
- Service mistakes
- Billing errors
- Service catastrophe

Service Encounter Failures
- Uncaring
- Impolite
- Unresponsive
- Unknowledgeable

Response to Service Failure
- Negative
- None
- Reluctant

Service Switching

Value Proposition

Pricing
- High
- Increases
- Unfair
- Deceptive

Inconvenience
- Location/hours
- Wait for appointment
- Wait for service

Competition
- Found better service

Others

Involuntary Switching
- Customer moved
- Provider closed

Ethical Problems
- Cheat   • Unsafe
- Hard sell • Conflict of interest

SOURCE
Adapted from Keaveney, S. M. (1995). Customer switching behavior in service industries: An exploratory study, *Journal of Marketing*, 59(April), pp. 71–82.

Address Key Churn Drivers

- **Deliver quality service**

- **Reduce inconvenience and non-monetary costs**

- **Have fair and transparent pricing**

- **Industry specific drivers**

  → **Cellular phone industry: handset replacement a common reason for subscribers discontinuing services – offer handset replacement programs**

- **Take active steps to retain customers**

  → *Save teams*: **specially trained call center staff to deal with customers who want to cancel their accounts**

  → **Be careful about how *save teams* are rewarded (see Service Insights 12.5)**

Other Ways to Reduce Churn

- **Implement Effective Complaint Handling and Service Recovery Procedures**

- **Increase Switching Costs**

  ➔ **Natural switching costs**

    - **e.g. Changing primary bank account – many related services tied to account**

  ➔ **Can be created by instituting contractual penalties for switching**

    - **Must be careful not to be perceived as holding customers hostage**

    - **High switching barriers and poor service quality likely to generate negative attitudes and bad word of mouth**

CRM: Customer Relationship Management Systems

Common Objectives Of CRM Systems (1)

- **Customer perspective**

  → **Unified customer interface that delivers customization and personalization**

  → **Vast service improvement and increase customer value**

- **Company perspective**

  → **Better segment, tier customer base and target promotion**

  → **Implement churn alert systems if customers are in danger of defecting**

- **Data collection**

  - ➔ Customer data such as contact details, demographics, purchasing history, service preferences, and the like

- **Data analysis**

  - ➔ Data captured is analyzed and categorized

  - ➔ Used to tier customer base and tailor service delivery accordingly

- **Sales force automation**

  - ➔ Sales leads, cross-sell and up-sell opportunities can be effectively identified and processed

  - ➔ Entire sales cycle from lead generation to close of sales and after-sales service can be tracked and facilitated through CRM system
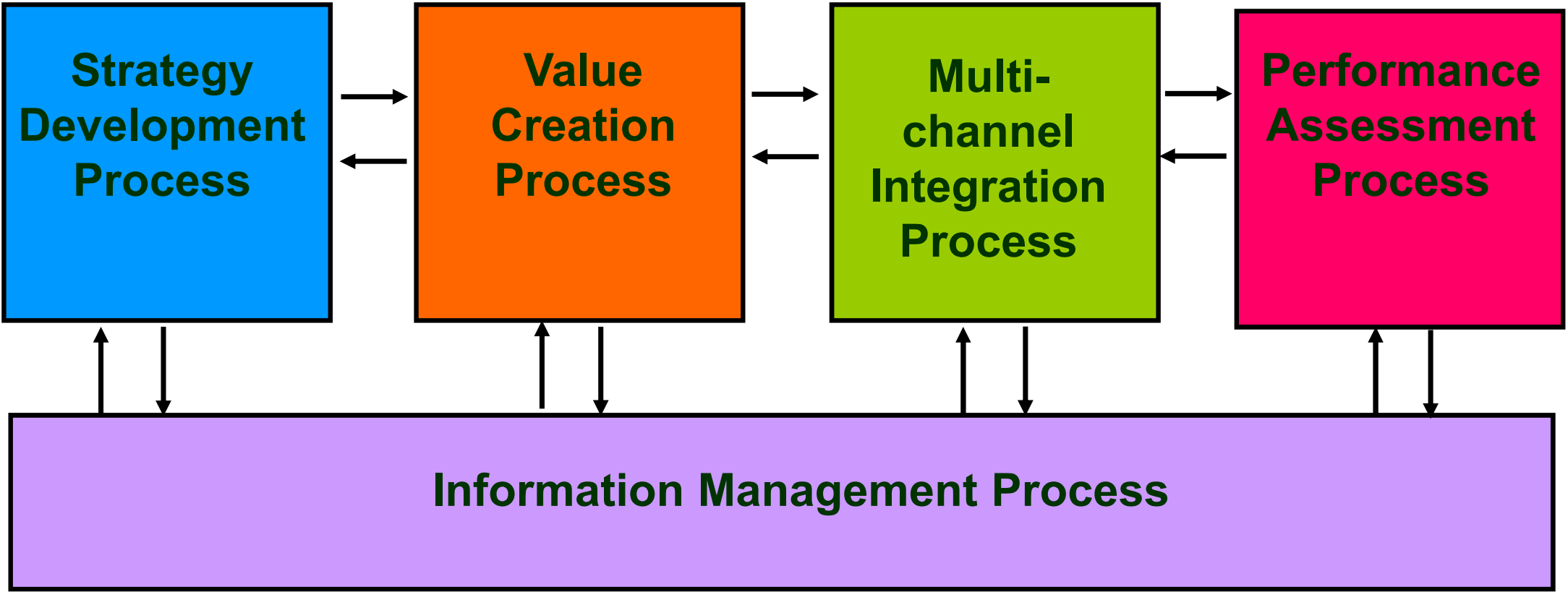
- **Marketing automation**

