Chapter 9

Managing the customer lifecycle: customer retention and development

By the end of this chapter, you will understand:

1. what is meant by the term 'customer retention'
2. the economics of customer retention
3. how to select which customers to target for retention
4. the distinction between positive and negative customer retention
5. several strategies for improving customer retention performance
6. several strategies for growing customer value
7. why and how customers are 'sacked'.

Introduction

The customer lifecycle is made up of three core customer management processes: customer acquisition, customer retention and customer development. The processes of customer retention and development are the focus of this chapter. Customer acquisition is covered in Chapter 8.

The major strategic purpose of CRM is to manage, for profit, a company's relationships with customers through three stages of the customer lifecycle: customer acquisition, customer retention and customer development.

A customer retention strategy aims to keep a high proportion of valuable customers by reducing customer defections (churn), and a customer development strategy aims to increase the value of those retained customers to the company. Just as customer acquisition is focused on particular prospects, retention and development also focus on particular customers. Focus is necessary because not all customers are worth retaining and not all customers have potential for development.

We will deal with the issue of retention first, before turning to development.

A number of important questions have to be answered when a company puts together a customer retention strategy.

- Which customers will be targeted for retention?
- What customer retention strategies will be used?
- How will the customer retention performance be measured?

We believe that these issues need to be carefully considered and programmed into a properly resourced customer retention plan. Many companies, perhaps as many as six out of ten, have no explicit customer retention plan in place.[1] Most companies spend a majority of their time, energy and resources chasing new business, with 75 per cent or more of marketing budgets being earmarked for customer acquisition.[2]

What is customer retention?

Customer retention is the maintenance of continuous trading relationships with customers over the long term. Customer retention is the mirror image of customer defection or churn. High retention is equivalent to low defection.[3]

Conventionally, customer retention is defined as:[4]

> Customer retention is the number of customers doing business with a firm at the end of a financial year, expressed as percentage of those who were active customers at the beginning of the year.

However, the appropriate interval over which retention rate should be measured is not always one year. Rather, it depends on the customer repurchase cycle. Car insurance and magazine subscriptions are bought on an annual basis. Carpet tiles and hi-fis are not. If the normal hi-fi replacement cycle is four years, then retention rate is more meaningful if it is measured over four years instead of twelve months. Additional complexity is added when companies sell a range of products and services, each with different repurchase cycles. Automobile dealers might sell cars, parts, fuel and service to a single customer. These products have different repurchase cycles which make it very difficult for the dealer to have a whole of customer perspective on retention.

Sometimes companies are not clear about whether an individual customer has defected. This is because of the location of customer-related data, which might be retained in product silos, channel silos or functional silos.

● **Product silos:** consider personal insurance. Insurance companies often have product-based information systems. Effectively, they regard an insurance policy as a customer. If the policy is renewed, the customer is regarded as retained. However, take a customer who shops around for a better price and, after the policy has expired, returns to the original insurer. The insurer may take the new policy to mean a new customer has been gained, and an old customer has churned. They would be wrong.
● **Channel silos:** in the B2B context, independent office equipment dealers have formed into cooperative buying groups to purchase goods at lower prices and benefit from other economies of scale in marketing. When a dealer stops buying direct from Brother Electronics and joins a buying group, Brother's customer data may report a defection, but all that has happened is that the dealer has begun to buy through a different channel.[5] Telecommunications companies acquire customers through many channels. Consider a customer who buys a 12 month mobile phone contract from a Vodafone-owned retail outlet. Part way through the year Vodafone launches a new pay-as-you-go product with no contractual obligation. The customer allows her current contract to expire and then buys the new pay-as-you-go product, not from a Vodafone outlet but from a supermarket.

Vodafone regards her as a lost customer because the contract was not renewed. They would be wrong.

● **Functional silos:** customer-related data are often kept in functional silos that are not integrated to provide a whole of customer perspective. A customer might not have made a product purchase for several years, and is therefore regarded as a churned customer on the sales database. However, the same customer might have several open queries or issues on the customer service database, and is therefore regarded as still active.

The use of aggregates and averages in calculating customer retention rates can mask a true understanding of retention and defection. This is because customers differ in their sales, costs-to-serve and buying behaviours. It is not unusual for a small number of customers to account for a large proportion of company revenue. If you have 100 customers and lose ten in the course of a year, your raw defection rate is 10 per cent. But what if these customers account for 25 per cent your company's sales? Is the true defection rate 25 per cent? Consideration of profit makes the computation even more complex. If the 10 per cent of customers that defected produce 50 per cent of your company's profits, is the true defection rate 50 per cent?

What happens if the 10 per cent of lost customers are at the other end of the sales and profit spectrum? In other words what if they buy very little and/or have a high cost-to-serve? It could be that they contribute less than 5 per cent to sales and actually generate a negative profit, i.e. they cost more to serve than they generate in margin. The loss of some customers might improve the company's profit performance. It is not inconceivable that a company could retain 90 per cent of its customers, 95 per cent of its sales and 105 per cent of its profit!

A solution to this problem is to consider three measures of customer retention:

1. **Raw customer retention rate:** this is the number of customers doing business with a firm at the end of a trading period, expressed as percentage of those who were active customers at the beginning of the period.
2. **Sales-adjusted retention rate:** this is the value of sales achieved from the retained customers, expressed as a percentage of the sales achieved from all customers who were active at the beginning of the period.
3. **Profit-adjusted retention rate:** this is the profit earned from the retained customers, expressed as a percentage of the profit earned from all customers who were active at the beginning of the period.

A high raw customer retention rate does not always signal excellent customer retention performance. This is because customer defection rates vary across cohorts of customers. Defection rates tend to be much higher for newer customers than longer tenure customers. Over time, as seller and buyer demonstrate commitment, trust grows and it becomes progressively more difficult to break the relationship.[6] Successful

customer acquisition programmes could produce the effect of a high customer defection rate, simply because new customers are more likely to defect.

A high sales-adjusted customer retention rate might also need some qualification. Consider a corporate customer purchasing office equipment. The customer's business is expanding fast. It purchased 30 personal computers (PCs) last year, 20 of which were sourced from Apex Office Supplies. This year it bought 50 PCs, of which 30 were from Apex. From Apex's point of view it has grown customer value by 50 per cent (from 20 to 30 machines), which it might regard as an excellent achievement. However, in a relative sense, Apex's share of customer has fallen from 67 per cent (20/30) to 60 per cent (30/50). How should Apex regard this customer? The customer is clearly a retained customer in a 'raw' sense, has grown in absolute value, but has fallen in relative value. Consider also a retail bank customer who maintains a savings account, but during the course of a year transfers all but a few dollars of her savings to a different institution in pursuit of a better interest rate. This customer is technically still active, but significantly less valuable to the bank.

Manage customer retention or value retention?

This discussion indicates that companies should focus on retaining customers that contribute value. Sometimes this will mean that the focus is not on retention of customers, *per se*, but on retention of share of wallet. In the banking industry, for example, it may be more important for companies to focus on managing the overall downward migration of customer spending than managing customer retention. Many customers simply change their buying behaviour rather than defect. Changes in buying behaviour may be responsible for greater changes in customer value than defection. One bank, for example, lost 3 per cent of its total balances when 5 per cent of checking account customers defected in a year, but lost 24 per cent of its total balances when 35 per cent of customers reduced the amounts deposited in their checking accounts. The need to manage migration, rather than defection, is particularly important when customers engage in portfolio purchasing by transacting with more than one supplier.[7]

Improving customer retention is an important objective for many CRM implementations. Its definition and measurement need to be sensitive to the sales, profitability and value issues discussed previously. It is important to remember that the fundamental purpose of focusing CRM efforts on customer retention is to ensure that the company maintains relationships with value-adding customers. It may not be beneficial to maintain relationships with all customers; some may be too costly to serve, others may be strategic switchers constantly in search of a better deal. These can be value-destroyers, not value-adders.

