MBS1123 | Marketing Management

Prepared by Dr Khairul Anuar

L3 – Creating Long-Term Loyalty Relationships

Chapter Questions

- How can companies deliver customer value, satisfaction, and loyalty?
- What is the lifetime value of customers and how can marketers maximize it?
- How can companies attract and retain customers and cultivate strong customer relationships?
- What are the pros and cons of database marketing?

Building Customer Value, Satisfaction, and Loyalty

- Creating loyal customers is at the heart of every business.

  ‘The only value your company will ever create is the value that comes from customers - the ones you have now and the ones you will have in the future. Businesses succeed by getting, keeping, and growing customers. Customers are the only reason you build factories, hire employees, schedule meetings, lay fiber-optic lines, or engage in any business activity. Without customers, you don’t have a business.’

  Marketing experts Don Peppers & Martha Rogers

Building Customer Value, Satisfaction, and Loyalty

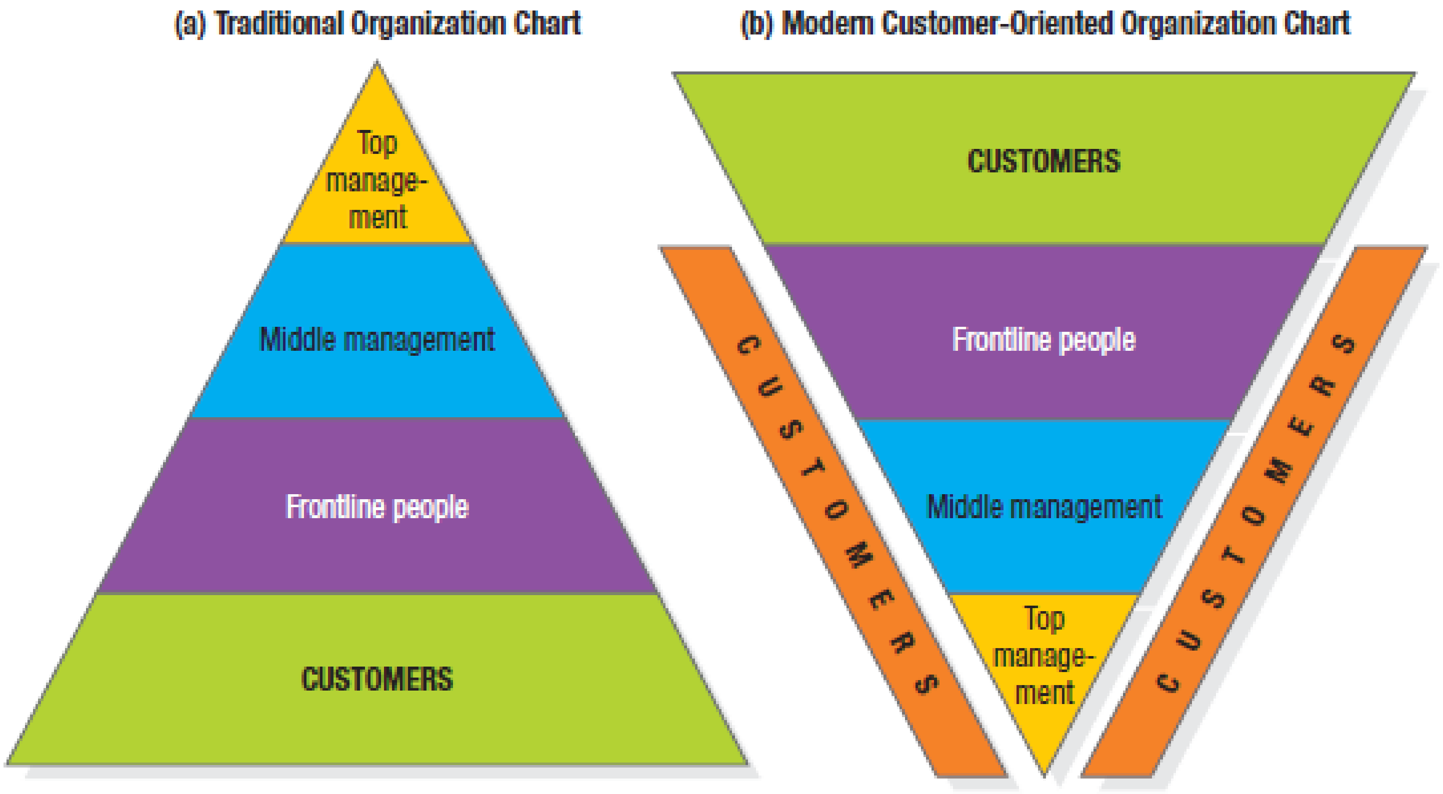
- Managers who believe the customer is the company's only true "profit center" consider the traditional organization chart in Fig. 5.1(a)