  → **Mining of customer data enables the firm to target its market**

  → **Goal to achieve one-to-one marketing and cost savings, often in the context of loyalty and retention programs**

  → **Results in increasing the ROI on its marketing expenditure**

  → **CRM systems also allows firms to judge effectiveness of marketing campaigns through the analysis of responses**

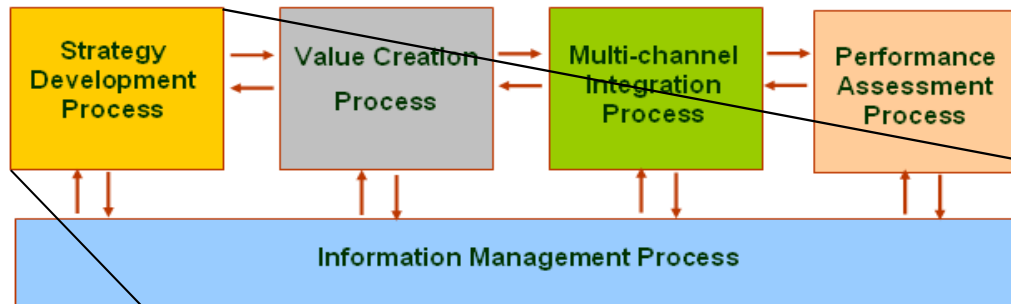- **Call center automation**

  → **Call center staff have customer information at their finger tips and can improve their service levels to all customers**

  → **Caller ID and account numbers allow call centers to identify the customer tier the caller belongs to, and to tailor the service accordingly**

    - **For example, platinum callers get priority in waiting loops.**

Comprehensive CRM Strategy (Fig 12.14)


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┌──────────────┐      ┌──────────────┐      ┌──────────────┐      ┌──────────────┐
│   Strategy   │ ───► │    Value     │ ───► │    Multi-    │ ───► │ Performance  │
│ Development  │ ◄─── │   Creation   │ ◄─── │   channel    │ ◄─── │  Assessment  │
│   Process    │      │   Process    │      │ Integration  │      │   Process    │
│              │      │              │      │   Process    │      │              │
└──────────────┘      └──────────────┘      └──────────────┘      └──────────────┘

┌──────────────────────────────────────────────────────────────────────────────┐
│                    Information Management Process                              │
└──────────────────────────────────────────────────────────────────────────────┘
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Strategy Development

➔ Assessment of business strategy

➔ Business strategy guides development of customer strategy

Strategy Development Process → Value Creation Process → Multi-channel Integration Process → Performance Assessment Process

Information Management Process
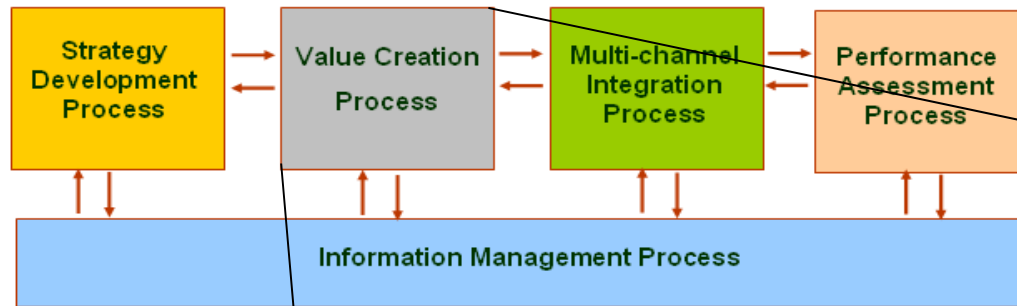
● **Value Creation**

➔ Translates business and customer strategies into specific value propositions for both customers and firm

- **Customers benefit from priority, tiered services, loyalty rewards and customization**

- **Company benefits from reduced customer acquisition and retention costs, and increased share-of-wallet**