Economics of customer retention

There is a strong economic argument in favour of customer retention, which was first introduced in Chapter 2. The argument goes as follows:[8]

1. **Increasing purchases as tenure grows:** over time, customers come to know their suppliers. Providing the relationship is satisfactory, trust grows while risk and uncertainty are reduced. Therefore, customers commit more of their spending to those suppliers with whom they have a proven and satisfactory relationship. Also, because suppliers develop deeper customer intimacy over time, they can enjoy better yields from their cross-selling efforts.
2. **Lower customer management costs over time:** the relationship start-up costs that are incurred when a customer is acquired can be quite high. It may take several years for enough profit to be earned from the relationship to recover those acquisition costs. For example, it can take six years to recover the costs of winning a new retail bank customer.[9] In the B2B context in particular, ongoing relationship maintenance costs such as selling and service costs can be low relative to the costs of winning the account. Therefore, there is a high probability that the account will become more profitable on a period-by-period basis as tenure lengthens. These relationship maintenance costs may eventually be significantly reduced or even eliminated as the parties become closer over time. In the B2B context, once automated processes are in place, transaction costs are effectively eliminated. Portals largely transfer account service costs to the customer. In the B2C context, especially in retailing, the assertion that acquisition costs generally exceed retention costs is hard to prove. This is in part because it is very difficult to isolate and measure customer acquisition costs.[10]
3. **Customer referrals:** customers who willingly commit more of their purchases to a preferred supplier are generally more satisfied than customers who do not. They are therefore more likely to utter positive word-of-mouth and influence the beliefs, feelings and behaviours of others. Research shows that customers who are frequent buyers are heavier referrers. For example, online clothing customers who have bought once refer three other people; after ten purchases they will have referred seven. In consumer electronics, the one-time customer refers four; the ten times customer refers 13. The referred customers spend about 50 to 75 per cent of the referrer's spending over the first three years of their relationship.[11] However, it is also likely that newly acquired customers, freshly enthused by their experience, would be powerful word-of-mouth advocates, perhaps more than longer-term customers who are more habituated.[12]
4. **Premium prices:** customers who are satisfied in their relationship may reward their suppliers by paying higher prices. This is because they get their sense of value from more than price alone. Customers

in an established relationship are also likely to be less responsive to price appeals offered by competitors.

These conditions mean that retained customers are generally more profitable than newly acquired customers. Drawing from their consulting experience, Dawkins and Reichheld report that a 5 per cent increase in customer retention rate leads to an increase in the net present value of customers by between 25 and 95 per cent across a wide range of industries, including credit cards, insurance brokerage, automobile services and office building management.[13] In short, customer retention drives up customer lifetime value.

Which customers to retain?

Simply, the customers who have greatest strategic value to your company are prime candidates for your retention efforts. These are the customers we defined as having high lifetime value or who are otherwise strategically significant as high volume customers, benchmarks, inspirations or door openers, as described in Chapter 5.

You need to bear in mind that the cost of customer retention may be considerable. Your most valued customers are also likely to be very attractive to your competitors. If the costs of retaining customers become too great then they might lose their status as strategically significant.

The level of commitment between your customer and you will figure in the decision about which customers to retain. If the customer is highly committed, they will be impervious to the appeals of competitors, and you will not need to invest so much in their retention. However, if you have highly significant customers who are not committed, you may want to invest considerable sums in their retention.

Some companies prefer to focus their retention efforts on their recently acquired customers. They often have greater future lifetime value potential than longer tenure customers. There is some evidence that retention rates rise over time, so if defections can be prevented in the early stages of a relationship, there will be a pay-off in future revenue streams.[14] A further justification for focusing on recently acquired customers comes from research into service failures. When customers experience service failure, they may be more forgiving if they have a history of good service with the service provider. In other words, customers who have been recently acquired and let down are more likely to defect or reduce their spending than customers who have a satisfactory history with the supplier.[15]

Retention efforts where there is portfolio purchasing can be very difficult. Should effort be directed at retaining the high-share customer with whom you have a profitable relationship, the medium-share customer from whom you might lose additional share to competitors or the low-share customer from whom there is considerable lifetime value potential? The answer will depend on the current value of the customer, the potential for growing that value, and the cost of maintaining and developing the relationship.

Strategies for customer retention

Positive and negative retention strategies

An important distinction can be made between strategies that lock the customer in by penalizing their exit from a relationship, and strategies that reward a customer for remaining in a relationship. The former are generally considered negative, and the latter positive, customer retention strategies. Negative customer retention strategies impose high switching costs on customers, discouraging their defection.

In a B2C context, mortgage companies have commonly recruited new customers with attractive discounted interest rates. When the honeymoon period is over, these customers may want to switch to another provider, only to discover that they will be hit with early redemption and exit penalties. Customers wishing to switch retail banks find that it is less simple than anticipated: direct debits and standing orders have to be reorganized. In a B2B context, a customer may have agreed a deal to purchase a given volume of raw material at a quoted price. Some way through the contract a lower cost supplier makes a better offer. The customer wants to switch, but finds that there are penalty clauses in the contract. The new supplier is unwilling to buy the customer out of the contract by paying the penalties.

Some customers find these switching costs are so high that they remain customers, though unwillingly. The danger for CRM practitioners is that negative customer retention strategies produce customers who feel trapped. They are likely to agitate to be freed from their obligations, taking up much management time. Also, they may utter negative word-of-mouth. They are unlikely to do further business with that supplier. Companies that pursue these strategies argue that customers need to be aware of what they are buying and the contracts they sign. The total cost of ownership (TCO) of a mortgage should, and does, include early redemption costs.

When presented with dissatisfied customers complaining about high relationship exit (switching) costs, companies have a choice. They can either enforce the terms and conditions, or not. The latter path is more attractive when the customer is strategically significant, particularly if the company can make an offer that matches that of the prospective new supplier.

Positive customer retention strategies

In the following sections we look at a number of positive customer retention strategies, including creating customer delight, adding

customer-perceived value, creating social and structural bonds and building customer engagement.

Customer delight

It is very difficult to build long-term relationships with customers if their needs and expectations are not understood and well met. It is a fundamental precept of modern customer management that companies should understand customers, and then acquire and deploy resources to ensure their satisfaction and retention. This is why CRM is grounded on detailed customer-related knowledge. Customers that you are not able to serve well may be better served by your competitors.

Delighting customers, or exceeding customer expectations, means going beyond what would normally satisfy the customer. This does not necessarily mean being world-class or best-in-class. It does mean being aware of what it usually takes to satisfy the customer and what it might take to delight or pleasantly surprise the customer. You cannot really strategize to delight the customer if you do not understand the customer's fundamental expectations. You may stumble onto attributes of your performance that do delight the customer, but you cannot consistently expect to do so unless you have deep customer insight. Consistent efforts to delight customers show your commitment to the relationship. Commitment builds trust. Trust begets relationship longevity.

Customer delight occurs when the customer's perception of their experience of doing business with you exceeds their expectation. In formulaic terms:

$$CD = P > E$$

where CD = customer delight, P = perception and E = expectation.

This formula implies that customer delight can be influenced in two ways: by managing expectations or by managing performance. In most commercial contexts customer expectations exceed customer perceptions of performance. In other words, customers can generally find cause for dissatisfaction. You might think that this would encourage companies to attempt to manage customer expectations down to levels that can be delivered. However, competitors may well be improving their performance in an attempt to meet customer expectations. If your strategy is to manage expectations down, you may well lose customers to the better performing company. This is particularly likely if you fail to meet customer expectations on important attributes.

Customers have expectations of many attributes, for example product quality, service responsiveness, price stability and the physical appearance of your people and vehicles. These are unlikely to be equally important. It is critical to meet customer expectations on attributes that are important to the customer. Online customers, for example, look for rapid and accurate order fulfilment, good price, high levels of customer service and website functionality. Online retailers must meet these basic requirements.

Dell Computers believes that customer retention is the outcome of their performance against three variables: order fulfilment (on-time, in full, no error (OTIFNE)), product performance (frequency of problems

encountered by customers) and after-sales service (percentage of problems fixed first time by technicians). The comments in parentheses are the metrics that Dell uses.