- Successful marketing companies invert the chart as in Figure 5.1(b). At the top are customers; next in importance are frontline people who meet, serve, and satisfy customers. Customers have been added along the sides of Figure 5.1(b) to indicate that managers at every level must be personally involved in knowing, meeting, and serving customers.

- With the rise of digital technologies such as the Internet, increasingly informed consumers today expect companies to do more than connect with them, more than satisfy them, and even more than delight them. They expect companies to listen and respond to them.

  ➢ *When Office Depot added customer reviews to its Web site in 2008, revenue and sales conversion increased significantly.*

Building Customer Value, Satisfaction, and Loyalty



Refer Dell case study, Kotler & Keller, page 124

Customer Perceived Value

- How do customers ultimately make choices?
- They tend to be value maximizers, within the bounds of search costs and limited knowledge, mobility, and income.
- Customers estimate which offer they believe - for whatever reason - will deliver the most perceived value and act on it (Figure 5.2).
- Whether the offer lives up to expectation affects customer satisfaction and the probability that the customer will purchase the product again.
  - ➢ *2008 survey asking U.S. consumers "Does [Brand X] give good value for what you pay?"*
    - ✓ *the highest scoring brands included Craftsman tools, Discovery Channel, History Channel, Google, and Rubbermaid.*

Customer Perceived Value

Figure 4.1 Determinants of Customer Perceived Value

Total customer benefit	Total customer cost
Product benefit	Monetary cost
Services benefit	Time cost
Personal benefit	Energy cost
Image benefit	Psychological cost

Customer Perceived Value

- **Customer-perceived value (CPV)** is the difference between the prospective customer’s evaluation of all the benefits and all the costs of an offering and the perceived alternatives.
-
- **Total customer benefit** is the perceived monetary value of the bundle of economic, functional, and psychological benefits customers expect from a given market offering because of the product, service, people, and image.

- **Total customer cost** is the perceived bundle of costs customers expect to incur in evaluating, obtaining, using, and disposing of the given market offering, including monetary, time, energy, and psychological costs.

Customer Perceived Value

- Customer-perceived value is thus based on the difference between benefits the customer gets and costs he or she assumes for different choices.

- The marketer can increase the value of the customer offering by raising economic, functional, or emotional benefits and/or reducing one or more costs.

- The customer choosing between two value offerings, V1 and V2:

  - ➢ will favor V1 if the ratio V1:V2 is larger than one,
  - ➢ favor V2 if the ratio is smaller than one, and
  - ➢ be indifferent if the ratio equals one.

  ✓ *Refer Caterpillar vs Komatsu case, page 125 - Kotler & Keller*

Choice Processes and Implications

- Identify major attributes and benefits that customers value
- Assess the qualitative importance of different attributes and benefits
- Assess the company's and competitor's performances on the different customer values against rated importance
- Examine ratings of specific segments
- Monitor customer values over time
- *Refer: Kotler and Keller, page 148*

Delivering High Customer Value

- Consumers have varying degrees of loyalty to specific brands, stores, and companies. What is Loyalty?

- *“Loyalty is a deeply held commitment to re-buy or re-patronize a preferred product or service in the future despite situational influences and marketing efforts having the potential to cause switching behavior.”*

Delivering High Customer Value

- The **value proposition** consists of the whole cluster of benefits the company promises to deliver; it is more than the core positioning of the offering.

- Eg, Volvo’s core positioning has been “safety,” but the buyer is promised more than just a safe car; other benefits include good performance, design, and safety for the environment.

- The value proposition is thus a promise about the experience customers can expect from the company’s market offering and their relationship with the supplier. Whether the promise is kept depends on the company’s ability to manage its value delivery system.

- The **value delivery system** includes all the experiences the customer will have on the way to obtaining and using the offering. At the heart of a good value delivery system is a set of core business processes that help deliver distinctive consumer value.

