# Creating Long-term Loyalty Relationships

**Today, companies face their toughest competition ever. Moving from a product-and-sales philosophy to a holistic marketing philosophy, however, gives them a better chance of outperforming the competition. The cornerstone of a well-conceived holistic marketing orientation is strong customer relationships. Marketers must connect with customers—informing, engaging, and maybe even energizing them in the process. Customer-centered companies are adept at building customer relationships, not just products; they are skilled in market engineering, not just product engineering. A pioneer in customer relationship management techniques is Harrah's Entertainment.**


*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 experience shows, successful marketers are those who carefully manage their customer base. In this chapter, we spell out in detail the ways they can go about winning customers and beating competitors. The answer lies largely in doing a better job of meeting or exceeding customer expectations.**

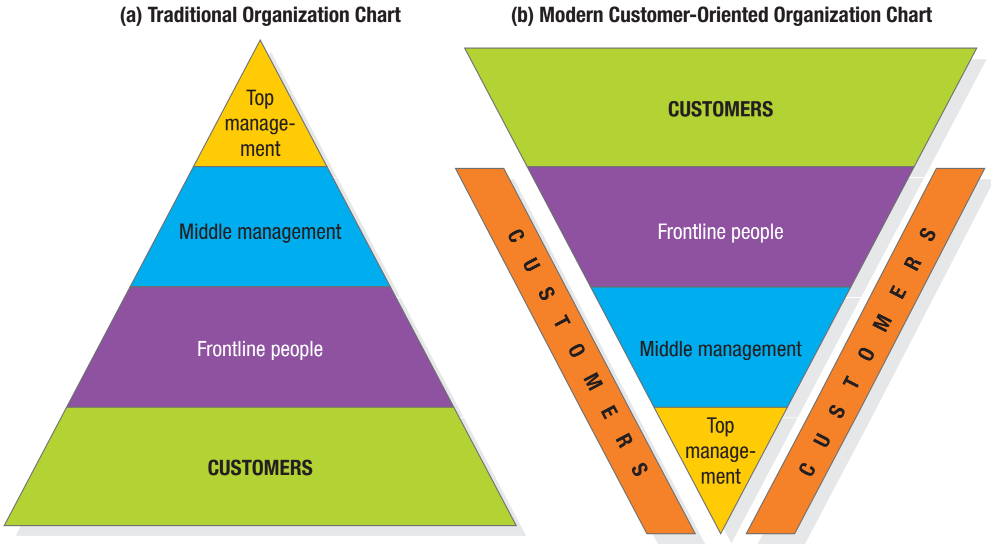
## Building Customer Value, Satisfaction, and Loyalty

Creating loyal customers is at the heart of every business.[2] As marketing experts Don Peppers and Martha Rogers say:[3]

> 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.

|Fig. 5.1|

Traditional Organization versus Modern Customer-Oriented Company Organization




Managers who believe the customer is the company's only true "profit center" consider the traditional organization chart in Figure 5.1(a)—a pyramid with the president at the top, management in the middle, and frontline people and customers at the bottom—obsolete.[4]

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; under them are the middle managers, whose job is to support the frontline people so they can serve customers well; and at the base is top management, whose job is to hire and support good middle managers. We have added customers 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.

Some companies have been founded with the customer-on-top business model, and customer advocacy has been their strategy—and competitive advantage—all along. 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.[5]

When Office Depot added customer reviews to its Web site in 2008, revenue and sales conversion increased significantly. The company also incorporated review-related terms to its paid search advertising campaign. As a result of these efforts, Web site revenue and the number of new buyers visiting the site both increased by more than 150 percent.[6]

When certain business decisions led to a deterioration of customer service, Dell's founder Michael Dell took decisive action.

## Customer Perceived Value

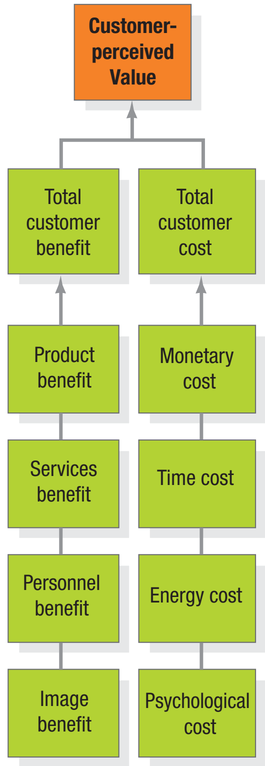
Consumers are better educated and informed than ever, and they have the tools to verify companies' claims and seek out superior alternatives.[7]

**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]

How then 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. In one 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.[9]

**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 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.




|Fig. 5.2| △

Determinants of Customer-Perceived Value

**APPLYING VALUE CONCEPTS** Suppose the buyer for a large construction company wants to buy a tractor for residential construction from either Caterpillar or Komatsu. He wants the tractor to deliver certain levels of reliability, durability, performance, and resale value. The competing salespeople carefully describe their respective offers. The buyer decides Caterpillar has greater product benefits based on his perceptions of those attributes. He also perceives differences in the accompanying services—delivery, training, and maintenance—and decides Caterpillar provides better service as well as more knowledgeable and responsive staff. Finally, he places higher value on Caterpillar's corporate image and reputation. He adds up all the economic, functional, and psychological benefits from these four sources—product, services, personnel, and image—and perceives Caterpillar as delivering greater customer benefits.

Does he buy the Caterpillar tractor? Not necessarily. He also examines his total cost of transacting with Caterpillar versus Komatsu, which consists of more than money. As Adam Smith observed over two centuries ago in *The Wealth of Nations*, "The real price of anything is the toil and trouble of acquiring it." Total customer cost also includes the buyer's time, energy, and psychological costs expended in product acquisition, usage, maintenance, ownership, and disposal. The buyer evaluates these elements together with the monetary cost to form a total customer cost. Then he considers whether Caterpillar's total customer cost is too high compared to total customer benefits. If it is, he might choose Komatsu. The buyer will choose whichever source delivers the highest perceived value.

Now let's use this decision-making theory to help Caterpillar succeed in selling to this buyer. Caterpillar can improve its offer in three ways. First, it can increase total customer benefit by improving economic, functional, and psychological benefits of its product, services, people, and/or image. Second, it can reduce the buyer's nonmonetary costs by reducing the time, energy, and psychological investment. Third, it can reduce its product's monetary cost to the buyer.

Suppose Caterpillar concludes the buyer sees its offer as worth $20,000. Further, suppose Caterpillar's cost of producing the tractor is $14,000. This means Caterpillar's offer generates $6,000 over its cost, so the firm needs to charge between $14,000 and $20,000. If it charges less than $14,000, it won't cover its costs; if it charges more, it will price itself out of the market.

Caterpillar's price will determine how much value it delivers to the buyer and how much flows to Caterpillar. If it charges $19,000, it is creating $1,000 of customer perceived value and keeping $5,000 for itself. The lower Caterpillar sets its price, the higher the customer perceived value and, therefore, the higher the customer's incentive to purchase. To win the sale, the firm must offer more customer perceived value than Komatsu does.[10] Caterpillar is well aware of the importance of taking a broad view of customer value.

**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


Caterpillar's market success is partly a result of how well the firm creates customer value.

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]

Very often, managers conduct a **customer value analysis** to reveal the company's strengths and weaknesses relative to those of various competitors. The steps in this analysis are:

1. ***Identify the major attributes and benefits customers value.*** Customers are asked what attributes, benefits, and performance levels they look for in choosing a product and vendors. Attributes and benefits should be defined broadly to encompass all the inputs to customers' decisions.
2. ***Assess the quantitative importance of the different attributes and benefits.*** Customers are asked to rate the importance of different attributes and benefits. If their ratings diverge too much, the marketer should cluster them into different segments.
3. ***Assess the company's and competitors' performances on the different customer values against their rated importance.*** Customers describe where they see the company's and competitors' performances on each attribute and benefit.
4. ***Examine how customers in a specific segment rate the company's performance against a specific major competitor on an individual attribute or benefit basis.*** If the company's offer exceeds the competitor's offer on all important attributes and benefits, the company can charge a higher price (thereby earning higher profits), or it can charge the same price and gain more market share.
5. ***Monitor customer values over time.*** The company must periodically redo its studies of customer values and competitors' standings as the economy, technology, and features change.

**CHOICE PROCESSES AND IMPLICATIONS** Some marketers might argue the process we have described is too rational. Suppose the customer chooses the Komatsu tractor. How can we explain this choice? Here are three possibilities.

1. ***The buyer might be under orders to buy at the lowest price.*** The Caterpillar salesperson's task is then to convince the buyer's manager that buying on price alone will result in lower long-term profits and customer value.
2. ***The buyer will retire before the company realizes the Komatsu tractor is more expensive to operate.*** The buyer will look good in the short run; he is maximizing personal benefit. The Caterpillar salesperson's task is to convince other people in the customer company that Caterpillar delivers greater customer value.
3. ***The buyer enjoys a long-term friendship with the Komatsu salesperson.*** In this case, Caterpillar's salesperson needs to show the buyer that the Komatsu tractor will draw complaints from the tractor operators when they discover its high fuel cost and need for frequent repairs.