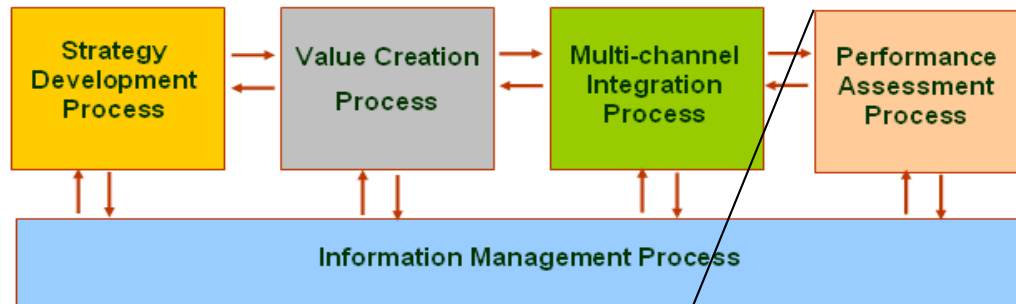➔ Dual creation of value: customers need to participate in CRM to reap value from firm's CRM initiatives
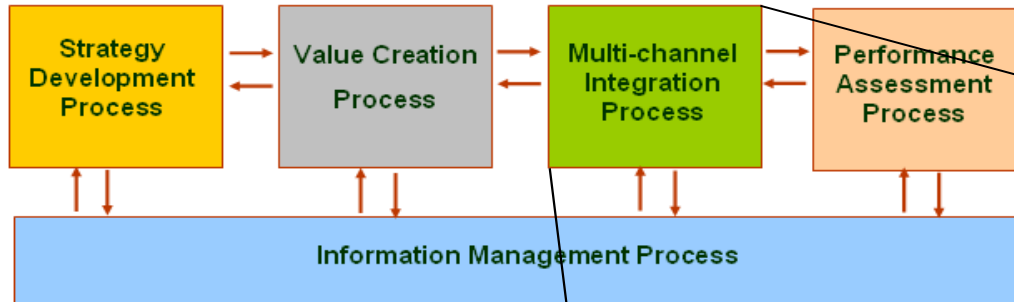
Multi-channel Integration

➜ Serve customers well across many potential interfaces

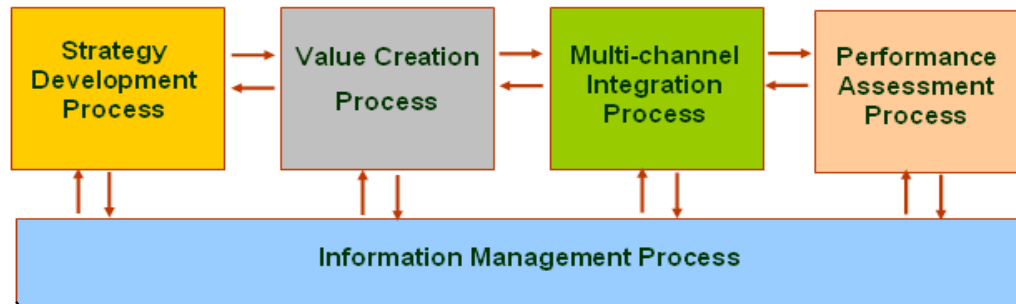➜ Offer a unified interface that delivers customization and personalization

● Performance Assessment

➔ Is CRM system creating value for key stakeholders?

➔ Are marketing and service standard objectives being achieved?

➔ Is CRM system meeting performance standards?

Information Management Process

Information Management

➔ Collect customer information from all channels

➔ Integrate it with other relevant information

➔ Make useful information available to the frontline

➔ Create and manage data repository, IT systems, analytical tools, specific application packages

Common Failures in CRM Implementation

- **Unfortunately, there is a high failure rate for CRM implementations**

- **Common reasons for failures**

  → **Viewing CRM as a technology Initiative**

  → **Lack of customer focus**

  → **Not enough understanding of customer lifetime value (CLV)**

  → **Inadequate support from top management**

  → **Lack of coordination**

  → **Failure to reengineer business processes**

  → **Underestimating the challenges in data integration**

Key Issues in Defining a Customer Relationship Strategy

- How should our value proposition change to increase customer loyalty?

- How much customization or one-to-one marketing and service delivery is appropriate and profitable?

- What is the increase in profit from increasing share-of-wallet with current customers? How much does this vary by customer tier and/or segment?

- How much time and resources can we provide to CRM right now?

- If we believe in customer relationship management, why haven't we taken more steps in that direction in past?

- What can we do today to develop customer relationships without spending on technology?

- **Customer loyalty as an important driver of profitability for service firms so firms need to**

    → **Assess value of loyal customer**

    → **Narrow gap between actual and potential customer value**

- **Wheel of Loyalty shows how firms can:**

    → **Build a foundation of loyalty**

    → **Create loyalty bonds**

    → **Reduce churn drivers**

- **Building a foundation of loyalty involves**

    → **Good fit between customer needs and capabilities**

    → **Searching for value, not just volume**

    → **Tiering services effectively**

    → **Obtaining customer satisfaction through service quality**

- **Customer loyalty bonds include**

  → **Reward-based bonds**

  → **Social bonds**

  → **Customization bonds**

  → **Structural bonds**

- **Strategies for reducing customer defections include**

  → **Analyzing customer defections and monitoring declining accounts**

  → **Addressing key churn drivers**

  → **Implementing effective complaint-handling and service recovery procedures**

  → **Increasing switching costs**

- **Customer relationship management (CRM) is a whole process by which relations with customers are built and maintained.**

- **An integrated CRM system includes**

  - ➔ **Strategy development process**

  - ➔ **Value creation process**

  - ➔ **Multichannel integration process**

  - ➔ **Performance assessment process**

- **Cresting a successful CRM program requires understanding common failures in CRM implementation and knowing how to get it right**