XC60
THE FIRST CAR TO STOP TRAFFIC. AND ITSELF.
INTRODUCING THE NEW VOLVO XC60 WITH CITY SAFETY.
Volvo. for life
VOLVO

Top Brands in Customer Loyalty

- Apple iPhone
- Clairol
- Samsung
- Mary Kay
- Grey Goose
- Clinique
- Avis
- Wal-Mart
- Google
- Amazon
- Bing
- J.Crew
- AT&T Wireless
- Discover Card
- Verizon Wireless
- Cheerios

2010 Data / Source: www.brandkeys.com

Total Customer Satisfaction

- In general, **satisfaction** is a person’s feelings of pleasure or disappointment that result from comparing a product’s perceived performance (or outcome) to expectations.
- If the performance falls short of expectations, the customer is dissatisfied. If it matches expectations, the customer is satisfied. If it exceeds expectations, the customer is highly satisfied or delighted.
- Customer assessments of product performance depend on many factors, especially the type of loyalty relationship the customer has with the brand.
- Consumers often form more favorable perceptions of a product with a brand they already feel positive about.

Total Customer Satisfaction

- Although the customer-centered firm seeks to create high customer satisfaction, that is not its ultimate goal.

- Increasing customer satisfaction by lowering price or increasing services may result in lower profits.

  - ➢ The company might be able to increase its profitability by means other than increased satisfaction (eg, by improving manufacturing processes or investing more in R&D).

  - ➢ Also, the company has many stakeholders, including employees, dealers, suppliers, and stockholders.

- Hence, the company must try to deliver a high level of customer satisfaction subject to also delivering acceptable levels to other stakeholders, given its total resources.

Monitoring Satisfaction

- Many companies are systematically measuring how well they treat customers, identifying the factors shaping satisfaction, and changing operations and marketing as a result.

- Wise firms measure customer satisfaction regularly, because it is one key to customer retention.

- A highly satisfied customer generally stays loyal longer, buys more as the company introduces new and upgraded products, talks favorably to others about the company and its products, pays less attention to competing brands and is less sensitive to price, offers product or service ideas to the company, and costs less to serve than new customers because transactions can become routine.

- Greater customer satisfaction has also been linked to higher returns and lower risk in the stock market.

Measuring Satisfaction

- **Periodic surveys** can track customer satisfaction directly and ask additional questions to measure repurchase intention and the respondent's likelihood or willingness to recommend the company and brand to others.

- Companies need to monitor their **competitors' performance**.

- They can monitor their **customer loss rate** and contact those who have stopped buying or who have switched to another supplier to find out why.

- Finally, companies can hire *mystery shoppers* to pose as potential buyers and report on strong and weak points experienced in buying the company's and competitors' products. Managers themselves can enter company and competitor sales situations where they are unknown and experience firsthand the treatment they receive, or they can phone their own company with questions and complaints to see how employees handle the calls

- <u>*Refer Kotler and Keller, page 151*</u>

Product and Service Quality

- Customer satisfaction will also depend on product and service quality.

‘**Quality** is the totality of features and characteristics of a product or service that bear on its ability to satisfy stated or implied needs.”

- ➢ The definition is clearly a customer-centered definition.
- ➢ We can say the seller has delivered quality whenever its product or service meets or exceeds the customers’ expectations.

Conformance Quality and Performance Quality

- A company that satisfies most of its customers' needs most of the time is called a quality company, but we need to distinguish between **conformance quality** and **performance quality** (or grade).

  - ➢ A Lexus provides higher performance quality than a Hyundai: The Lexus rides smoother, goes faster, and lasts longer.
  - ➢ Yet both a Lexus and a Hyundai deliver the same conformance quality if all the units deliver their respective promised quality.

Impact of Quality

- Product and service quality, customer satisfaction, and company profitability are intimately connected.
- Higher levels of quality result in higher levels of customer satisfaction, which support higher prices and (often) lower costs.
- Studies have shown a high correlation between relative product quality and company profitability.
- Companies that have lowered costs to cut corners have paid the price when the quality of the customer experience suffers: When Northwest Airlines stopped offering free magazines, pillows, movies, and even minibags of pretzels on domestic flights, it also raised prices and reduced its flight schedule.
  - ➢ Subsequently, Northwest came in last of all top U.S. airlines in customer satisfaction polls soon thereafter. As one frequent flier noted, Northwest acts low cost without *being* low cost."