The point is clear: Buyers operate under various constraints and occasionally make choices that give more weight to their personal benefit than to the company's benefit.

Customer-perceived value is a useful framework that applies to many situations and yields rich insights. It suggests that the seller must assess the total customer benefit and total customer cost associated with each competitor's offer in order to know how his or her offer rates in the buyer's mind. It also implies that the seller at a disadvantage has two alternatives: increase total customer benefit or decrease total customer cost. The former calls for strengthening or augmenting the economical, functional, and psychological benefits of the offering's product, services, personnel, and image. The latter calls for reducing the buyer's costs by reducing the price or cost of ownership and maintenance, simplifying the ordering and delivery process, or absorbing some buyer risk by offering a warranty.[12]

**DELIVERING HIGH CUSTOMER VALUE** Consumers have varying degrees of loyalty to specific brands, stores, and companies. Oliver defines **loyalty** as "a deeply held commitment to rebuy or repatronize a preferred product or service in the future despite situational influences and marketing efforts having the potential to cause switching behavior."[13] Table 5.1 displays brands with the greatest degree of customer loyalty according to one 2010 survey.[14]

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. For example, 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.[15] 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.[16]

**TABLE 5.1** Top 25 Brands in Customer Loyalty

| Brand | Category | Rankings | |
|---|---|---|---|
| | | 2010 | 2009 |
| Apple iPhone | Wireless Handset | 1 | 1 |
| Clairol (hair color) | Hair Color | 2 | NA |
| Samsung | Wireless Handset | 3 | 2 |
| Mary Kay | Cosmetics (Mass Merchandiser) | 4 | 7 |
| Grey Goose | Vodka | 5 | 6 |
| Clinique (cosmetics: Luxury) | Cosmetics (Luxury) | 6 | 19 |
| AVIS | Car Rental | 7 | 8 |
| Walmart | Retail Store (Discount) | 8 | 5 |
| Google | Search Engine | 9 | 3 |
| Amazon.com | Online Book/Music | 10 | 10 |
| Bing | Search Engine | 11 | NA |
| J. Crew | Retail Store (Apparel) | 12 | 23 |
| AT&T Wireless | Wireless Phone | 13 | 123 |
| Discover Card | Credit Card | 14 | 121 |
| Verizon Wireless | Wireless Phone | 15 | 21 |
| Intercontinental Hotels | Hotel (Luxury) | 16 | 103 |
| Cheerios | Breakfast Cereal: Kids | 17 | 71 |
| Dunkin' Donuts | Coffee | 18 | 54 |
| Home Depot | Retail Store (Home Improvement) | 19 | 192 |
| Domino's Pizza | Pizza | 20 | 156 |
| Barilla | Pasta Sauce | 21 | NA |
| Canon | MFP Copier | 22 | 44 |
| Nike | Athletic Footwear | 23 | 178 |
| Coors Light | Beer (Light) | 24 | 63 |
| Acer | Computer (Netbook) | 25 | NA |

**Source:** "2010 Brand Keys Customer Loyalty Leaders List," www.brandkeys.com.


**Although safety is Volvo's core position, the value proposition the firm offers customers includes other benefits too.**

## 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.[17] 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.[18] Customer assessments of product performance depend on many factors, especially the type of loyalty relationship the customer has with the brand.[19] Consumers often form more favorable perceptions of a product with a brand they already feel positive about.

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 (for example, by improving manufacturing processes or investing more in R&D). Also, the company has many stakeholders, including employees, dealers, suppliers, and stockholders. Spending more to increase customer satisfaction might divert funds from increasing the satisfaction of other "partners." Ultimately, 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.[20]

How do buyers form their expectations? Expectations result from past buying experience, friends' and associates' advice, and marketers' and competitors' information and promises. If marketer raise expectations too high, the buyer is likely to be disappointed. If it sets expectations too low, it won't attract enough buyers (although it will satisfy those who do buy).[21] Some of today's most successful companies are raising expectations and delivering performances to match. Korean automaker Kia found success in the United States by launching low-cost, high-quality cars with enough reliability to offer 10-year, 100,000 mile warranties.

## 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.[22]

Wise firms measure customer satisfaction regularly, because it is one key to customer retention.[23] 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.[24] Greater customer satisfaction has also been linked to higher returns and lower risk in the stock market.[25]

The link between customer satisfaction and customer loyalty is not proportional, however. Suppose customer satisfaction is rated on a scale from one to five. At a very low level of satisfaction (level one), customers are likely to abandon the company and even bad-mouth it. At levels two to four, customers are fairly satisfied but still find it easy to switch when a better offer comes along. At level five, the customer is very likely to repurchase and even spread good word of mouth about the company. High satisfaction or delight creates an emotional bond with the brand or company, not just a rational preference. Xerox's senior management found its "completely satisfied" customers were six times more likely to repurchase Xerox products over the following 18 months than even its "very satisfied" customers.[26]

The company needs to recognize, however, that customers vary in how they define good performance. Good delivery could mean early delivery, on-time delivery, or order completeness, and two customers can report being "highly satisfied" for different reasons. One may be easily satisfied most of the time and the other might be hard to please but was pleased on this occasion.[27]

**MEASUREMENT TECHNIQUES** *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. One of the nation's largest and most diversified new-home builders, Pulte Homes, wins more awards in J.D. Power's annual survey than any other by constantly measuring how well it's doing with customers and tracking them over a long period of time. Pulte surveys customers just after they buy their homes and again several years later to make sure they're still happy.[28] "Marketing Insight: Net Promoter and Customer Satisfaction" describes why some companies believe just one well-designed question is all that is necessary to assess customer satisfaction.[29]

Companies need to monitor their competitors' performance too. 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, as described in Chapter 3, 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

Marketing Insight

## Net Promoter and Customer Satisfaction

Many companies make measuring customer satisfaction a top priority, but how should they go about doing it? Bain's Frederick Reichheld suggests only one customer question really matters: "How likely is it that you would recommend this product or service to a friend or colleague?" According to Reichheld, a customer's willingness to recommend results from how well the customer is treated by frontline employees, which in turn is determined by all the functional areas that contribute to a customer's experience.[30]

Reichheld was inspired in part by the experiences of Enterprise Rent-A-Car. When the company cut its customer satisfaction survey in 1998 from 18 questions to 2—one about the quality of the rental experience and the other about the likelihood customers would rent from the company again—it found those who gave the highest ratings to their rental experience were three times as likely to rent again than those who gave the second highest rating. The firm also found that diagnostic information managers collected from dissatisfied customers helped it fine-tune its operations.

In a typical Net Promoter survey that follows Reichheld's thinking, customers are asked to rate their likelihood to recommend on a 0 to 10-point scale. Marketers then subtract *detractors* (those who gave a 0 to 6) from *promoters* (those who gave a 9 or 10) to arrive at the Net Promoter Score (NPS). Customers who rate the brand with a 7 or 8 are deemed *passively satisfied* and are not included. A typical set of NPS scores falls in the 10 percent to 30 percent range, but world-class companies can score over 50 percent. Some firms with top NPS scores include USAA (89 percent), Apple (77 percent), Amazon.com (74 percent), Costco.com (73 percent), and Google (71 percent).

Reichheld is gaining believers. GE, American Express, and Microsoft among others have all adopted the NPS metric, and GE has tied 20 percent of its managers' bonuses to its NPS scores. When the European unit of GE Healthcare scored low, follow-up research revealed that response times to customers were a major problem. After it overhauled its call center and put more specialists in the field, GE Healthcare's Net Promoter scores jumped 10 to 15 points. BearingPoint found clients who gave it high Net Promoter scores showed the highest revenue growth.

Reichheld says he developed NPS in response to overly complicated—and thus ineffective—customer surveys. So it's not surprising that client firms praise its simplicity and strong relationship to financial performance. When Intuit applied Net Promoter to its TurboTax product, feedback revealed dissatisfaction with the software's rebate procedure. After Intuit dropped the proof-of-purchase requirement, sales jumped 6 percent.

Net Promoter is not without critics. One comprehensive academic study of 21 firms and more than 15,000 consumers in Norway failed to find any superiority of Net Promoter over other metrics such as the ACSI measure, discussed later in this chapter.