Figure 9.1 identifies a number of priorities for improvement (PFIs) for a restaurant company. The PFIs are the attributes where customer satisfaction scores are low, but the attributes are important to customers. In the example, the PFIs are food quality and toilet cleanliness. There would be no advantage in investing in speedier service or more helpful staff.
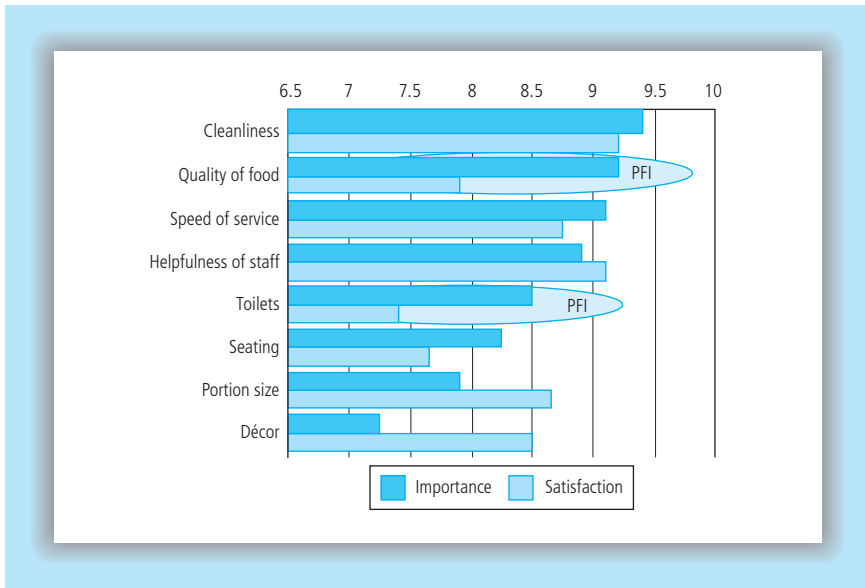
Figure 9.1
Using customer satisfaction and importance data to identify priorities for improvement

Kano's customer delight model

Noriaki Kano has developed a product quality model that distinguishes between three forms of quality. Basic qualities are those that the customer routinely expects in the product. These expectations are often unexpressed until the product fails. For example, a car's engine should start first time every time, and the sunroof should not leak. The second form is linear quality. These are attributes of which the customer wants more or less; for example, better comfort, better fuel economy and reduced noise levels. Marketing research can usually identify these requirements. Better performance on these attributes generates better customer satisfaction. The third form is attractive quality. These are attributes that surprise, delight and excite customers. They are answers to latent, unarticulated, needs and are often difficult to identify in marketing research. As shown in Figure 9.2, Kano's analysis suggests that customers can be delighted in two ways: by enhancing linear qualities beyond expectations and by creating innovative attractive qualities.[16]

Exceeding expectations need not be costly. For example, a sales representative could do a number of simple things such as:

● volunteer to collect and replace a faulty product from a customer rather than issuing a credit note and waiting for the normal call cycle to schedule a call on the customer
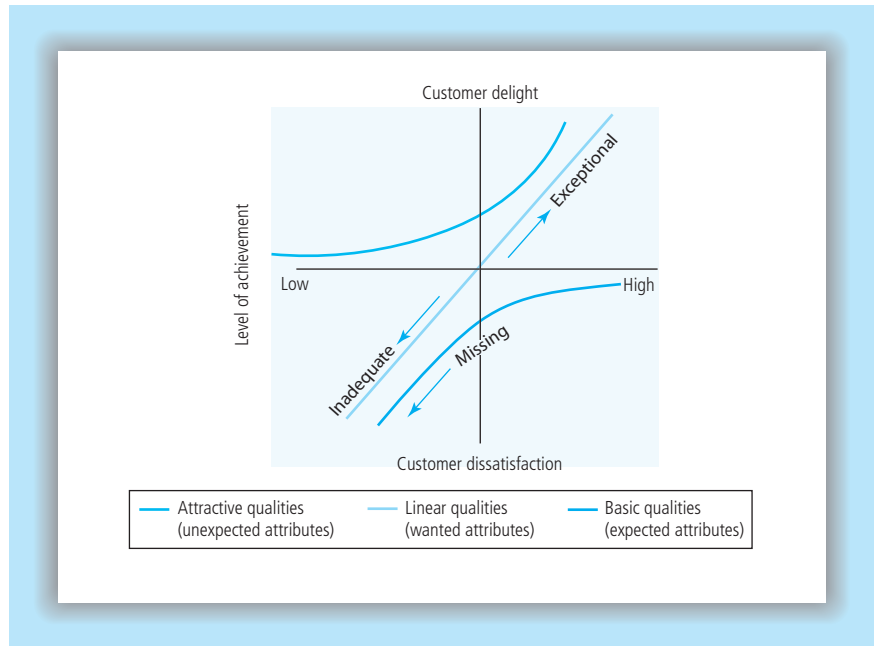
Figure 9.2
Customer delight
through product
quality.
Source: Kano 1995

- offer better, lower cost solutions to the customer, even though that might reduce profit margin
- provide information about the customer's served market. A packaging company, for example, might alert a fast-moving consumer goods manufacturer customer to competitive initiatives in their served markets.

Some efforts to delight customers can go wrong. For example, sooner is not necessarily better: if a retail store customer has requested delivery between 1 pm and 3 pm, and the driver arrives an hour early, the truck may clog up goods inwards and interfere with a carefully scheduled unload plan. Many contact centres play music while callers are waiting online. This is to divert the caller's attention and to create the illusion of faster passage of time. However, the cycle time of the selected music must not be too fast, otherwise callers will be exposed to the same songs repeatedly. Also, the music needs to be appropriate to the context. Customers may not appreciate '(I Can't Get No) Satisfaction' by the Rolling Stones if they are waiting online to complain.

A number of companies have adopted 'Customer Delight' as their mission, including Cisco, American Express and Kwik Fit, the auto service chain. Others pay homage to the goal but do not organize to achieve it. In the service industries, customer delight requires frontline employees to be trained, empowered and rewarded for doing what it takes to delight customers. It is in the interaction with customers that contact employees have the opportunity to understand and exceed their expectations. The service quality attributes of empathy and responsiveness are on show when employees successfully delight customers.

Companies sometimes complain that investing in customer delight is unproductive. As noted earlier, expectations generally increase as competitors strive to offer better value to customers. Over time, as customers experience delight, their expectations change. What was exceptional becomes the norm. In Kano's terms, what used to be an attractive attribute becomes a linear or basic attribute. It no longer delights. Delight decays into normal expectation, and companies have to look for new ways to pleasantly surprise customers. In a competitive environment, it seems to make little sense to resist the quest for customer delight because competitors will simply drive up expectations anyway.

Add customer-perceived value

The second major positive customer retention strategy is to add customer-perceived value. Companies can explore ways to create additional value for customers. The ideal is to add value for customers without creating additional costs for the company. If costs are incurred then the value-adds may be expected to recover those costs. For example, a customer club may be expected to generate a revenue stream from its membership.

There are three common forms of value-adding programme: loyalty schemes, customer clubs and sales promotions.

Loyalty schemes

Loyalty schemes reward customers for their patronage. Loyalty schemes or programmes can be defined as follows:

> A loyalty programme is a scheme that offers delayed or immediate incremental rewards to customers for their cumulative patronage.

The more a customer spends, the higher the reward. Loyalty schemes have a long history. In 1844, in the UK, the Rochdale Pioneers developed a cooperative retailing operation that distributed surpluses back to members in the form of a dividend. The surpluses were proportionate to customer spend. S&H Pink Stamps and Green Shield stamps were collected in the 1950s and 1960s, and redeemed for gifts selected from catalogues. In the 1970s, Southwest Airlines ran a 'Sweetheart Stamps' programme that enabled travellers to collect proofs of purchase and surrender them for a free flight for their partner.[17]

Today's CRM-enabled loyalty schemes owe their structure to the frequent flier programmes (FFP) that started with American Airlines' Advantage programme in 1981. The airline made a strategic decision to use its spare capacity as a resource to generate customer loyalty. Airlines are high fixed-cost businesses. Costs do not change much, regardless of whether the load factor is 25 per cent or 95 per cent. American knew that filling the empty seats would have little impact on costs, but could impact significantly on future demand. The airline searched its reservation system, SABRE, for details of frequent fliers in order to offer them the reward of free flights.