✓ *Refer Kotler & Keller, page 154, on British Airways*

Maximizing Customer Lifetime Value

Customer Profitability

Lifetime Value

Customer-Product Profitability Analysis

Refer to Figure 5.3

- Customers are arrayed along the columns and products along the rows.

- Each cell contains a symbol representing the profitability of selling that product to that customer.

  - ➢ Customer 1 is very profitable; he buys two profit-making products (P1 and P2).
  - ➢ Customer 2 yields mixed profitability; he buys one profitable product (P1) and one unprofitable product (P3).
  - ➢ Customer 3 is a losing customer because he buys one profitable product (P1) and two unprofitable products (P3 and P4).

  - ➢ What can the company do about customers 2 and 3?
    - ✓ (1) It can raise the price of its less profitable products or eliminate them, or
    - ✓ (2) it can try to sell customers 2 and 3 its profit-making products.

  Unprofitable customers who defect should not concern the company. In fact, the company should encourage them to switch to competitors.

Customer-Product Profitability Analysis

Figure 5.3: Customer-Product Profitability Analysis

Customers

Products	C_1	C_2	C_3	
P_1	+	+	+	Highly profitable product
P_2	+			Profitable product
P_3		−	−	Unprofitable product
P_4			−	Highly unprofitable product
	High-profit customer	Mixed-bag customer	Losing customer	

Estimating Lifetime Value

- The case for maximizing long-term customer profitability is captured in the concept of customer lifetime value.

- **Customer lifetime value (CLV)** describes the NPV of the stream of future profits expected over the customer's lifetime purchases. The company must subtract from its expected revenues the expected costs of attracting, selling, and servicing the account of that customer, applying the appropriate discount rate (say, between 10% and 20%, depending on cost of capital and risk attitudes).
- Lifetime value calculations for a product or service can add up to tens of thousands of dollars or even into six figures. Many methods exist to measure CLV.

- Workings:
  - ❖ Annual customer revenue: $400
  - ❖ Average number of loyal years: 20
  - ❖ Company profit margin: 10
  - ❖ Customer lifetime value: $1000

Customer Relationship Management

- **CRM** is the process of carefully managing detailed information about individual customers and all customer touch points to maximize customer loyalty.

- A *customer touch point* is any occasion on which a customer encounters the brand and product— from actual experience to personal or mass communications to casual observation.

- CRM enables companies to provide excellent real-time customer service through the effective use of individual account information.

- Based on what they know about each valued customer, companies can customize market offerings, services, programs, messages, and media.

- CRM is important because a major driver of company profitability is the aggregate value of the company's customer base.

Customer Relationship Management

- Eg. For hotel, the touch points include reservations, check-in and checkout, frequent-stay programs, room service, business services, exercise facilities, laundry service, restaurants, and bars.

- The Four Seasons relies on personal touches, such as a staff that always addresses guests by name, highpowered employees who understand the needs of sophisticated business travelers, and at least one best-in-region facility, such as a premier restaurant or spa.

Framework for CRM

1. ***Identify your prospects and customers.*** Don't go after everyone. Build, maintain, and mine a rich customer database with information from all the channels and customer touch points.

2. ***Differentiate customers in terms of (1) their needs and (2) their value to your company.*** Spend proportionately more effort on the most valuable customers (MVCs). Estimate NPV of all future profits from purchases, margin levels, and referrals, less customer-specific servicing costs.

3. ***Interact with individual customers to improve your knowledge about their individual needs and to build stronger relationships.*** Formulate customized offerings you can communicate in a personalized way.

4. ***Customize products, services, and messages to each customer.*** Facilitate customer interaction through the company contact center and Web site

Attracting and Retaining Customers

- Companies seeking to expand their profits and sales must spend considerable time and resources searching for new customers.

- Different acquisition methods yield customers with varying CLVs.

- One study showed that customers acquired through the offer of a 35% discount had about one-half the long-term value of customers acquired without any discount.

- Campaigns that target loyal customers by reinforcing the benefits they enjoy often also attract new customers.

- Two-thirds of the considerable growth spurred by UK mobile communication leader O2's loyalty strategy was attributed to recruitment of new customers, the remainder from reduced defection.

Attracting and Retaining Customers

- **Reducing defection** is not enough to attract new customers; the company must also keep them and increase their business. Too many companies suffer from high **customer churn** or defection. Adding customers here is like adding water to a leaking bucket.

- Cellular carriers and cable TV operators are plagued by “spinners,” customers who switch carriers at least three times a year looking for the best deal. Many lose 25 percent of their subscribers each year, at an estimated cost of $2 billion to $4 billion. Some of the dissatisfaction defecting customers cite comes from unmet needs and expectations, poor product/service quality and high complexity, and billing errors.

Reducing Defection

- To reduce the defection rate, the company must:

1. ***Define and measure its retention rate.*** For a magazine, subscription renewal rate is a good measure of retention. For a college, it could be first- to second-year retention rate, or class graduation rate.

2. ***Distinguish the causes of customer attrition and identify those that can be managed better.*** Not much can be done about customers who leave the region or go out of business, but much can be done about those driven away by poor service, shoddy products, or high prices.

3. ***Compare the lost customer's lifetime value to the costs of reducing the defection rate.*** As long as the cost to discourage defection is lower than the lost profit, spend the money to try to retain the customer.

Attracting and Retaining Customers

- Reduce the rate of defection
- Increase longevity
- Enhance share of wallet
- Terminate low-profit customers
- Focus more effort on high-profit customers

Retention Dynamics

- Figure 5.4 shows the main steps in attracting and retaining customers in terms of a funnel and some sample questions to measure customer progress through the funnel.

- The **marketing funnel** identifies the percentage of the potential target market at each stage in the decision process, from merely aware to highly loyal.

- Consumers must move through each stage before becoming loyal customers.

- Some marketers extend the funnel to include loyal customers who are brand advocates or even partners with the firm.

Retention Dynamics

- By calculating *conversion rates*—the % of customers at one stage who move to the next - the funnel allows marketers to identify any bottleneck stage or barrier to building a loyal customer franchise.

- If the percentage of recent users is significantly lower than triers, for instance, something might be wrong with the product or service that prevents repeat buying.

- The funnel also emphasizes how important it is not just to attract new customers, but to retain and cultivate existing ones.

- Satisfied customers are the company's *customer relationship capital.* If the company were sold, the acquiring company would pay not only for the plant and equipment and brand name, but also for the delivered *customer base,* the number and value of customers who will do business with the new firm.

Retention Dynamics

- Consider this data about customer retention:

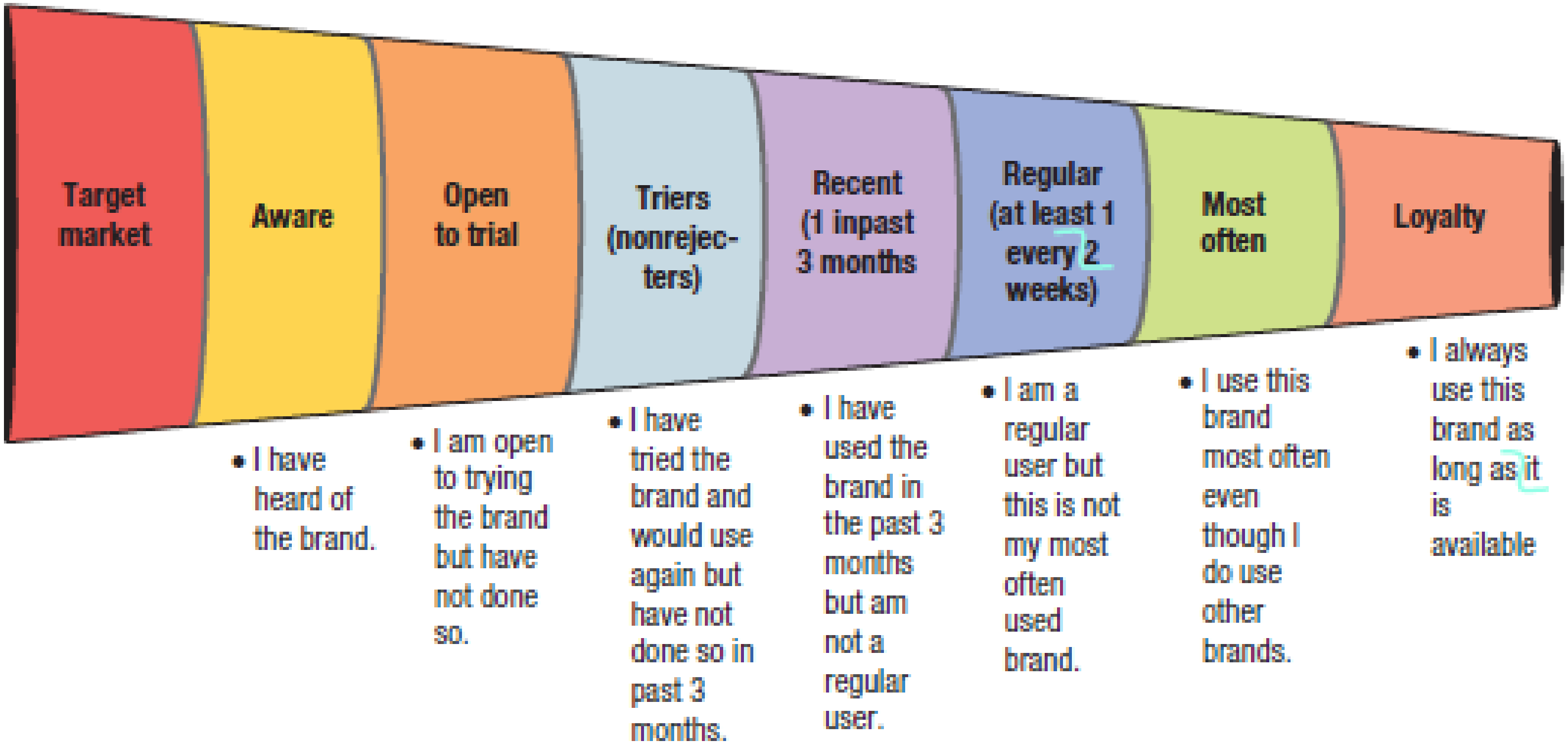
  - Acquiring new customers can cost five times more than satisfying and retaining current ones. It requires a great deal of effort to induce satisfied customers to switch from their current suppliers.

  - The average company loses 10 percent of its customers each year.

  - A 5 percent reduction in the customer defection rate can increase profits by 25 percent to 85 percent, depending on the industry.

  - Profit rate tends to increase over the life of the retained customer due to increased purchases, referrals, price premiums, and reduced operating costs to service.

Figure 5.4 The Marketing Funnel



Managing Customer Base

- Customer profitability analysis and the marketing funnel help marketers decide how to manage groups of customers that vary in loyalty, profitability, and other factors.
- A key driver of shareholder value is the aggregate value of the customer base.
- Winning companies improve that value by excelling at strategies like the following:
  - ➢ *Reducing the rate of customer defection.*
  - ➢ *Increasing the longevity of the customer relationship.*
  - ➢ *Enhancing the growth potential of each customer through "share of wallet," cross-selling, and up-selling.*
  - ➢ *Making low-profit customers more profitable or terminating them.*
  - ➢ *Focusing disproportionate effort on high-profit customers.*
  - ✓ <u>*(Refer handout: Kotler & Keller, page 140-141*</u>

Managing Customer Base

- Winning companies improve that value by excelling at strategies like the following:

• ***Reducing the rate of customer defection.*** Selecting and training employees to be knowledgeable and friendly increases the likelihood that customers' shopping questions will be answered satisfactorily. Whole Foods, the world's largest retailer of natural and organic foods, woos customers with a commitment to market the best foods and a team concept for employees.

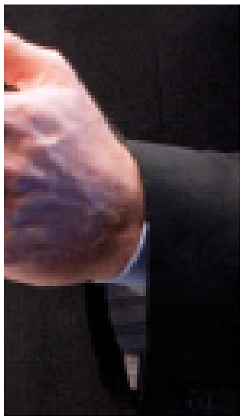
• ***Increasing the longevity of the customer relationship.*** The more engaged with the company, the more likely a customer is to stick around. Nearly 65 percent of new Honda purchases replace an older Honda. Drivers cited Honda's reputation for creating safe vehicles with high resale value.

• ***Enhancing the growth potential of each customer through "share of wallet," cross-selling, and up-selling.*** Sales from existing customers can be increased with new offerings and opportunities. Harley-Davidson sells more than motorcycles and accessories like gloves, leather jackets, helmets, and sunglasses. Its dealerships sell more than 3,000 items of clothing—some even have fitting rooms. Licensed goods sold by others range from predictable items (shot glasses, cue balls, and Zippo cigarette lighters) to the more surprising (cologne, dolls, and cell phones).

• ***Making low-profit customers more profitable or terminating them.*** To avoid the direct need for termination, marketers can encourage unprofitable customers to buy more or in larger quantities, forgo certain features or services, or pay higher amounts or fees. Banks, phone companies, and travel agencies all now charge for once-free services to ensure minimum revenue levels. Firms can also discourage those with questionable profitability prospects. Progressive Insurance screens customers and diverts the potentially unprofitable to competitors. "Free" customers who pay little or nothing and are subsidized by paying customers - as in print and online media, employment and dating services, and shopping malls—may still create useful direct and indirect network effects, however, an important function.

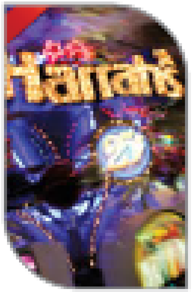
• ***Focusing disproportionate effort on high-profit customers.*** The most profitable customers can be treated in a special way. Thoughtful gestures such as birthday greetings, small gifts, or invitations to special sports or arts events can send them a strong positive signal.

Building Customer Value, Satisfaction, and Loyalty



Dell Dell rode to success by offering low-priced computers, logistical efficiency, and after-sales service. The firm's maniacal focus on low costs has been a key ingredient in its success. When the company shifted its customer-service call centers to India and the Philippines to cut costs, however, understaffing frequently led to 30-minute waits for customers. Almost half the calls required at least one transfer. To discourage customer calls, Dell even removed its toll-free service number from its Web site. With customer satisfaction slipping, and competitors matching its product quality and prices *and* offering improved service, Dell's market share and stock price both declined sharply. Dell ended up hiring more North American call center employees. "The team was managing cost instead of managing service and quality," Michael Dell confesses.[8]

Harrah’s Builds Relationships



In 1997, Harrah's Entertainment, in Las Vegas, launched a pioneering loyalty program that pulled all customer data into a centralized warehouse and provided sophisticated analysis to better understand the value of the investments the casino made in its customers. Harrah's has over 10 million active members in its Total Rewards loyalty program, a system it has fine-tuned to achieve near-real-time analysis: As customers interact with slot machines, check into casinos, or buy meals, they receive reward offers—food vouchers or gambling credits, for example—based on the predictive analyses. The company has now identified hundreds of highly specific customer segments, and by targeting offers to each of them, it can almost double its share of customers' gaming budgets and generate $6.4 billion annually (80 percent of its gaming revenue). Harrah's dramatically cut back its traditional ad spending, largely replacing it with direct mail and e-mail—a good customer may receive as many as 150 pieces in a year. Data from the Total Rewards program even influenced Harrah's decision to buy Caesars Entertainment, when company research revealed that most of Harrah's customers who visited Las Vegas without staying at a Harrah's-owned hotel were going to Caesars Palace. Harrah's latest loyalty innovation is a mobile marketing program that sends time-based and location-based offers to customers' mobile devices in real time.[1]

As Harrah's experien
are those who carefully r
chapter, we spell out in det
customers and beating co
doing a better job of meetin

Caterpillar Caterpillar has become a leading firm by maximizing total customer value in the construction-equipment industry, despite challenges from a number of able competitors such as John Deere, Case, Komatsu, Volvo, and Hitachi. First, Caterpillar produces high-performance equipment known for reliability and durability—key purchase considerations in heavy industrial equipment. The firm also makes it easy for customers to find the right product by providing a full line of construction equipment and a wide range of financial terms. Caterpillar maintains the largest number of independent construction-equipment dealers in the industry. These dealers all carry a complete line of Caterpillar products and are typically better trained and perform more reliably than competitors' dealers. Caterpillar has also built a worldwide parts and service system second to none in the industry. Customers recognize all the value Caterpillar creates in its offerings, allowing the firm to command a premium price 10 percent to 20 percent higher than competitors. Caterpillar's biggest challenges are a reenergized Komatsu, which has made a strong push in China, and some supply chain issues in introducing new products.[11]