**Sources:** Fred Reichheld, *Ultimate Question: For Driving Good Profits and True Growth* (Cambridge, MA: Harvard Business School Press, 2006); Jena McGregor, "Would You Recommend Us?" *BusinessWeek*, January 30, 2006, pp. 94–95; Kathryn Kranhold, "Client-Satisfaction Tool Takes Root," *Wall Street Journal*, July 10, 2006; Fred Reichheld, "The One Number You Need to Grow," *Harvard Business Review*, December 2003; Timothy L. Keiningham, Bruce Cooil, Tor Wallin Andreassen, and Lerzan Aksoy, "A Longitudinal Examination of Net Promoter and Firm Revenue Growth," *Journal of Marketing*, 71 (July 2007), pp. 39–51; Neil A. Morgan and Lopo Leotte Rego, "The Value of Different Customer Satisfaction and Loyalty Metrics in Predicting Business Performance," *Marketing Science,* 25, no. 5 (September–October 2006), pp. 426–39; Timothy L. Keiningham, Lerzan Aksoy, Bruce Cooil, and Tor W. Andreassen, "Linking Customer Loyalty to Growth," *MIT Sloan Management Review* (Summer 2008), pp. 51–57; Timothy L. Keiningham, Lerzan Aksoy, Bruce Cooil, and Tor W. Andreassen, "Commentary on 'The Value of Different Customer Satisfaction and Loyalty Metrics in Predicting Business Performance,'" *Marketing Science*, 27, no. 3 (May–June 2008), 531–32.

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.

**INFLUENCE OF CUSTOMER SATISFACTION** For customer-centered companies, customer satisfaction is both a goal and a marketing tool. Companies need to be especially concerned with their customer satisfaction level today because the Internet provides a tool for consumers to quickly spread both good and bad word of mouth to the rest of the world. Some customers set up their own Web sites to air grievances and galvanize protest, targeting high-profile brands such as United Airlines, Home Depot, and Mercedes-Benz.[31]

The University of Michigan's Claes Fornell has developed the American Customer Satisfaction Index (ACSI) to measure consumers' perceived satisfaction with different firms, industries, economic sectors, and national economies.[32] Table 5.2 displays some of the 2009 leaders.

Companies that do achieve high customer satisfaction ratings make sure their target market knows it. Once they achieved number one status in their category on J.D. Power's customer satisfaction ratings, Hyundai, American Express, Medicine Shoppe (a chain pharmacy), and Alaska Airways have communicated that fact.

**TABLE 5.2** 2009 ACSI Scores by Industry

| Industry | Firm | Score |
|---|---|---|
| Airlines | Southwest Airlines | 81 |
| Apparel | Jones Apparel | 84 |
| Automobiles & Light Vehicles | Lexus & BMW | 87 |
| Banks | Wachovia | 76 |
| Breweries | Molson Coors Brewing | 83 |
| Cable & Satellite TV | DIRECTV | 71 |
| Cellular Telephones | Nokia | 74 |
| Cigarettes | Philip Morris | 79 |
| Department & Discount Stores | Nordstrom & Kohl's | 80 |
| Energy Utilities | Sempra Energy | 80 |
| Express Delivery | FedEx | 84 |
| Fixed Line Telephone Service | Cox Communications | 74 |
| Food Manufacturing | H. J. Heinz | 89 |
| Health Insurance | Blue Cross and Blue Shield | 73 |
| Hotels | Hilton Hotels | 79 |
| Internet Brokerage | Fidelity Investments | 80 |
| Internet News & Information | MSNBC.com | 76 |
| Internet Portals & Search Engines | Google | 86 |
| Internet Travel | Expedia | 77 |
| Life Insurance | Prudential Financial | 79 |
| Personal Care & Cleaning Products | Clorox | 87 |
| Personal Computers | Apple | 85 |
| Soft Drinks | Dr Pepper Snapple | 87 |
| Supermarkets | Publix | 82 |
| Wireless Telephone Service | Verizon Wireless | 74 |

**Source:** ACSI LLC, www.theacsi.org. Used with permission.

**CUSTOMER COMPLAINTS** Some companies think they're getting a sense of customer satisfaction by tallying complaints, but studies show that while customers are dissatisfied with their purchases about 25 percent of the time, only about 5 percent complain. The other 95 percent either feel complaining is not worth the effort or don't know how or to whom to complain. They just stop buying.[33]

Of the customers who register a complaint, 54 percent to 70 percent will do business with the organization again if their complaint is resolved. The figure goes up to a staggering 95 percent if the customer feels the complaint was resolved *quickly*. Customers whose complaints are satisfactorily resolved tell an average of 5 people about the good treatment they received.[34] The average dissatisfied customer, however, gripes to 11 people. If each of these tells still other people, the number exposed to bad word of mouth may grow exponentially.

No matter how perfectly designed and implemented a marketing program is, mistakes will happen. The best thing a company can do is make it easy for customers to complain. Suggestion forms, toll-free numbers, Web sites, and e-mail addresses allow for quick, two-way communication. The 3M Company claims that over two-thirds of its product improvement ideas come from listening to customer complaints.

Given the potential downside of having an unhappy customer, it's critical that marketers deal with negative experiences properly.[35] Beyond that, the following procedures can help to recover customer goodwill:[36]

1. Set up a 7-day, 24-hour toll-free hotline (by phone, fax, or e-mail) to receive and act on customer complaints.
2. Contact the complaining customer as quickly as possible. The slower the company is to respond, the more dissatisfaction may grow and lead to negative word of mouth.
3. Accept responsibility for the customer's disappointment; don't blame the customer.
4. Use customer service people who are empathic.
5. Resolve the complaint swiftly and to the customer's satisfaction. Some complaining customers are not looking for compensation so much as a sign that the company cares.

## Product and Service Quality

Satisfaction will also depend on product and service quality. What exactly is quality? Various experts have defined it as "fitness for use," "conformance to requirements," and "freedom from variation." We will use the American Society for Quality's definition: **Quality** is the totality of features and characteristics of a product or service that bear on its ability to satisfy stated or implied needs.[37] This 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.

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.[38] The drive to produce goods that are superior in world markets has led some countries—and groups of countries—to recognize or award prizes to companies that exemplify the best quality practices, such as the Deming Prize in Japan, the Malcolm Baldrige National Quality Award in the United States, and the European Quality Award.

Companies that have lowered costs to cut corners have paid the price when the quality of the customer experience suffers:[39] 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. As one frequent flier noted, "Northwest acts low cost without *being* low cost." Not surprisingly, Northwest came in last of all top U.S. airlines in both the ACS index and J.D. Power's customer satisfaction poll soon thereafter. Home Depot also encountered turbulence when it became overly focused on cost cutting.

**Home Depot** When Home Depot decided to expand into the contractor supply business, while also cutting costs and streamlining operations in 1,816 U.S. stores, it replaced many full-time workers with part-timers who soon made up about 40 percent of store staff. The chain's ACS index of customer satisfaction dropped to the bottom among major U.S. retailers, 11 points behind customer-friendly competitor Lowe's, and its share price slid 24 percent during the biggest home improvement boom in U.S. history. To turn the company around, new management simplified operations. Store managers were given three goals to achieve—cleaner warehouses, stocked shelves, and top customer service. The 200+ e-mails sent from the corporate office on a typical Monday were replaced with one—the rest of the information was made available online. In a new practice called "power hours," on weekdays from 10 AM to 2 PM and all day Saturday and Sunday, employees were to do nothing but serve customers. To make sure the new strategy stuck, performance reviews were changed so store employees were evaluated almost entirely on customer service.[40]


Home Depot instituted a number of changes in its operations to improve customer service and satisfaction.

Quality is clearly the key to value creation and customer satisfaction. Total quality is everyone's job, just as marketing is everyone's job. "Marketing Memo: Marketing and Total Quality" outlines the role of marketing in maximizing total quality for the firm.

# Maximizing Customer Lifetime Value

Ultimately, marketing is the art of attracting and keeping profitable customers. Yet every company loses money on some of its customers. The well-known 80–20 rule states that 80 percent or more of the company's profits come from the top 20 percent of its customers. Some cases may be more extreme—the most profitable 20 percent of customers (on a per capita basis) may contribute as much as 150 percent to 300 percent of profitability. The least profitable 10 percent to 20 percent, on the other hand, can actually reduce profits between 50 percent to 200 percent per account, with the middle 60 percent to 70 percent breaking even.[41] The implication is that a company could improve its profits by "firing" its worst customers.

**marketing Memo**

## Marketing and Total Quality

Marketers play several roles in helping their companies define and deliver high-quality goods and services to target customers

- They correctly identify customers' needs and requirements.
- They communicate customer expectations properly to product designers.
- They make sure customers' orders are filled correctly and on time.
- They check that customers have received proper instructions, training, and technical assistance in the use of the product.
- They stay in touch with customers after the sale to ensure they are, and remain, satisfied.
- They gather customer ideas for product and service improvements and convey them to the appropriate departments.

When marketers do all this, they make substantial contributions to total quality management and customer satisfaction, as well as to customer and company profitability.

It's not always the company's largest customers, who can demand considerable service and deep discounts, who yield the most profit. The smallest customers pay full price and receive minimal service, but the costs of transacting with them can reduce their profitability. Midsize customers who receive good service and pay nearly full price are often the most profitable.

## Customer Profitability

A **profitable customer** is a person, household, or company that over time yields a revenue stream exceeding by an acceptable amount the company's cost stream for attracting, selling, and serving that customer. Note the emphasis is on the *lifetime* stream of revenue and cost, not the profit from a particular transaction.[42] Marketers can assess customer profitability individually, by market segment, or by channel.

Many companies measure customer satisfaction, but few measure individual customer profitability.[43] Banks claim this is a difficult task, because each customer uses different banking services and the transactions are logged in different departments. However, the number of unprofitable customers in their customer base has appalled banks that have succeeded in linking customer transactions. Some report losing money on over 45 percent of their retail customers.

**CUSTOMER PROFITABILITY ANALYSIS** A useful type of profitability analysis is shown in Figure 5.3.[44] 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 profitability analysis (CPA)** is best conducted with the tools of an accounting technique called **activity-based costing (ABC)**. ABC accounting tries to identify the real costs associated with serving each customer—the costs of products and services based on the resources they consume. The company estimates all revenue coming from the customer, less all costs.

With ABC, the costs should include the cost not only of making and distributing the products and services, but also of taking phone calls from the customer, traveling to visit the customer, paying for entertainment and gifts—all the company's resources that go into serving that customer. ABC also allocates indirect costs like clerical costs, office expenses, supplies, and so on, to the activities that use them, rather than in some proportion to direct costs. Both variable and overhead costs are tagged back to each customer.

Companies that fail to measure their costs correctly are also not measuring their profit correctly and are likely to misallocate their marketing effort. The key to effectively employing ABC is to define and judge "activities" properly. One time-based solution calculates the cost of one minute of overhead and then decides how much of this cost each activity uses.[45]

|Fig. 5.3|

Customer-Product Profitability Analysis

Customers

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

## Measuring Customer Lifetime Value

The case for maximizing long-term customer profitability is captured in the concept of customer lifetime value.[46] **Customer lifetime value (CLV)** describes the net present value 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 percent and 20 percent, 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.[47]

Many methods exist to measure CLV.[48] "Marketing Memo: Calculating Customer Lifetime Value" illustrates one. CLV calculations provide a formal quantitative framework for planning customer investment and help marketers adopt a long-term perspective. One challenge, however, is to arrive at reliable cost and revenue estimates. Marketers who use CLV concepts must also take into account the short-term, brand-building marketing activities that help increase customer loyalty.

# Cultivating Customer Relationships

Companies are using information about customers to enact precision marketing designed to build strong long-term relationships.[49] Information is easy to differentiate, customize, personalize, and dispatch over networks at incredible speed.

### marketing Memo — Calculating Customer Lifetime Value

Researchers and practitioners have used many different approaches for modeling and estimating CLV. Columbia's Don Lehmann and Harvard's Sunil Gupta recommend the following formula to estimate the CLV for a not-yet-acquired customer:

$$CLV = \sum_{t=0}^{T} \frac{(p_t - c_t)r_t}{(1+i)^t} - AC$$

where $p_t$ = price paid by a consumer at time $t$,

$c_t$ = direct cost of servicing the customer at time $t$,

$i$ = discount rate or cost of capital for the firm,

$r_t$ = probability of customer repeat buying or being "alive" at time $t$,

$AC$ = acquisition cost,

$T$ = time horizon for estimating $CLV$.

A key decision is what time horizon to use for estimating CLV. Typically, three to five years is reasonable. With this information and estimates of other variables, we can calculate CLV using spreadsheet analysis.

Gupta and Lehmann illustrate their approach by calculating the CLV of 100 customers over a 10-year period (see Table 5.3). In this example, the firm acquires 100 customers with an acquisition cost per customer of \$40. Therefore, in year 0, it spends \$4,000. Some of these customers defect each year. The present value of the profits from this cohort of customers over 10 years is \$13,286.52. The net CLV (after deducting acquisition costs) is \$9,286.52, or \$92.87 per customer.

Using an infinite time horizon avoids having to select an arbitrary time horizon for calculating CLV. In the case of an infinite time horizon, if margins (price minus cost) and retention rates stay constant over time, the future CLV of an existing customer simplifies to the following:

$$CLV = \sum_{t=1}^{\infty} \frac{mr^t}{(1+i)^t} = m\frac{r}{(1+i-r)}$$

In other words, CLV simply becomes margin ($m$) times a *margin multiple* $[r/(1+i-r)]$.

Table 5.4 shows the margin multiple for various combinations of $r$ and $i$ and a simple way to estimate CLV of a customer. When retention rate is 80 percent and discount rate is 12 percent, the margin multiple is about two and a half. Therefore, the future CLV of an existing customer in this scenario is simply his or her annual margin multiplied by 2.5.

**Sources:** Sunil Gupta and Donald R. Lehmann, "Models of Customer Value," Berend Wierenga, ed., *Handbook of Marketing Decision Models* (Berlin, Germany: Springer Science and Business Media, 2007); Sunil Gupta and Donald R. Lehmann, "Customers as Assets," *Journal of Interactive Marketing* 17, no. 1 (Winter 2006), pp. 9–24; Sunil Gupta and Donald R. Lehmann, *Managing Customers as Investments* (Upper Saddle River, NJ: Wharton School Publishing, 2005); Peter Fader, Bruce Hardie, and Ka Lee, "RFM and CLV: Using Iso-Value Curves for Customer Base Analysis," *Journal of Marketing Research* 42, no. 4 (November 2005), pp. 415–30; Sunil Gupta, Donald R. Lehmann, and Jennifer Ames Stuart, "Valuing Customers," *Journal of Marketing Research* 41, no. 1 (February 2004), pp. 7–18; Werner J. Reinartz and V. Kumar, "On the Profitability of Long-Life Customers in a Noncontractual Setting: An Empirical Investigation and Implications for Marketing," *Journal of Marketing* 64 (October 2000), pp. 17–35.

TABLE 5.3 A Hypothetical Example to Illustrate CLV Calculations

| | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Number of Customers | 100 | 90 | 80 | 72 | 60 | 48 | 34 | 23 | 12 | 6 | 2 |
| Revenue per Customer | | 100 | 110 | 120 | 125 | 130 | 135 | 140 | 142 | 143 | 145 |
| Variable Cost per Customer | | 70 | 72 | 75 | 76 | 78 | 79 | 80 | 81 | 82 | 83 |
| Margin per Customer | | 30 | 38 | 45 | 49 | 52 | 56 | 60 | 61 | 61 | 62 |
| Acquisition Cost per Customer | 40 | | | | | | | | | | |
| Total Cost or Profit | –4,000 | 2,700 | 3,040 | 3,240 | 2,940 | 2,496 | 1,904 | 1,380 | 732 | 366 | 124 |
| Present Value | –4,000 | 2,454.55 | 2,512.40 | 2,434.26 | 2,008.06 | 1,549.82 | 1,074.76 | 708.16 | 341.48 | 155.22 | 47.81 |

TABLE 5.4 Margin Multiple

| | Discount Rate | | | |
|---|---|---|---|---|
| **Retention Rate** | **10%** | **12%** | **14%** | **16%** |
| **60%** | 1.20 | 1.5 | 1.11 | 1.07 |
| **70%** | 1.75 | 1.67 | 1.59 | 1.52 |
| **80%** | 2.67 | 2.50 | 2.35 | 2.22 |
| **90%** | 4.50 | 4.09 | 3.75 | 3.46 |

But information cuts both ways. For instance, customers now have a quick and easy means of doing comparison shopping through sites such as Bizrate.com, Shopping.com, and PriceGrabber.com. The Internet also facilitates communication between customers. Web sites such as Epinions.com and Yelp.com enable customers to share information about their experiences with various products and services. Customer empowerment has become a way of life for many companies that have had to adjust to a shift in the power with their customer relationships.

## Customer Relationship Management

**Customer relationship management (CRM)** is the process of carefully managing detailed information about individual customers and all customer "touch points" to maximize loyalty.[50] 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. For a 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, high-powered employees who understand the needs of sophisticated business travelers, and at least one best-in-region facility, such as a premier restaurant or spa.[51]

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.[52]

**PERSONALIZING MARKETING** The widespread usage of the Internet allows marketers to abandon the mass market practices that built brand powerhouses in the 1950s, 1960s, and 1970s for new approaches that are a throwback to marketing practices from a century ago, when merchants literally knew their customers by name. *Personalizing marketing* is about making sure the brand and its marketing are as relevant as possible to as many customers as possible—a challenge, given that no two customers are identical.

Jones Soda

**Jones Soda** Peter van Stolk founded Jones Soda on the premise that Gen Y consumers would be more accepting of a new soft drink brand if they felt they discovered it themselves. Jones Soda initially was sold only in shops that sell surfboards, snowboards, and skateboards. The Jones Soda Web site would encourage fans to send in personal photos for possible use on Jones Soda labels. Although only a small number were picked from tens of thousands of entries, the approach helped create relevance and an emotional connection. Customers could also purchase bottles with customized labels. Famous for unusual flavors such as Turkey and Gravy, Pineapple Upside Down, Berry White (a pun on singer Barry White), Purple Carrot, and Lemon Drop Dead, the company also adds pithy words of wisdom from customers under the bottle cap to create additional relevance and distinctiveness. The approach worked for a number of years—revenue grew at 15 percent to 30 percent annually—until an ill-fated foray into canned soda and selling through mass market retailers Target and Walmart resulted in some devastating financial losses and a vow to return to the company's personal-touch roots.[53]

An increasingly essential ingredient for the best relationship marketing today is the right technology. GE Plastics could not target its e-mail effectively to different customers if it were not for advances in database software. Dell could not customize computer ordering for its global corporate customers without advances in Web technology. Companies are using e-mail, Web sites, call centers, databases, and database software to foster continuous contact between company and customer.

E-commerce companies looking to attract and retain customers are discovering that personalization goes beyond creating customized information.[54] For example, the Lands' End Live Web site offers visitors the opportunity to talk with a customer service representative. Nordstrom takes a similar approach to ensure online buyers are as satisfied with the company's customer service as in-store visitors. Domino's has put the customer in charge of ordering a pizza delivery every step of the way.

Domino's

**Domino's** Domino's has introduced a new "build-your-own-pizza" feature on its Web site that allows customers to watch a simulated photographic version of their pizza as they select a size, choose a sauce, and add toppings. The Web site also shows exactly what the completed pizza would cost in the process. It lets customers track orders from when the pizza enters the oven to when it leaves the store. Domino's also introduced a new point-of-sale system that streamlined the logistics of online and phone orders. This system improved accuracy, increased repeat visits, and boosted revenues and processes.[55]

Companies are also recognizing the importance of the personal component to CRM and what happens once customers make actual contact with the company. Employees can create strong bonds with customers by individualizing and personalizing relationships. In essence, thoughtful companies turn their customers into clients. Here is the distinction:

> Customers may be nameless to the institution; clients cannot be nameless. Customers are served as part of the mass or as part of larger segments; clients are served on an individual basis. Customers are served by anyone who happens to be available; clients are served by the professional assigned to them.[56]

To adapt to customers' increased desire for personalization, marketers have embraced concepts such as permission marketing and one-to-one marketing.

*Permission marketing*, the practice of marketing to consumers only after gaining their expressed permission, is based on the premise that marketers can no longer use "interruption marketing" via mass media campaigns. According to Seth Godin, a pioneer in the technique, marketers can develop stronger consumer relationships by respecting consumers' wishes and sending messages only when they express a willingness to become more involved with the brand.[57] Godin believes permission marketing works because it is "anticipated, personal, and relevant."

Permission marketing, like other personalization approaches, presumes consumers know what they want. But in many cases, consumers have undefined, ambiguous, or conflicting preferences. "Participatory marketing" may be a more appropriate concept than permission marketing, because marketers and consumers need to work together to find out how the firm can best satisfy consumers.

Don Peppers and Martha Rogers outline a four-step framework for *one-to-one marketing* that can be adapted to CRM marketing as follows:[58]

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). Apply activity-based costing and calculate customer lifetime value. Estimate net present value 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.

One-to-one marketing is not for every company: It works best for firms that normally collect a great deal of individual customer information and carry a lot of products that can be cross-sold, need periodic replacement or upgrading, and offer high value. For others, the required investment in information collection, hardware, and software may exceed the payout. With automobiles that can cost over $100,000, Aston Martin engages in one-to-one marketing with a select group of customers. High-end dealerships offer separate owners-only clubroom sections and weekend getaways to test-drive new models.[59]

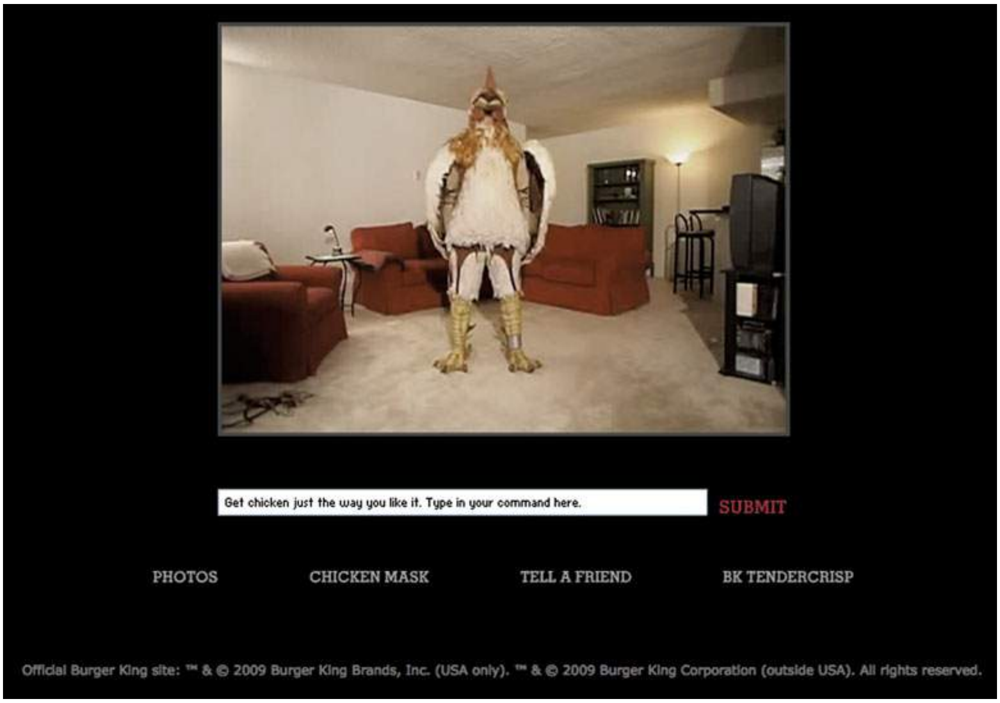
**CUSTOMER EMPOWERMENT** Often seen as the flag bearer for marketing best practices, P&G's former chairman, A.G. Lafley, created shockwaves with his Association of National Advertisers' speech in October 2006. "The power is with the consumer," proclaimed Lafley, and "marketers and retailers are scrambling to keep up with her. Consumers are beginning in a very real sense to own our brands and participate in their creation. We need to learn to let go." In support of his contention, Lafley pointed out how a teenager had created an animated spot for Pringles snacks that was posted on YouTube; how Pantene, the hair care products company, had created a campaign that encouraged women to cut their hair and donate the clippings to make wigs for cancer patients; and how sales of Cover Girl Outlast lipstick increased 25 percent after the firm put mirrored ads in women's restrooms asking, "Is your lipstick still on?" and ran targeted five-second TV ads with the same theme.[60]

Other marketers have begun to advocate a "bottom-up" grassroots approach to marketing, rather than the more traditional "top-down" approach in which marketers feel they are calling the shots. Burger King has launched attention-getting edgy campaigns in recent years ("Whopper Freakout," "Subservient Chicken," and "Wake Up With the King") on consumer-friendly new media such as YouTube, MySpace, video games, and iPods. Allowing the customer to take charge just makes sense for a brand whose slogan is "Have It Your Way" and whose main rival, McDonald's, already owns the more staid family market.

Marketers are helping consumers become evangelists for brands by providing them resources and opportunities to demonstrate their passion. Doritos held a contest to let consumers name their next flavor. Converse asked amateur filmmakers to submit 30-second short films that demonstrated their inspiration from the iconic sneaker brand. The best of the 1,800 submissions were showcased in the Converse Gallery Web site, and the best of the best became TV commercials. Sales of shoes via the Web site doubled in the month after the gallery's launch.[61]

Even business-to-business firms are getting into the action. PAETEC provides telecommunications services to hotels, universities, and other companies. It has grown into a $500 million company in six years, and its growth is due entirely to customer evangelism. PAETEC's primary marketing strategy: Invite current customers and key prospects to dine on PAETEC's tab and meet

**Burger King's "Subservient Chicken" marketing campaign reinforced the brand's core promise of putting the customer in charge.**




one another. No boring PowerPoint presentations here, just customers talking about their telecommunications challenges and their unfiltered experiences being PAETEC customers. Prospects are sold on the company by other customers.[62]

Although much has been made of the newly empowered consumer—in charge, setting the direction of the brand, and playing a much bigger role in how it is marketed—it's still true that only *some consumers* want to get involved with *some of the brands* they use and, even then, only *some of the time*. Consumers have lives, jobs, families, hobbies, goals, and commitments, and many things matter more to them than the brands they purchase and consume. Understanding how to best market a brand given such diversity is crucially important.

**CUSTOMER REVIEWS AND RECOMMENDATIONS** Although the strongest influence on consumer choice remains "recommended by relative/friend," an increasingly important decision factor is "recommendations from consumers." With increasing mistrust of some companies and their advertising, online customer ratings and reviews are playing an important role for Internet retailers such as Amazon.com and Shop.com.

Online pet food retailer PETCO actually started using consumer product ratings and reviews in e-mails and banner ads, finding the click-through rate increased considerably as a result.[63] Brick-and-mortar retailers such as Staples and Cabela's are also recognizing the power of consumer reviews and have begun to display them in their stores.[64]

Despite consumer acceptance of such reviews, however, their quality and integrity is always in question. In one famous example, over a period of seven years, the cofounder and CEO of Whole Foods Market reportedly posted more than 1,100 entries on Yahoo! Finance's online bulletin board under a pseudonym, praising his company and criticizing competitors.

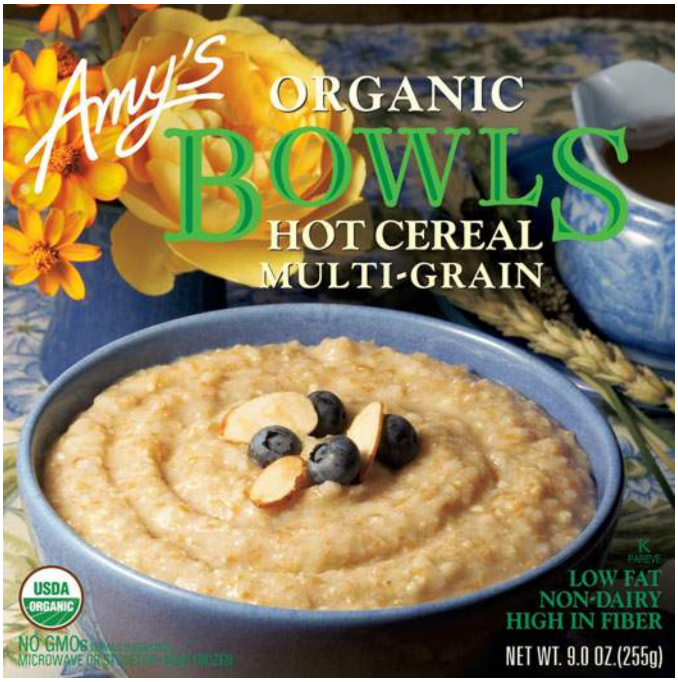
Some sites offer summaries of reviews to provide a range of product evaluations. Metacritic aggregates music, game, TV, and movie reviews from leading critics—often from more than 100 publications—averaged into a single 1 to 100 score. Review sites are important in the video game industry because of the influence they wield and the product's high selling price—often $50 to $60. Some game companies tie bonuses for their developers to game scores on the more popular sites. If a major new release doesn't make the 85-plus cutoff, the publisher's stock price may even drop.[65]

Bloggers who review products or services have become important because they may have thousands of followers; blogs are often among the top links returned in online searches for certain brands or categories. A company's PR department may track popular blogs via online services such as Google alerts, BlogPulse, and Technorati. Firms also court the favor of key bloggers via free samples, advance information, and special treatment. Most bloggers disclose when they are given free samples by companies.

For smaller brands with limited media budgets, online word of mouth is critical. To generate prelaunch buzz for one of its new hot cereals, organic food maker Amy's Kitchen shipped out samples before its release to several of the 50 or so vegan, gluten-free, or vegetarian food bloggers the company tracks. When favorable reviews appeared on these blogs, the company was besieged by e-mails asking where the cereal could be bought.[66]

Negative reviews actually can be surprisingly helpful. A January 2007 Forrester study of 10,000 consumers of Amazon.com's electronics and home and garden products found that 50 percent found negative reviews helpful. Most consumers purchased the products regardless of negative comments because they felt the comments reflected personal tastes and opinions that differed from their own. Because consumers can better learn the advantages and disadvantages of products through negative reviews, fewer product returns may result, saving retailers and producers money.[67]

Online retailers often add their own recommendations, "If you like that black purse, you'll love this red blouse." One source estimated that recommendation systems contribute 10 percent to 30 percent of an online retailer's sales. Specialized software tools help online retailers facilitate customer "discovery" or unplanned purchases. When Blockbuster adopted one such system, cancellation rates fell and subscribers nearly doubled the number of movies on their order lists.[68]




**Amy's Kitchen sent product samples to carefully selected bloggers to quickly spread the word about its new products.**

At the same time, online companies need to make sure their attempts to create relationships with customers don't backfire, as when customers are bombarded by computer-generated recommendations that consistently miss the mark. Buy a lot of baby gifts on Amazon.com, and your personalized recommendations suddenly don't look so personal! E-tailers need to recognize the limitations of online personalization at the same time that they try harder to find technology and processes that really work.

## Attracting and Retaining Customers

Companies seeking to expand their profits and sales must spend considerable time and resources searching for new customers. To generate leads, they develop ads and place them in media that will reach new prospects; send direct mail and e-mails to possible new prospects; send their salespeople to participate in trade shows where they might find new leads; purchase names from list brokers; and so on.

Different acquisition methods yield customers with varying CLVs. One study showed that customers acquired through the offer of a 35 percent discount had about one-half the long-term value of customers acquired without any discount.[69] 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.[70]

**REDUCING DEFECTION** It is not enough to attract new customers; the company must also keep them and increase their business.[71] 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.[72]

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.[73]
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.

**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.

By calculating *conversion rates*—the percentage 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. Consider this data about customer retention:[74]

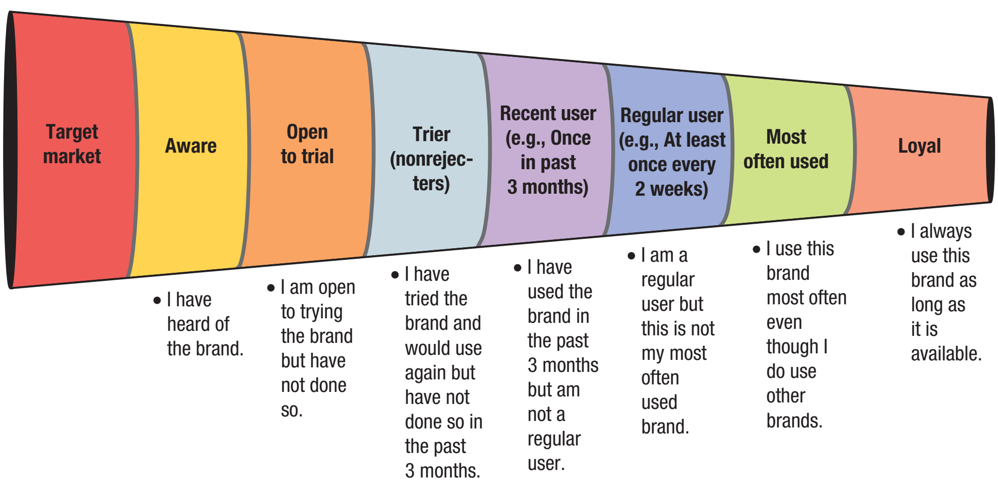
- Acquiring new customers can cost five times more than satisfying and retaining current ones. It requires a great deal of effort to induce satisfied customers to switch from their current suppliers.
- The average company loses 10 percent of its customers each year.
- A 5 percent reduction in the customer 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.

**MANAGING THE 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.[75] 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.*** 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.

|Fig. 5.4|

The Marketing Funnel



- ***Enhancing the growth potential of each customer through "share of wallet," cross-selling, and up-selling.***[76] 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.[77] 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.[78] "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.[79]
- ***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 Loyalty

Creating a strong, tight connection to customers is the dream of any marketer and often the key to long-term marketing success. Companies that want to form such bonds should heed some specific considerations (see △ Figure 5.5). One set of researchers sees retention-building activities as adding financial benefits, social benefits, or structural ties.[80] The following sections explain three types of marketing activities companies are using to improve loyalty and retention.

**INTERACTING WITH CUSTOMERS** Listening to customers is crucial to customer relationship management. Some companies have created an ongoing mechanism that keeps their marketers permanently plugged in to frontline customer feedback.

- Deere & Company, which makes John Deere tractors and has a superb record of customer loyalty—nearly 98 percent annual retention in some product areas—has used retired employees to interview defectors and customers.[81]
- Chicken of the Sea has 80,000 members in its Mermaid Club, a core-customer group that receives special offers, health tips and articles, new product updates, and an informative e-newsletter. In return, club members provide valuable feedback on what the company is doing and thinking of doing. Feedback from club members has helped design the brand's Web site, develop messages for TV advertising, and craft the look and text on the packaging.[82]
- Build-A-Bear Workshop uses a "Cub Advisory Board" as a feedback and decision-input body. The board is made up of twenty 8- to 12-year-olds who review new-product ideas and give a "paws up or down." Many products in the stores are customer ideas.[83]

But listening is only part of the story. It is also important to be a customer advocate and, as much as possible, take the customers' side and understand their point of view.[84] USAA Insurance's legendary quality of service has led to the highest customer satisfaction in the industry. USAA subscribers will often tell stories about how the company looks out for them, even counseling them not

- Create superior products, services, and experiences for the target market.
- Get cross-departmental participation in planning and managing the customer satisfaction and retention process.
- Integrate the "Voice of the Customer" to capture their stated and unstated needs or requirements in all business decisions.
- Organize and make accessible a database of information on individual customer needs, preferences, contacts, purchase frequency, and satisfaction.
- Make it easy for customers to reach appropriate company staff and express their needs, perceptions, and complaints.
- Assess the potential of frequency programs and club marketing programs.
- Run award programs recognizing outstanding employees.

|Fig. 5.5| △

**Forming Strong Customer Bonds**

**Feedback from members of its Mermaid Club has helped Chicken of the Sea improve its marketing and customer appeal.**


to take out more insurance than they need. With such levels of trust, USAA enjoys high customer loyalty and significant cross-selling opportunities.[85]

**DEVELOPING LOYALTY PROGRAMS** **Frequency programs (FPs)** are designed to reward customers who buy frequently and in substantial amounts.[86] They can help build long-term loyalty with high CLV customers, creating cross-selling opportunities in the process. Pioneered by the airlines, hotels, and credit card companies, FPs now exist in many other industries. Most supermarket chains offer price club cards that grant discounts on certain items.[87]

Typically, the first company to introduce a FP in an industry gains the most benefit, especially if competitors are slow to respond. After competitors react, FPs can become a financial burden to all the offering companies, but some companies are more efficient and creative in managing them. Some FPs generate rewards in a way that locks customers in and creates significant costs to switching. FPs can also produce a psychological boost and a feeling of being special and elite that customers value.[88]

**Club membership programs** can be open to everyone who purchases a product or service, or limited to an affinity group or those willing to pay a small fee. Although open clubs are good for building a database or snagging customers from competitors, limited-membership clubs are more powerful long-term loyalty builders. Fees and membership conditions prevent those with only a fleeting interest in a company's products from joining. These clubs attract and keep those customers responsible for the largest portion of business. Apple has a highly successful club.

Apple

**Apple** Apple encourages owners of its computers to form local Apple-user groups. By 2009, there were over 700, ranging in size from fewer than 30 members to over 1,000. The groups provide Apple owners with opportunities to learn more about their computers, share ideas, and get product discounts. They sponsor special activities and events and perform community service. A visit to Apple's Web site will help a customer find a nearby user group.[89]

**CREATING INSTITUTIONAL TIES** The company may supply customers with special equipment or computer links that help them manage orders, payroll, and inventory. Customers are less inclined to switch to another supplier when it means high capital costs, high search costs, or the loss of loyal-customer discounts. A good example is McKesson Corporation, a leading pharmaceutical wholesaler, which invested millions of dollars in EDI (Electronic Data Interchange) capabilities to help independent pharmacies manage inventory, order-entry processes, and shelf space. Another example is Milliken & Company, which provides proprietary software programs, marketing research, sales training, and sales leads to loyal customers.

## Win-Backs

Regardless of how hard companies may try, some customers inevitably become inactive or drop out. The challenge is to reactivate them through win-back strategies.[90] It's often easier to reattract ex-customers (because the company knows their names and histories) than to find new ones. Exit interviews and lost-customer surveys can uncover sources of dissatisfaction and help win back only those with strong profit potential.[91]

# Customer Databases and Database Marketing

Marketers must know their customers.[92] And in order to know the customer, the company must collect information and store it in a database from which to conduct database marketing. A **customer database** is an organized collection of comprehensive information about individual customers or prospects that is current, accessible, and actionable for lead generation, lead qualification, sale of a product or service, or maintenance of customer relationships. **Database marketing** is the process of building, maintaining, and using customer databases and other databases (products, suppliers, resellers) to contact, transact, and build customer relationships.

## Customer Databases

Many companies confuse a customer mailing list with a customer database. A **customer mailing list** is simply a set of names, addresses, and telephone numbers. A customer database contains much more information, accumulated through customer transactions, registration information, telephone queries, cookies, and every customer contact.

Ideally, a customer database also contains the consumer's past purchases, demographics (age, income, family members, birthdays), psychographics (activities, interests, and opinions), mediagraphics (preferred media), and other useful information. The catalog company Fingerhut possesses some 1,400 pieces of information about each of the 30 million households in its massive customer database.

Ideally, a **business database** contains business customers' past purchases; past volumes, prices, and profits; buyer team member names (and ages, birthdays, hobbies, and favorite foods); status of current contracts; an estimate of the supplier's share of the customer's business; competitive suppliers; assessment of competitive strengths and weaknesses in selling and servicing the account; and relevant customer buying practices, patterns, and policies.

A Latin American unit of the Swiss pharmaceutical firm Novartis keeps data on 100,000 of Argentina's farmers, knows their crop protection chemical purchases, groups them by value, and treats each group differently.

## Data Warehouses and Data Mining

Savvy companies capture information every time a customer comes into contact with any of their departments, whether it is a customer purchase, a customer-requested service call, an online query, or a mail-in rebate card.[93] Banks and credit card companies, telephone companies, catalog marketers, and many other companies have a great deal of information about their customers, including not only addresses and phone numbers, but also transactions and enhanced data on age, family size, income, and other demographic information.

These data are collected by the company's contact center and organized into a **data warehouse** where marketers can capture, query, and analyze them to draw inferences about an individual customer's needs and responses. Telemarketers can respond to customer inquiries based on a complete picture of the customer relationship, and customized marketing activities can be directed to individual customers.

dunnhumby

**dunnhumby** British research firm dunnhumby has increased the profitability of struggling retailers by gleaning insights from their loyalty program data and credit card transactions. The firm helped British supermarket giant Tesco tailor coupons and special discounts to its loyalty card shoppers. Tesco decided against dropping a poor-selling type of bread after dunnhumby's analysis revealed it was a "destination product" for a loyal cohort that would shop elsewhere if it disappeared. Other U.S. clients have included Kroger, Macy's, and Home Depot. For a major European catalog company, dunnhumby found that not only did shoppers with different body types prefer different clothing styles, they also shopped at different times of the year: Slimmer consumers tended to buy early in a new season, whereas larger folks tended to take fewer risks and wait until later in the season to see what would be popular.[94]

Through **data mining,** marketing statisticians can extract from the mass of data useful information about individuals, trends, and segments. Data mining uses sophisticated statistical and mathematical techniques such as cluster analysis, automatic interaction detection, predictive modeling, and neural networking. Some observers believe a proprietary database can provide a company with a significant competitive advantage.[95] See Figure 5.6 for some examples.

In general, companies can use their databases in five ways:

1. ***To identify prospects***—Many companies generate sales leads by advertising their product or service. The ads generally contain a response feature, such as a business reply card or toll-free phone number, and the company builds its database from customer responses. It sorts through the database to identify the best prospects, then contacts them by mail or phone to try to convert them into customers.

|Fig. 5.6|

## Examples of Database Marketing

**Qwest** Twice a year Qwest sifts through its customer list looking for customers that have the potential to be more profitable. The company's database contains as many as 200 observations about each customer's calling patterns. By looking at demographic profiles, plus the mix of local versus long-distance calls or whether a consumer has voice mail, Qwest can estimate potential spending. Next, the company determines how much of the customer's likely telecom budget is already coming its way. Armed with that knowledge, Qwest sets a cutoff point for how much to spend on marketing to this customer.

**Royal Caribbean** Royal Caribbean uses its database to offer spur-of-the-moment cruise packages to fill all the berths on its ships. It focuses on retired people and single people because they are more able to make quick commitments. Fewer empty berths mean maximized profits for the cruise line.

**Fingerhut** The skillful use of database marketing and relationship building has made catalog house Fingerhut one of the nation's largest direct-mail marketers. Not only is its database full of demographic details such as age, marital status, and number of children, but it also tracks customers' hobbies, interests, and birthdays. Fingerhut tailors mail offers based on what each customer is likely to buy. Fingerhut stays in continuous touch with customers through regular and special promotions, such as annual sweepstakes, free gifts, and deferred billing. Now the company has applied its database marketing to its Web sites.

**Mars** Mars is a market leader not only in candy, but also in pet food. In Germany, Mars has compiled the names of virtually every cat-owning family by contacting veterinarians and by advertising a free booklet titled "How to Take Care of Your Cat." Those who request the booklet fill out a questionnaire, so Mars knows the cat's name, age, and birthday. Mars now sends a birthday card to each cat each year, along with a new catfood sample or money-saving coupons for Mars brands.

**American Express** It is no wonder that, at its secret location in Phoenix, security guards watch over American Express's 500 billion bytes of data on how its customers have used the company's 35 million green, gold, and platinum charge cards. Amex uses the database to include precisely targeted offers in its monthly mailing of millions of customer bills.

2. ***To decide which customers should receive a particular offer***—Companies interested in selling, up-selling, and cross-selling set up criteria describing the ideal target customer for a particular offer. Then they search their customer databases for those who most closely resemble the ideal. By noting response rates, a company can improve its targeting precision. Following a sale, it can set up an automatic sequence of activities: One week later send a thank-you note; five weeks later send a new offer; ten weeks later (if customer has not responded) phone and offer a special discount.
3. ***To deepen customer loyalty***—Companies can build interest and enthusiasm by remembering customer preferences and sending appropriate gifts, discount coupons, and interesting reading material.
4. ***To reactivate customer purchases***—Automatic mailing programs (automatic marketing) can send out birthday or anniversary cards, holiday shopping reminders, or off-season promotions. The database can help the company make attractive or timely offers.
5. ***To avoid serious customer mistakes***—A major bank confessed to a number of mistakes it had made by not using its customer database well. In one case, the bank charged a customer a penalty for late payment on his mortgage, failing to note he headed a company that was a major depositor in this bank. The customer quit the bank. In a second case, two different staff members of the bank phoned the same mortgage customer offering a home equity loan at different prices. Neither knew the other had made the call. In a third case, the bank gave a premium customer only standard service in another country.

## The Downside of Database Marketing and CRM

Database marketing is most frequently used by business marketers and service providers that normally and easily collect a lot of customer data, like hotels, banks, airlines, and insurance, credit card, and phone companies. Other types of companies in the best position to invest in CRM are those that do a lot of cross-selling and up-selling (such as GE and Amazon.com) or whose customers have highly differentiated needs and are of highly differentiated value to the company. Packaged-goods retailers and consumer packaged-goods companies use database marketing less frequently, though some (such as Kraft, Quaker Oats, Ralston Purina, and Nabisco) have built databases for certain brands. Some businesses cited as CRM successes include Enterprise Rent-A-Car, Pioneer Hi-Bred Seeds, Fidelity Investments, Lexus, Intuit, and Capital One.[96]

Having covered the upside of database marketing, we also need to cover the downside. Five main problems can prevent a firm from effectively using CRM.

1. ***Some situations are just not conducive to database management.*** Building a customer database may not be worthwhile when: (1) the product is a once-in-a-lifetime purchase (a grand piano); (2) customers show little loyalty to a brand (there is lots of customer churn); (3) the unit sale is very small (a candy bar) so CLV is low; (4) the cost of gathering information is too high; and (5) there is no direct contact between the seller and ultimate buyer.
2. ***Building and maintaining a customer database requires a large, well-placed investment in computer hardware, database software, analytical programs, communication links, and skilled staff.*** It's difficult to collect the right data, especially to capture all the occasions of company interaction with individual customers. Deloitte Consulting found that 70 percent of firms found little or no improvement from implementing CRM because the CRM system was poorly designed, it became too expensive, users didn't make much use of it or report much benefit, and collaborators ignored the system. Sometimes companies mistakenly concentrate on customer contact processes without making corresponding changes in internal structures and systems.[97]
3. ***It may be difficult to get everyone in the company to be customer oriented and use the available information.*** Employees find it far easier to carry on traditional transaction marketing than to practice CRM. Effective database marketing requires managing and training employees as well as dealers and suppliers.
4. ***Not all customers want a relationship with the company.*** Some may resent knowing the company has collected that much personal information about them. Online companies should explain their privacy policies and give consumers the right not to have their information stored. European countries do not look favorably on database marketing and are protective of consumers' private information. The European Union passed a law handicapping the

growth of database marketing in its 27 member countries. "Marketing Insight: The Behavioral Targeting Controversy" reviews some privacy and security issues.

5. ***The assumptions behind CRM may not always hold true.***[98] High-volume customers often know their value to a company and can leverage it to extract premium service and/or price discounts, so that it may not cost the firm less to serve them. Loyal customers may expect and demand more and resent any attempt to charge full prices. They may also be jealous of attention lavished on other customers. When eBay began to chase big corporate customers such as IBM, Disney, and Sears, some mom-and-pop businesses that helped build the brand felt abandoned.[99] Loyal customers also may not necessarily be the best ambassadors for the brand. One study found those who scored high on behavioral loyalty and bought a lot of a company's products were less active word-of-mouth marketers than customers who scored high on attitudinal loyalty and expressed greater commitment to the firm.

Thus, the benefits of database marketing do not come without significant costs and risks, not only in collecting the original customer data, but also in maintaining and mining them. When it works, a data warehouse yields more than it costs, but the data must be in good condition, and the discovered relationships must be valid and acceptable to consumers.

Marketing Insight

## The Behavioral Targeting Controversy

The emergence of *behavioral targeting* is allowing companies to track the online behavior of target customers and find the best match between ads and prospects. Tracking an individual's Internet usage behavior relies on cookies—randomly assigned numbers, codes, and data that are stored on the user's computer hard drive and reveal which sites have been visited, the amount of time spent there, which products or pages were viewed, which search terms entered, and so on.

Most behavioral targeting is carried out by online ad networks owned by large Internet firms such as Google or AOL, as well as by some Internet service providers (ISPs). These online ad networks—such as AdBrite, which has more than 70,000 sites in its online marketplace—use cookies to track consumers' movements through all their affiliated sites. A new customer signing up with Microsoft for a free Hotmail e-mail account, for example, is required to give the company his or her name, age, gender, and zip code. Microsoft can then combine those facts with information such as observed online behavior and characteristics of the area in which the customer lives, to help advertisers better understand whether, when, and how to contact that customer. Although Microsoft must be careful to preserve consumer privacy—the company claims it won't purchase an individual's income history—it can still provide advertising clients with behavioral targeting information.

For example, Microsoft can help a DiningIn franchisee zero in on working moms aged 30 to 40 in a given neighborhood with ads designed to reach them before 10 AM when they're most likely to be planning their evening meal. Or if a person clicks on three Web sites related to auto insurance and then visits an unrelated site for sports or entertainment, auto insurance ads may show up on that site, in addition to the auto insurance sites. This practice ensures that ads are readily apparent for a potential customer likely to be in the market. Microsoft claims behavioral targeting can increase the likelihood a visitor clicks an ad by as much as 76 percent.

Proponents of behavioral targeting maintain that consumers see more relevant ads in this way. Because the ads are more effective as a result, greater ad revenue is available to support free online content. Spending on behavioral targeting is projected to grow to $4.4 billion or 8.6 percent of total online ad spending by 2012.

But consumers have significant misgivings about being tracked online by advertisers. In one 2009 U.S. survey, about two-thirds of respondents objected to the practice, including 55 percent of respondents aged 18 to 24. Two-thirds of respondents also believed laws should give people the right to know everything a Web site knows about them. Government regulators wonder whether industry self-regulation will be sufficient or legislation is needed.

Proponents of behavioral targeting maintain that many consumers lack full understanding of different tracking practices and would be less concerned if they knew exactly how it worked. Their claims of anonymity and privacy, however, have been weakened by events such as a leak at AOL of online behavioral data in 2006 for 650,000 users and overly aggressive attempts to institute data capture procedures at Facebook and various ISPs.

**Sources:** Elisabeth Sullivan, "Behave," *Marketing News*, September 15, 2008, pp. 12–15; Stephanie Clifford, "Two-Thirds of Americans Object to Online Tracking," *New York Times*, September 30, 2009; Jessica Mintz, "Microsoft Adds Behavioral Targeting," *Associated Press*, December 28, 2006; Becky Ebenkamp, "Behavior Issues," *Brandweek*, October 20, 2008, pp. 21–25; Brian Morrissey, "Connect the Thoughts," *Adweek Media*, June 29, 2009, pp. 10–11; Laurie Birkett, "The Cookie That Won't Crumble," *Forbes*, January 18, 2010, p. 32; Alden M. Hayashi, "How *Not* to Market on the Web," *MIT Sloan Management Review* (Winter 2010), pp. 14–15.

# Summary

1. Customers are value maximizers. They form an expectation of value and act on it. Buyers will buy from the firm that they perceive to offer the highest customer-delivered value, defined as the difference between total customer benefits and total customer cost.
2. A buyer's satisfaction is a function of the product's perceived performance and the buyer's expectations. Recognizing that high satisfaction leads to high customer loyalty, companies must ensure that they meet and exceed customer expectations.
3. Losing profitable customers can dramatically affect a firm's profits. The cost of attracting a new customer is estimated to be five times the cost of keeping a current customer happy. The key to retaining customers is relationship marketing.
4. Quality is the totality of features and characteristics of a product or service that bear on its ability to satisfy stated or implied needs. Marketers play a key role in achieving high levels of total quality so that firms remain solvent and profitable.
5. Marketing managers must calculate customer lifetime values of their customer base to understand their profit implications. They must also determine ways to increase the value of the customer base.
6. Companies are also becoming skilled in customer relationship management (CRM), which focuses on developing programs to attract and retain the right customers and meeting the individual needs of those valued customers.
7. Customer relationship management often requires building a customer database and data mining to detect trends, segments, and individual needs. A number of significant risks also exist, so marketers must proceed thoughtfully.

# Applications

## Marketing Debate

### Online versus Offline Privacy

As more firms practice relationship marketing and develop customer databases, privacy issues are emerging as an important topic. