Customer Relationship Management

Chapter Fourteen
Key Learning Points

- The economics of customer loyalty
- A general framework for customer relationship management
- The importance of a customer database
- Defining, measuring, and building customer satisfaction
- Frequency marketing programs
- Importance of mass customization
- New metrics for measuring success
Figure 14.1
The Buyer-Seller Relationship

Overview

Transaction buyers
- Interested only in the purchase at hand

Relationship customers
- Interested in the benefits of buyer and seller interdependency

Customer relationship management (CRM) programs develop programs of interest to relationship customers.
Figure 14.2
Impact of a 5% Increase in Retention Rate on Customer Net Present Value

<table>
<thead>
<tr>
<th>Industry</th>
<th>Increase in Customer Net Present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising Agency</td>
<td>95</td>
</tr>
<tr>
<td>Auto/home Insurance</td>
<td>84</td>
</tr>
<tr>
<td>Auto Service</td>
<td>81</td>
</tr>
<tr>
<td>Branch Bank Deposits</td>
<td>85</td>
</tr>
<tr>
<td>Credit Card</td>
<td>75</td>
</tr>
<tr>
<td>Industrial Brokerage</td>
<td>50</td>
</tr>
<tr>
<td>Industrial Distribution</td>
<td>45</td>
</tr>
<tr>
<td>Industrial Laundry</td>
<td>45</td>
</tr>
<tr>
<td>Life Insurance</td>
<td>90</td>
</tr>
<tr>
<td>Office Building Management</td>
<td>40</td>
</tr>
<tr>
<td>Publishing</td>
<td>85</td>
</tr>
<tr>
<td>Software</td>
<td>35</td>
</tr>
</tbody>
</table>

Figure 14.3
Why Loyal Customers are More Profitable

Figure 14.4
A Framework for Customer Relationship Management

- Create a Database
- Analysis
- Customer Selection
- Customer Targeting
- Relationship Marketing
- Privacy Issues
- Metrics
### Figure 14.5
**Customer Information File**

<table>
<thead>
<tr>
<th>Customers</th>
<th>Characteristics</th>
<th>Purchase History</th>
<th>Contacts</th>
<th>Response</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
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<tr>
<td>n</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Figure 14.6
Getting More Customer Interaction

<table>
<thead>
<tr>
<th>Interaction Frequency</th>
<th>Customer Interaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Personal Computers</td>
</tr>
<tr>
<td></td>
<td>Internet Infrastructure</td>
</tr>
<tr>
<td>High</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Banks</td>
</tr>
<tr>
<td></td>
<td>Telecom</td>
</tr>
<tr>
<td></td>
<td>Retail</td>
</tr>
<tr>
<td></td>
<td>Airlines</td>
</tr>
<tr>
<td></td>
<td>Packaged Goods</td>
</tr>
<tr>
<td></td>
<td>Drugs</td>
</tr>
<tr>
<td></td>
<td>Furniture</td>
</tr>
<tr>
<td></td>
<td>Autos</td>
</tr>
</tbody>
</table>
# Table 14.1

**U.S. Hotel Usage by Consumer Segment in 2002**

<table>
<thead>
<tr>
<th></th>
<th>Individual Guests</th>
<th>Share of Hotel Nights</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Frequent travelers</strong></td>
<td>10%</td>
<td>44%</td>
</tr>
<tr>
<td>(≥23 nights a year)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Moderate travelers</strong></td>
<td>40</td>
<td>44</td>
</tr>
<tr>
<td>(6–22 nights a year)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Light travelers</strong></td>
<td>50</td>
<td>12</td>
</tr>
<tr>
<td>(1–5 nights a year)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a For U.S. population aged 21 to 74; in 2002 approximately 83 million individual guests accounted for approximately 860 million hotel nights.

*Source:* Travel Industry Association of America (TIA); TNS; U.S. Census Bureau; McKinsey analysis.
Calculating Profitability

Customer Profitability = \[ \sum_{t} \sum_{j} (P_j - C_j) - \sum_{k} MC_k - AC \]

Where:
- \( t \) = the number of past and current time periods measured
- \( j \) = the number of product purchased in a time period
- \( k \) = the number of marketing tools used in a time period
- \( P \) = price
- \( C \) = cost
- \( MC \) = cost of marketing tool
Table 14.2
Margin Multiple
\[
\frac{r}{1 + i - r}
\]

<table>
<thead>
<tr>
<th>Retention Rate</th>
<th>10%</th>
<th>12%</th>
<th>14%</th>
<th>16%</th>
</tr>
</thead>
<tbody>
<tr>
<td>60%</td>
<td>1.20</td>
<td>1.15</td>
<td>1.11</td>
<td>1.07</td>
</tr>
<tr>
<td>70%</td>
<td>1.75</td>
<td>1.67</td>
<td>1.59</td>
<td>1.52</td>
</tr>
<tr>
<td>80%</td>
<td>2.67</td>
<td>2.50</td>
<td>2.35</td>
<td>2.22</td>
</tr>
<tr>
<td>90%</td>
<td>4.50</td>
<td>4.09</td>
<td>3.75</td>
<td>3.46</td>
</tr>
</tbody>
</table>

Figure 14.7
Customer Life Cycle Profit Pattern in the Credit Card Industry

Table 14.3
Descriptive Statistics on Customer Profitability for Physicians

<table>
<thead>
<tr>
<th>Number of Observations</th>
<th>834</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum</td>
<td>$62,407.20</td>
</tr>
<tr>
<td>Minimum</td>
<td>$-12,814.12</td>
</tr>
<tr>
<td>Mean</td>
<td>$7,026.04</td>
</tr>
<tr>
<td>Median</td>
<td>$3,536.68</td>
</tr>
</tbody>
</table>

Figure 14.8
Customer Profit Ordering for Physicians: Highest to Lowest

Customer Targeting for Retention

Conventional direct-marketing approaches are used to contact and keep customers.
Activity

Customer X’s CIF indicates that until recently, he visited the casino on average twice a month to play blackjack at the high stakes table. But in the last 12 months, customer X has visited only twice.

As marketing manager for the casino, what type of offer would you target towards customer X?
Figure 14.9
Customer Satisfaction Model

- Market Communications
- Image
- Word of Mouth
- Past Experience
- Customer Needs
Figure 14.10
Customer Satisfaction Scales

101-Point Scale

0% Complete Dissatisfaction

100% Complete Satisfaction

5-Point Scale

Excellent

Good

Satisfactory

Not Too Satisfactory

Poor

(Percentage Strongly Satisfied)

(Percentage Not Satisfied)

4-Point/5-Point Scale

Much Better

Better

About the Same

Not as Good

Both Not Satisfactory

Much Worse

10-Point Scale

Not Important at All

Extremely Important

1 2 3 4 5 6 7 8 9 10

1 2 3 4 5 6 7 8 9 10

Excellent

Poor
Figure 14.11
Some Sample ACSI Scores

| Airlines            | Base-line | 96 | 97 | 98 | 99 | 00 | 01 | 02 | 03 | 04 | 05 | 06 | 07 | 08 | 09 | Previous Year % Change |
|---------------------|-----------|----|----|----|----|----|----|----|----|----|----|----|----|----|------------------------|
| Southwest Airlines  | 78        | 76 | 76 | 74 | 72 | 70 | 70 | 74 | 75 | 73 | 74 | 74 | 76 | 79 | 81 | 2.5                    |
| All others          | NM        | 74 | 70 | 62 | 67 | 63 | 64 | 72 | 74 | 73 | 74 | 74 | 75 | 76 | 77 | 2.7                    |
| Continental Airlines| 67        | 66 | 64 | 66 | 64 | 62 | 67 | 68 | 68 | 67 | 70 | 67 | 69 | 62 | 68 | 9.7                    |
| Airlines            | 72        | 69 | 67 | 65 | 63 | 63 | 61 | 66 | 67 | 66 | 66 | 65 | 63 | 62 | 64 | 3.2                    |
| Delta Air Lines     | 77        | 67 | 69 | 65 | 68 | 66 | 61 | 66 | 67 | 67 | 65 | 64 | 59 | 60 | 64 | 6.7                    |
| American Airlines   | 70        | 71 | 62 | 67 | 64 | 63 | 62 | 63 | 67 | 66 | 64 | 62 | 60 | 52 | 60 | −3.2                   |
| US Airways          | 72        | 66 | 68 | 65 | 61 | 62 | 60 | 63 | 64 | 62 | 57 | 62 | 61 | 54 | 59 | 9.3                    |
| Northwest Airlines  | 69        | 67 | 64 | 63 | 53 | 62 | 56 | 65 | 64 | 64 | 61 | 61 | 57 | 57 | 0.0                    |
| United Airlines     | 71        | 70 | 68 | 65 | 62 | 62 | 59 | 64 | 63 | 64 | 61 | 63 | 56 | 56 | 56 | 0.0                    |
Relationship Marketing Programs

Customer satisfaction

Merely satisfying customers may not keep them loyal to the firm/brand.

Net promoter - customer loyalty metric

Scores above 75 are high.
Relationship Marketing Programs

Customer Types Classified By Loyalty and Satisfaction

- Loyalist / Apostle
- Mercenary
- Defector / Terrorist
- Hostage
Relationship Marketing Programs

- Customer service supplements the main product or service.
- Moments of truth are critical.
Discussion Question

The competition for students is intensifying on many campuses.

What contact points can result in “moments of truth” which may make or break a student’s decision to become (or stay) a student at a given University?
Figure 14.12
The Augmented Product

Figure 14.13
Zappos Web Site
Relationship Marketing Programs

Customer Service Principles

- Service is the backbone of business.
- Customer satisfaction measures great service.
- Compensation plans determine behavior.
- Sales and service are complementary.
- Service department hours signal dedication to customer satisfaction.
- Service technicians should work together.
Discussion Question

Customer service is never more critical than when consumers complain. Think of a recent experience which led you to complain, either in person at the time of the incident, or later, via phone, letter or e-mail.

1. *From a CRM perspective, how did the firm handle your complaint?*

2. *What else could the firm have done?*
Relationship Marketing Programs

Customer service can differentiate your brand.

- Service guarantees
- Service recovery
  - Training is necessary.
  - Service recovery can boost loyalty.
- Web-based customer service has improved substantially.
“One of the major trends in marketing in the 1990s is the tremendous growth in loyalty programs, or in general, frequency marketing.”

- Russell S. Winer
Illustration

Colloquy provides examples of loyalty marketing, white papers on related subjects, and tracks loyalty programs being used in a variety of industries.

Register for free at www.colloquy.com and explore the recent news and examples.
Relationship Marketing Programs

Technology drives loyalty programs.

- Most are card-based.
- Transaction data is tracked.
**Relationship Marketing Programs**

**Potential Frequency Program Problems**

- Making the reward too high
- Ubiquity
- Confusing loyalty with repeat buying
- Lack of inspiration
- Lack of customer communication
- Insufficient database analysis
Relationship Marketing Programs

Mass customization
- Positively influences retention and loyalty
- Most often used for manufactured goods
Creating a sense of affinity for brands is a challenging task.

Marketing managers often seek to create a customer community.

Successful online communities offer certain benefits.
Successful Internet Communities Offer:

- A forum for exchange.
- A sense of place.
- Congenial and stimulating dialogues.
- Encouragement for active participation.
Relationship Marketing Programs

Other ideas:
- Volunteer Ambassador program
- Customer defection research studies
Relationship Marketing Programs

Privacy issues

- Critically important for two key reasons.
- Online communities need to post privacy policy information.
## Table 14.4
CRM-Oriented Metrics

<table>
<thead>
<tr>
<th>1. Traditional marketing metrics</th>
<th>3. Popular customer-based value metrics</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Market share</td>
<td>a. Share of category requirement</td>
</tr>
<tr>
<td>b. Sales growth</td>
<td>b. Size of wallet</td>
</tr>
<tr>
<td>2. Primary customer-based metrics</td>
<td>c. Share of wallet</td>
</tr>
<tr>
<td>a. Acquisition rate</td>
<td>d. Expected share of wallet</td>
</tr>
<tr>
<td>b. Acquisition cost</td>
<td></td>
</tr>
<tr>
<td>c. Retention rate</td>
<td>4. Strategic customer-based value metrics</td>
</tr>
<tr>
<td>d. Survival rate</td>
<td>a. Past customer value</td>
</tr>
<tr>
<td>e. ( P ) (Active)</td>
<td>b. RFM value</td>
</tr>
<tr>
<td>f. Lifetime duration</td>
<td>c. Customer lifetime value</td>
</tr>
<tr>
<td>g. Win-bank rate</td>
<td>d. Customer equity</td>
</tr>
</tbody>
</table>


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Executive Summary

- Buyer-seller relationships do not end with the sale.
- Customer loyalty has economic advantages.
- CRM develops and manages long-term customer relationships.
- Complete CRM programs have several steps.
- Customer satisfaction is key.
- Outstanding customer service taps into the augmented product.
- Frequency programs help maintain loyalty.
- Mass customization helps develop long-term relationships.
- Brand communities help to stimulate customer interactions.
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