This basic model has migrated from airlines into many other B2C sectors: hotels, restaurants, retail, car hire, gas stations and bookstores,

for example. It has also transferred into B2B contexts with many suppliers offering loyalty rewards to long-term customers.

The mechanics of these schemes have changed over time. Initially, stamps were collected. The first card-based schemes were anonymous, i.e. they carried no personal data, not even the name of the participant. Then magnetic stripe cards were introduced, followed by chip-embedded cards that carried a lot of personal and transactional data. Innovators developed their own individual schemes. Eventually, these transformed into linked schemes, in which, for example, it was possible to collect air miles from various participating companies such as gas stations, credit cards and food retailers. Current schemes are massively different from the early programmes. For example, Nectar is a consortium loyalty scheme operating in the UK managed not by the participants, but by an independent third party. Its core retail participants are all number one or two in their respective markets: Sainsbury's, Barclaycard, Debenhams and BP. Shoppers register with the scheme, then carry a single magnetic stripe card and collect points that are converted into vouchers redeemable in a wide range of retailers, including supermarkets, liquor stores, catalogue retailers, restaurants, hotels, cinemas, travel outlets and tourist attractions. Each of the major retail participants had been a member of another loyalty programme, and customers were able to convert their existing credits to Nectar points (see Figure 9.3).
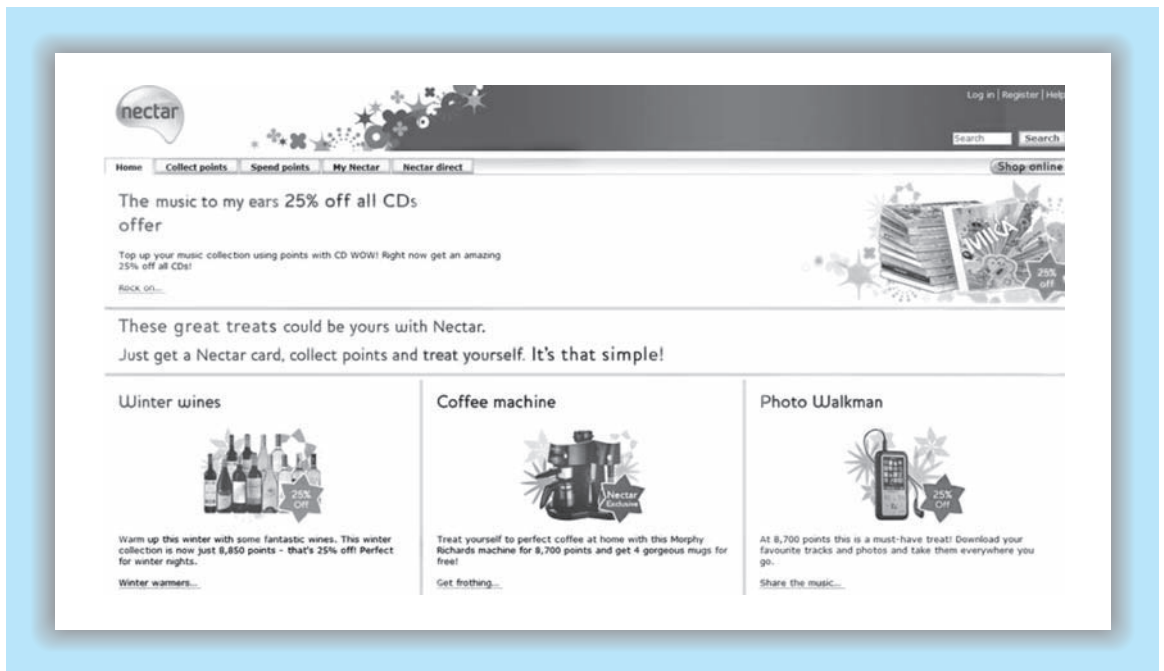

Figure 9.3 Nectar loyalty program

Loyalty programmes provide added value to consumers at two points, during credit acquisition and at redemption. Although the credits have

no material value until they are redeemed, they may deliver some pre-redemption psychological benefits to customers, such as a sense of belonging and of being valued, and an enjoyable anticipation of desirable future events. At the redemption stage, customers receive both psychological and material benefits. The reward acts to positively reinforce purchase behavior. It also demonstrates that the company appreciates its customers. This sense of being recognized as valued and important can enhance customers' overall sense of well-being and emotional attachment to the firm. However, customers can become loyal to the scheme, rather than to the company or brand behind the scheme.[18]

Loyalty schemes are not without critics. Critics question their cost and effectiveness. Certainly, they can be very expensive to establish and manage. In respect of operating costs, retail schemes typically reward customers with a cash rebate or vouchers equivalent to 1 per cent of purchases. This comes straight out of the bottom line so a retailer that is making 5 per cent margin loses one-fifth or 20 per cent of its profit to fund the scheme. There may also be a significant investment in technology to support the scheme, and marketing to launch and sustain the scheme. Supermarket operator Safeway dropped its UK loyalty programme, which had been costing about £30 million annually. Shell is reported to have spent up to £40 million to develop its smart card scheme.[19] Unredeemed credits represent liabilities for scheme operators. For example, it has been suggested that if all the unused air miles were redeemed on the same day it would take 600 000 Boeing 747s to meet the demand.[20]

Case 9.1

Loyalty programme at Boots the Chemist

Boots the Chemist is the UK's leading health and beauty retailer. Ninety per cent of the UKs 60 million plus population visits a Boots store at least once a year. The company has an annual turnover of around £3 billion from a network of some 1500 stores in the UK and Irish Republic.

Boots launched their CRM strategy in 1999. It was built around the 'Advantage Card', a loyalty programme enabled by a chip-embedded smart card. The standard reward for purchases is four points for every £1 spent, equivalent to a 4 per cent discount or rebate. This is a very generous rate of reward compared to the other retail sectors, where the major supermarket loyalty schemes represent a 1 per cent saving for customers.

After an initial investment in excess of £30 million, the programme has become the third largest retail loyalty scheme in the UK. Boots reported that it took three years to achieve the programme's revenue objectives, and there have been many other benefits such as higher levels of customer retention, increased in-store spending and overall increased profitability.

Boots took its time to introduce the scheme, rather than rapidly following the trend to loyalty schemes in the early 1990s. It conducted extensive market research to determine which customer segments to target, how to differentiate their programme and how to ensure that it fitted the organization's image. The market research discovered that 83 per cent of Boots' customers were female, aged 20–45, who on 55 per cent of their visits to a store purchased

a non-essential 'indulgent' item. Considering the results from the market research, the 'Advantage Card' was targeted towards female customers, rewarding them with indulgent items instead of reducing the cost of their normal shopping.

Since inception the card has become the largest smart card-based retail loyalty card scheme in the world. It currently has over 13 million cardholders, and more than 40 per cent of transactions in-store are now linked to the card.

Schemes are also criticized for their effectiveness. Critics claim that schemes have become less distinctive and value-adding as many competitors now operate me-too programmes. Indeed, it is very hard to find any hotel chain that does not have a loyalty programme. Customers now expect to accumulate credits as part of the standard hotel value proposition. Many UK supermarket shoppers carry loyalty cards from more than one supermarket.[21] The customer's choice set when grocery shopping might include all suppliers with whom they have a card-based relationship.

One major concern is that loyalty schemes may not be creating loyalty at all. Loyalty takes two forms: attitudinal and behavioural loyalty. Attitudinal loyalty is reflected in positive affect towards the brand or supplier. Behavioural loyalty is reflected in purchasing behaviour.[22] There is very little longitudinal evidence about shifts in customer behaviours after joining a loyalty scheme. One retailing study, however, using longitudinal data from a convenience store franchise, found that shoppers who were heavy buyers at the beginning of a loyalty programme did not change their patronage behaviour after joining. However, shoppers whose initial patronage levels were low or moderate gradually became more behaviourally loyal to the firm, increasing their shopping spend at the franchise. For light buyers, the loyalty programme encouraged shoppers to buy from additional categories, thus deepening their relationship with the franchise.[23]

Whether or not they develop loyalty, these schemes certainly reward buying behaviour. Accumulated credits represent investments that the customer has made in the scheme or the brands behind the scheme. When customers get no return from this investment, they can be deeply distressed. Members of at least five airline schemes, Braniff, Midway, MGM Grand, Legend and Ansett, lost their air miles when their airlines folded. Members of Pan Am's FFP were fortunate to have their credits transferred into Delta Airlines when Pan Am stopped flying. Frequent fliers of Australia-based Ansett forfeited their miles after the airline stopped flying in 2001. Passengers organized themselves into a group to lobby, ultimately unsuccessfully, for their loyalty to be recognized and rewarded by the company administrators, or prospective purchasers of the airline.

Additionally, loyalty schemes are successful enablers of customer insight. Personalized cards are obtained only after registering personal data. Then it becomes possible to monitor transactional behaviour. Chip-embedded smart cards carry the information on the card itself. A huge

amount of data is generated that can be warehoused and subjected to data mining for insights into purchasing behaviour. These insights can be used to guide marketing campaigns and offer development. Boots, for example, ran a series controlled experiments mailing health and beauty offers to select groups of carefully profiled customers. It achieved 40 per cent response rates, in comparison to 5 per cent from the control group.[24]

The loyalty scheme concept has been migrated into the online environment. One of the innovators, beenz, which was established in 1998, has not survived. Other scheme brands include iPoints (see Figure 9.4) and MyPoints.

Figure 9.4
www.ipoints.co.uk
website

Customer clubs

Customer clubs have been established by many organizations. A customer club can be defined as follows:

> A customer club is a company-run membership organization that offers a range of value-adding benefits exclusively to members.

The initial costs of establishing a club can be quite high, but thereafter most clubs are expected to cover their operating expenses and, preferably, return a profit. Research suggests that customer clubs are successful at promoting customer retention.[25]

To become a member and obtain benefits, clubs require customers to register. With these personal details, the company is able to begin

interaction with customers, learn more about them, and develop offers and services for them. Clubs can only succeed if members experience benefits they value. Club managers can assemble and offer a range of value-adding services and products that, given the availability of customer data, can be personalized to segment or individual level. Among the more common benefits of club membership are access to member-only products and services, alerts about upcoming new and improved products, discounts, magazines and special offers. For example, IKEA FAMILY, the home furnishing retailer's club, offers members discounts on selected IKEA products, a free home furnishing magazine quarterly, news updates via e-mail and discounts on exclusive IKEA FAMILY products.

There are a huge number of customer clubs. One report estimates that there are 'several hundreds' in Germany alone.[26] B2C clubs include:

● Swatch the Club (see www.swatch.com)
● The Pampers Parenting Institute (see http://us.pampers.com/en_US/ppi.do)
● The Harley Owners' Group (HOG) (see http://www.harley-davidson.com/wcm/Content/Pages/HOG/hog_selector.jsp?locale=en_US)
● The Volkswagen Club (see http://www.vw-club.de/).

There are over a million paid-up members of the Harley Owners' Group (see Figure 9.5), which was established in 1983. They choose from two levels of membership, full and associate, and a variable membership

Figure 9.5
Harley Owners'
Group

length, from one year to lifetime. Among the many benefits are roadside assistance, a membership manual, a touring handbook, a dedicated website, magazines, a mileage programme, a selection of pins and patches, membership in over 1000 chapters, invitations to events and rallies, and a lot more.

Sales promotions

Whereas loyalty schemes and clubs are relatively durable, sales promotions offer only temporary enhancements to customer value. Sales promotions, as we saw in the last chapter can also be used for customer acquisition. Retention-oriented sales promotions encourage the customer to repeat purchase, so the form they take is different. Here are some examples.

● **In-pack or on-pack voucher:** customers buy the product and receive a voucher entitling them to a discount off one or more additional purchases.

Figure 9.6 Cash-back sales promotion

- **Rebate or cash back:** rebates are refunds that the customer receives after purchase. The value of the rebate can be adjusted in line with the quantity purchased, in order to reward customers who meet high volume targets.
- **Patronage awards:** customers collect proofs of purchase, such as store receipts or barcodes from packaging, which are surrendered for cash or gifts. The greater the volume purchased the bigger the award.
- **Free premium for continuous purchase:** the customer collects several proofs of purchase and mails them in, or surrenders them at retail outlets to obtain a free gift. Sometimes the gift might be part of a collectable series. For example, a manufacturer of preserves and jams developed a range of collectable enamel badges. Customers collected proofs of purchase and mailed them in to receive a badge. There were 20 different badges in the series. This promotion was so popular that a secondary market was established so that collectors could trade and swap badges to obtain the full set.
- **Collection schemes:** these are long-running schemes where the customer collects items with every purchase. Kellogg's ran a promotion in which they inserted picture cards of carefully chosen sports stars into packets of cereals. Customers didn't know which card they had until they bought and opened the pack. These became collectable items.
- **Self-liquidating premium:** a self-liquidating promotion is one that recovers its own direct costs. Typically, consumers are invited to collect proofs of purchase, and mail them in with a personal cheque or money order. This entitles the customer to buy a product at a discounted premium, such as a camera or gardening equipment. The promoter will have reached a deal with the suppliers of the products to buy in bulk at a highly discounted rate, perhaps on a sale or return basis. Margins earned from the sale of product, plus the value of the cheque or money order cover the costs of running the promotion which, as a consequence, becomes self-liquidating.

Bonding

The next positive customer retention strategy is customer bonding. B2B researchers have identified many different forms of bond between customers and suppliers. These include interpersonal bonds, technology bonds (as in EDI), legal bonds and process bonds. These different forms can be split into two major categories: social and structural.[27]

Social bonds

Social bonds are found in positive interpersonal relationships between people on both sides of the customer-supplier dyad. Positive interpersonal relationships are characterized by high levels of trust and commitment. Successful interpersonal relationships may take time to evolve, as uncertainty and distance are reduced. As the number of episodes linking customer and supplier grow, there is greater opportunity for social bonds to develop. Suppliers should understand that if they act opportunistically or fail to align themselves to customer preferences, trust and confidence will be eroded.

Strong social bonds can emerge between employees in companies having similar sizes, cultures and locations. For example, small and medium-sized businesses generally prefer to do business with similar sized companies, and Japanese companies prefer to do business with other Japanese companies. Geographic bonds emerge when companies in a trading area cooperate to support each other.

Social relationships between buyer and seller can be single or multi-level. A single-level relationship might exist between the supplier's account manager and the customer's procurement officer. The more interpersonal links there are between the dyad, the more resistant the relationship is to breakdown. For example, technical, quality and operations people talk to their equivalents on the other side.

Social bonds characterized by trust generally precede the development of structural bonds. Mutual investments in business relationships serve as structural bonds. These structural bonds can be formally recognized in an alliance or joint venture having legal status. Companies are unlikely to commit resources if there is a low level of trust in the partner's integrity and competence.

Structural bonds

Structural bonds are established when companies and customers commit resources to a relationship. Generally, these resources yield mutual benefits for the participants. For example, a joint customer-supplier quality team can work improving quality compliance, benefiting both companies. Resources committed to a relationship may or may not be recoverable if the relationship breaks down. For example, investments made in training a customer's operatives are non-returnable. On the other hand, a chilled products manufacturer that has installed refrigerated space at a distributor's warehouse may be able to dismantle and retrieve it if the relationship dissolves.

A key feature of structural bonding is investment in adaptations to suit the other party. Suppliers can adapt any element of the offer – product, process, price and inventory levels, for example – to suit the customer. Customers, on the other hand, also make adaptations. For example, they can adapt their manufacturing processes to accommodate a supplier's product or technology.

Power imbalances in relationships can produce asymmetric adaptations. A major multiple retailer might force adaptations from small suppliers, while making no concessions itself. For example, it could insist on a reduction in product costs, co-branding of point-of-sale material, or even attempt to coerce the supplier not to supply competitors.

Different types of structural bond can be identified. All are characterized by an investment of one or both parties in the other:

- **Financial:** where the seller offers a financial inducement to retain the customer. Insurance companies form financial bonds with customers by offering no-claims discounts, tenure related discounts and multi-policy discounts.
- **Legal:** when there is a contract or common ownership linking the relational partners.

- **Equity:** where both parties invest in order to develop an offer for customers. For example, the owners of airports invest in the shells of the duty-free retail outlets. The retailer invests in the internal fixtures and fittings.
- **Knowledge-based:** when each party grows to know and understand the other's processes and structures, strengths and weaknesses.
- **Technological:** when the technologies of the relational partners are aligned, for example, with EDI, just-in-time logistics and manufacturing.
- **Process:** when processes of the two organizations are aligned. For example, the quality assurance programme on the supplier side and the quality inspection programme on the customer side. Some suppliers manage inventory levels for their customers, ensuring inventory levels are optimized. This is known as vendor managed inventory (VMI). The chemicals company, Solvay Interox, uses telemetry systems to perform VMI for its customers.
- **Values-based:** some companies are renowned for their strong values. Co-operative Bank is known for its pro-environment, ethical stance. It bonds closely with other companies, such as investment houses, that adopt the same position. It refuses to invest in companies that have poor environmental records.
- **Geographic:** these bonds exist when companies in a trading area (street, city region or country) create a buyer–seller–referral network that supports all members of their group. In the UK, retailers in downtown Leamington Spa have combated out of town developments by creating a loyalty programme in which customers can collect and redeem loyalty credits at any member store.
- **Project:** when the partners are engaged in some special activity outside of their normal commercial arrangements, for example, a new product development project. There may be an exchange of resources to enable the desired outcome to be achieved, for example, an exchange of engineers and technologists between the companies.
- **Multi-product:** when a customer buys several products from a supplier, the bond is more difficult to break. There are economies for customers when they deal with fewer suppliers. When a relationship with a supplier of several products is dissolved, the customer may incur significant money, search and psychic costs in identifying one or more replacements. Further, the level of perceived risk attached to a new relationship may become uncomfortable.

Case 9.2

Customer retention at Korea Telecom

Korea Telecom places a high level of importance on creating valuable relationships with customers, both business and consumer, in the telecommunications markets of South Korea and South East Asia.

The organization places significant emphasis on maintaining high retention rates in markets which are becoming increasingly competitive. Korea Telecom estimates that it costs around

US$185 to gain a consumer for its broadband Internet service, and about two years for the organization to recover the cost. Consequently the organization undertakes a number of activities as part of its CRM strategy to retain customers, for example bundling together of a number of services such as Internet, mobile and home phone at a discount to customers who enter into service contracts for at least two years.

Social bonds are generally easier to break than structural bonds. Structural bonds link organizations. Social bonds link people. If the account manager and procurement officer do not grow to trust each other, they may fall out, but this is unlikely to bring down a joint venture.

Build customer engagement

The final positive strategy for building customer retention is to build customer engagement. Various studies have indicated that customer satisfaction is not enough to ensure customer longevity. For example, Reichheld reports that 65 to 85 per cent of recently defected customers claimed to be satisfied with their previous suppliers.[28] Another study reports that one in ten customers who said they were completely satisfied, scoring ten out of ten on a customer satisfaction scale, defected to a rival brand the following year.[29] Having satisfied customers is, increasingly, no more than a basic requirement of being in the game.

Highly engaged customers have levels of emotional or rational attachment or commitment to a brand, experience or organization that are so strong that they are highly resistant to competitive influence. The terms engagement, attachment and commitment tend to be used interchangeably to describe this phenomenon. The topic of customer engagement was introduced in Chapter 6.

Learning from research into customer commitment

A number of authorities have urged companies to work on developing customer commitment so that they develop a strong attachment to, or engagement with, a brand or company.[30]

Three different forms of commitment have been identified: instrumental, relational, and values-based.[31]

1. **Instrumental commitment:** this occurs when customers are convinced that no other offer or company could do a better job of meeting their needs. They are not just very satisfied, but unbeatably satisfied. All expressed and latent needs have been met. When a customer feels that his or her bank has the best products, the best access, the best processes, the lowest interest rates on loans and the best reputation, he or she is committed.

2. **Relational commitment:** customers can become highly attached to a company's people. An emotional tie may be formed with an individual person, a work group or the generalized company as a whole. Customers who talk about 'my banker' or 'my mechanic' or 'my builder' are expressing this attachment. They feel a sense of personal identification with that individual. Often, these are employees who 'break the rules' or 'go the extra mile' to completely satisfy customers. They are reliable, competent, empathic and responsive. When these employees recover an at-risk customer, they create a friend. Customer-focused organizations make heroes out of these individuals. They are feted and celebrated. For example, American Express tells the story of a customer service agent who responded to a call from a customer who had been robbed, by arranging to have replacement travellers checks delivered personally to the customer. The CSA also confirmed the customer's hotel reservation, arranged for a car to collect the customer from the phone booth and notified the police, all above and beyond the call of duty. Customers can also become attached to a work group. In banking, for example, some customers are highly committed to a specific branch and prefer not to transact elsewhere. Finally, customers can become attached to an organization as a whole, believing its people to be better than competitors on dimensions that are important to the customer. They may provide 'the best service' or be 'the friendliest people'.

3. **Values-based commitment:** customers become committed when their values are aligned with those of the company. Values can be defined as follows:

> Values are core beliefs that transcend context and serve to organize and direct attitudes and behaviours

Customers have many and varied core beliefs, such as environmental consciousness, honesty, child protection, independence, family-centredness and so on. Many of these reflect cultural norms. Where these values coincide with those of an organization, the customer may become committed to the organization. Companies that are accused of using child labour, damaging the environment or otherwise acting unethically place themselves at risk. Nestlé had been accused of marketing infant formula in African countries where the infrastructure made its use dangerous. Many babies died as mothers used unclean water and unsterilized equipment. This is estimated to have cost the company $40 million.[32] Sales of Shell fuel were estimated to have fallen between 20 and 50 per cent during the Brent Spar boycott.[33] The company had planned to decommission the 4000 tonne Brent Spar oil platform by dumping it into the North Sea. Just as customers can take action against companies that they feel are in beach of their values, they can also commit to companies that mirror with their values. Research supports the claim that there is a hierarchical relationship from values, to attitudes, to purchase intention, and ultimately to purchase.[34]

A number of companies benefit from values-based commitment: Body Shop, John Lewis, Harley Davidson, Co-operative Bank and Virgin.

- **Body Shop International**, the health and beauty retailer, was founded by Anita and Gordon Roddick. The company's values include a refusal to source products tested on animals, and support for community trade, human rights and the environment. A successful and influential business was developed on the back of these values. Body Shop influenced other retailers to become more sensitive to these issues.
- **The John Lewis Partnership** is a UK-based department store with a 140-year history. It is a mutual organization, owned by its staff and incorporated as a trust. Profits are not distributed to external shareholders; they are shared with employees who are regarded as partners. The company is reputed to look after these partners very well including, for example, having a final salary pension scheme.
- **Harley Davidson**, the US motorcycle manufacturer, has a phenomenally committed customer base. When Harley riders replace their bikes, 95 per cent buy another Harley. The bike is a central part of a lifestyle that is grounded on fraternity, independence and rebellion. Image is critical to the Harley rider. In the US, the average age of a Harley rider is 47 (up from 38 a decade ago), the median income is US$83 000 and the typical cruiser bike costs $17 000. The challenge of Harley is to develop value propositions that appeal to a younger customer.[35]
- **Co-operative Bank** is positioned in the UK retail banking market as the ethical bank. The mutually-owned bank believes its ethical stance is directly responsible for about 20 per cent of pre-tax profits. One-third of the bank's customers moved to the bank because of its ethical and eco-friendly policies.[36]
- **The Virgin Group** is a family of over 200 privately owned strategic business units ranging from airline to rail, cosmetics, cola, telecommunications, music and financial services. In 2006 group sales reached £10 billion. The values of the Virgin brand are integrity, value for money, quality and fun. Virgin Group is chaired by its founder, the renegade but highly visible Sir Richard Branson. Customers are attracted to the brand because of its reputation for fairness, simplicity and transparency. Customers trust the brand and rely on it in markets that are new to them. For example, Virgin was a late mover into the UKs indexed linked mutual fund marketplace. It still managed to become market leader in 12 months, despite having no history as a financial institution.

Highly engaged customers are more involved with your brand or company. This not only implies frequent purchasing, but also other attributes of what might be called 'corporate citizenship', such as being an unpaid advocate by uttering positive word-of-mouth, providing frequent feedback on their experiences, participating in company research, contributing to new product or service development, being more forgiving if the company makes a mistake or service fails, and participating in online communities and user groups.

The outcome of higher levels of engagement, it is claimed, is a more durable customer relationship. One report, for example, indicates that the rate of account closures at a bank were 37 per cent lower for emotionally engaged customers than for rationally satisfied customers.[37]

Context makes a difference

Context makes a difference to customer retention in two ways. First, there are some circumstances when customer acquisition makes more, indeed the only, sense as a strategic goal. Secondly, customer retention strategies will vary according to the environment in which the company competes.

When launching a new product or opening up a new market a company's focus has to be on customer acquisition. In contexts where there are one-off purchases such as funerals, infrequent purchases such as heart surgery, or unique conditions such as gave rise to the demand for Y2K compliance software, customer retention is subordinate to acquisition.

The impact of contextual conditions on the choice and timing of customer retention practices has not been thoroughly researched. However, we can see that a number of contextual considerations impact on customer retention practices:

● **Number of competitors:** in some industries there is a notable lack of competitors, meaning that companies do not suffer badly from customer churn. This typically applies in state-provided services such as education and utilities such as gas, electricity, rail and telecommunications, whether deregulated or not. When customers are dissatisfied they have no competitor to turn to. They may also believe that the competitors in the market are not truly differentiated by their service standards. In other words, each supplier is as bad as the others. The result is inertia.
● **Corporate culture:** in corporate banking, the short-term profit requirement of both management and shareholders has resulted in a lack of genuine commitment to relationship banking. Banks have been very opportunistic in their preference for transactional credit-based relationships with customers.[38]
● **Channel configuration:** sellers may not have the opportunity to maintain direct relationships with the ultimate buyers and users of their products. Instead, they may rely on their intermediaries. Caterpillar, for example, does not have a relationship with the contractors who use their equipment. Instead, it works in partnership with about 1500 independent dealers around the world to provide customer service, training, field support and inventories of spare parts.
● **Purchasing practices:** the purchasing procedures adopted by buyers can also make the practice of customer retention futile. Customers do not always want relationships with their suppliers. For example, towards the end of the 1990s, government departments in the UK and elsewhere adopted compulsory competitive tendering (CCT) as their mechanism for making purchasing decisions. The process is designed to prevent corrupt relationships developing and to ensure that tax-payers get good value for money, i.e. pay a low price for the services rendered. Every year or so, current suppliers and other

vendors are invited to pitch for the business. Price is often the primary consideration for the choice of supplier.

● **Ownership expectations:** the demands of business owners can subordinate customer retention to other goals. For example, Korean office equipment manufacturers are very focused on sales volumes. They require their wholly-owned overseas distributors to buy quotas of product from Korea and sell them in the served market, regardless of whether the products are well-matched to local market conditions and customer requirements. The distributors are put in a position of having to create demand against competitors that do a better job of understanding and meeting customer requirements.[39]

● **Ethical concerns:** public sector medical service providers cannot simply focus on their most profitable customers or products. This would result in the neglect of some patients and a failure to address other areas of disease management. Private sector providers do not necessarily face this problem. The Shouldice Hospital in Ontario specializes in hernia repairs. Their website, www.shouldice.com, reports that they have repaired 300 000 hernias over a 60 year period, with a 99 per cent success rate. They even organize annual reunions. Recently, these events have been attended by 1000 satisfied patients.

Key performance indicators of customer retention programmes

CRM practitioners are concerned with achieving a number of key performance indicators (KPIs) for these customer retention activities, among them:

● raw customer retention rate
● raw customer retention rate in each customer segment
● sales-adjusted retention rate
● sales-adjusted retention rate in each customer segment
● profit-adjusted retention rate
● profit-adjusted retention rate in each customer segment
● cost of customer retention
● share of wallet of the retained customers
● customer churn rate per product category, sales region or channel
● cost-effectiveness of customer retention tactics.

The choice of KPI will vary according to context. Some companies do not have enough data to compute raw retention rate per segment. Others may not know their share of wallet (share of customer spending on the category).

The role of research

Companies can reduce levels of customer churn by researching a number of questions:

1. Why are customers churning?
2. Are there any lead indicators of impending defection?
3. What can be done to address the root causes?

The first question can be answered by contacting and investigating a sample of former customers to find out why they took their business elsewhere.

Customers defect for all sort of reasons, not all of which can be foreseen, prevented or managed by a company. For example, Susan Keaveney identified eight causes of switching behaviours in service industries generally: price, inconvenience, core service failures, failed employee responses to service failure, ethical problems, involuntary factors, competitive issues and service encounter failures. Only six of these eight causes of switching behaviours can be influenced by the service provider.[40] Another industry-specific study found that between 20 per cent and 25 per cent of supermarket shoppers changed their primary store in a 12 month period. Twenty-four per cent of switchers changed allegiance because a new competitive store had opened, 14 per cent because they had moved house, 11 per cent for better quality and 10 per cent for better choice.[41]

The second question attempts to find out if customers give any early warning signals of impending defection. If these were identified the company could take pre-emptive action. Signals might include the following:

- reduced RFM scores (recency–frequency–monetary value)
- non-response to a carefully targeted offer
- reduced levels of customer satisfaction
- dissatisfaction with complaint handling
- reduced share of customer (e.g. customer only flies one leg of an international flight on your airline)
- inbound calls for technical or product-related information
- late payment of an invoice
- querying an invoice
- customer touchpoints are changed, e.g. store closes, change of website address
- customer change of address.

Customer researchers are also advised to analyse the reasons for customer defection, and to identify the root causes.[42] Sometimes these can be remedied by management. For example, if you lose customers because of the time taken to deal with a complaint, management can audit and overhaul the complaints management process. This might involve identifying the channels and touchpoints through which complaints enter the business, updating complaints database management, or training and empowering frontline staff. Root causes can be analysed by customer

segment, channel and product. The 80:20 rule may be applicable. In other words, it may be possible to eliminate 80 per cent of the causes of customer defections with relative ease.

Strategies for customer development

Customer development is the process of growing the value of retained customers. Companies generally attempt to cross-sell and up-sell products into the customer base while still having regard for the satisfaction of the customer. Cross-selling, which aims to grow share of wallet can be defined as follows:

> Cross-selling is selling additional products and services to an existing customer.

Up-selling can be defined as follows:

> Up-selling is selling higher priced or higher margin products and services to an existing customer.

Customers generally do not respond positively to persistent and repeated efforts to sell additional products and services that are not related to their requirements. Indeed, there is an argument that companies should seek to down-sell where appropriate. This means identifying and providing lower cost solutions to the customers' problems, even if it means making a lower margin. Customers may regard up-selling as opportunistic and exploitative, thereby reducing the level of trust they have in the supplier, and putting the relationship at risk. However, multi-product ownership creates a structural bond that decreases the risk of relationship dissolution. There are a number of CRM technologies that are useful for customer development purposes.

- **Campaign management** software is used to create up-sell and cross-sell customer development campaigns and track their effectiveness, particularly in terms of sales and incremental margin.
- **Event-based marketing:** campaigns are often associated with events. For example, a bank will offer a customer an investment product if deposits in a savings account reach a trigger point.
- **Data mining:** offers are based on intelligent data mining. Transactional histories record what customers have already bought. Data mining can tell you the probability of a customer buying any other products (propensity to buy), based on their transactional history or demographic/psychographic profile. First Direct, the Internet and telephone bank, uses propensity to buy scores to run targeted, event-driven cross-sell campaigns through direct mail and call centres. They aim at high conversion rates through follow-up calls.

- **Customization:** offers are customized at segment or unique customer level. Also personalized is the communication to the customer and the channel of communication: e-mail, surface mail, SMS or phone call, for example.
- **Channel integration:** customer development activities are integrated across channels. It is regarded as bad customer management practice to have different channels making different offers to the same customer. In retail, channel integration is observed when channels such as stores, web and direct to consumer channels act in an integrated, customer-centric manner. For this to happen, customer information and customer development plans need to be shared across channels.
- **Integrated customer communications:** the messages communicated to customers are consistent across all channels.
- **Marketing optimization:** optimization software is available from CRM analytics organizations such as SAS. Optimization enables marketers to enjoy optimal returns from up-sell and cross-sell campaigns across multiple channels and customer segments, taking account of issues such as budget constraints, communication costs, contact policies (e.g. no more than two offers to be communicated to any customer in any quarter), customers' transactional histories and propensities to buy.

In professional services, the client audit is often the foundation for cross-selling and up-selling of clients. In B2B environments, sales representatives need to be alert to opportunities for cross- and up-selling. This means understanding customers' manufacturing processes, and knowing their product innovation plans.

In mature markets, where customer acquisition is difficult or expensive, the development of retained customers is an important source of additional revenues. For example, in the mature mobile telecommunications market, the penetration of handsets is at a very high level. Winning new-to-market customers is regarded as too difficult, since these are the laggards and expensive to convert. Network operators have begun to focus on selling additional services to their existing customer bases, including data applications.

Strategies for terminating customer relationships

Companies rarely hesitate to terminate employee positions that serve no useful purpose. In a similar vein, a review of customer value might identify customers that are candidates for dismissal, including customers who will never be profitable or who serve no other useful strategic purpose. More specifically, these include fraudsters, persistent late payers, serial complainants, those who are capricious and change their

minds with cost consequences for the supplier, and switchers who are constantly searching for a better deal. This certainly happens in reverse; customers sack suppliers when they switch vendors.

Relationships dissolve when one partner no longer views the relationship as worth continuing investment. In a B2B context, activity links, resource ties and actor bonds would be severed. However, even if there is no strategic value in a customer, dissolution of the relationship is not always an attractive option because of contractual obligations, expectations of mutuality, word-of-mouth risks and network relationships.

McKinsey reports that 30 to 40 per cent of a typical company's revenues are generated by customers who, on a fully costed, standalone, basis would be unprofitable.[43] It is therefore important to conduct regular reviews of the customer base to identify potential candidates for dismissal. If this is not done sales, marketing and service resources will continue to be suboptimally deployed. Nypro, a large plastic injection moulder, had 800 customers and sales of $50 million in 1987 when it decided to move out of low value-add manufacturing. Many of these customers served no useful strategic purpose and, by 1997, the company had only 65 customers, all of whom were large and required value-added solutions rather than cheap moulded products. However, sales revenues were $450 million.

Sacking customers needs to be conducted with sensitivity. Customers may be well connected and spread negative word-of-mouth about their treatment. In the year 2000, UK banks began a programme of branch closures in geographic areas that were unprofitable. Effectively, they were sacking low-value customers in working-class and rural areas. There was considerable bad publicity, the government intervened and the closure strategy was reviewed.

Case 9.3

Sacking unprofitable customers at the CBA

The Commonwealth Bank of Australia (CBA), like many other banks, has been criticized in the media for adopting a strategy of sacking unprofitable customers.

In recent years the bank has closed branches in many areas that were considered unprofitable, particularly in less populated areas of rural and regional Australia. The bank believes customers are unprofitable if their balance is less than $500. For these customers the bank has introduced higher bank fees. The bank has also introduced transaction fees of up to $3 when customers withdraw their money over the counter in a branch.

The media has widely speculated that actions such as these by many banks will continue to occur as banks and other financial institutions attempt to shift customers to electronic banking channels, where the cost to the bank of performing a simple deposit or withdrawal transaction can be just a few cents as opposed to a few dollars for similar over-the-counter service in a branch.

There are a number of strategies for sacking customers:

- **Raise prices:** customers can choose to pay the higher price. If not, they effectively remove themselves from the customer base. Where price is customized this is a feasible option. When banks introduced transaction fees for unprofitable customers many left in search of a better deal.
- **Unbundle the offer:** you could take a bundled value proposition, unbundle it, reprice the components and reoffer it to the customer. This makes the value in the offer transparent, and enables customers to make informed choices about whether they want to pay the unbundled price.
- **Respecify the product:** this involves redesigning the product so that it no longer appeals to the customer(s) you want to sack. For example, the airline BA made a strategic decision to target frequent-flying business travellers who they regarded as high value. They redesigned the cabins in their fleet, reducing the number of seats allocated to economy travellers.
- **Reorganize sales, marketing and service departments** so that they no longer focus on the sackable segments or customers. You would stop running marketing campaigns targeted at these customers, prevent salespeople calling on them and discontinue servicing their queries.
- **Introduce ABC class service:** you could migrate customers down the service ladder from high quality face-to-face service from account teams, to sales representatives, or even further to contact centre or web-based self-service. This eliminates cost from the relationship and may convert an unprofitable customer into profit. In a B2C context, this equates to shifting customers from a high-cost to a low-cost service channel. Frontier Bank, for example, introduced a no-frills telephone account for business customers who needed no cash processing facilities. A minimum balance was needed for the bank to cover its operating costs. Customers who did not maintain the targeted credit balance in their account were invited to switch to other products in other channels. If they refused, the bank asked them to close their account.[44]

Empirical evidence on how companies terminate customer relationships is sparse. However, one study of German engineering companies reports that very few firms have a systematic approach to managing unprofitable customers. Most respondents confirm that unprofitable relationships are commonplace; indeed, a fifth of firms have a customer base more than half of which is not, or not yet, profitable. Companies fall into three clusters in respect of the customer-sacking behaviours:[45]

1. **Hardliners** take an active and rigorous stance in terminating unprofitable relationships, including the regular clearance of their customer portfolio. More qualitative implications, such as a potential loss of trust in relationships with other customers or negative word-of-mouth, do not seem to hinder their willingness to sack unprofitable customers.

2. **Appeasers** take a more cautious approach concerning the termination of unprofitable relationships, above all due to strategic considerations such as not playing customers into competitors' hands.
3. The **undecided** are reluctant to terminate unprofitable relationships, mainly because they fear the costs of attracting new customers.

Summary

In this chapter we have looked at the important issues of how companies can retain, develop and, if necessary, sack customers. The economic argument for focusing on customer retention is based on four claims about what happens as customer tenure lengthens: the volume and value of purchasing increases, customer management costs fall, referrals increase and customers become less price sensitive. Measures of customer retention vary across industry because of the length of the customer repurchase cycle. There are three possible measures of customer retention. Raw customer retention is the number of customers doing business with a firm at the end of a trading period, expressed as percentage of those who were active customers at the beginning of the same period. This raw figure can be adjusted for sales and profit. Customer retention efforts are generally directed at customers who are strategically valuable. These same customers may be very attractive to competitors and may be costly to retain.

A number of alternative strategies can be used to retain customers. A distinction can be made between positive and negative retention strategies. Negative retention strategies impose switching costs on customers if they defect. Positive retention strategies reward customers for staying. There are four main forms of positive retention strategy. These are meeting and exceeding customer expectations, finding ways to add value, creating social and structural bonds and building customer engagement. Companies have a number of methods for adding value, including loyalty schemes, customer clubs and sales promotions. What is an appropriate customer retention strategy will be contextually defined. Not all strategies work in all circumstances. In addition to customer retention, two other customer management activities were discussed in this chapter. These are developing and sacking customers. Customer development aims to increase the value of the customer by cross-selling or up-selling products and services to existing customers. The termination of customer relationships aims to improve the profitability of the customer base by divesting customers who show no signs of ever becoming profitable or strategically significant.

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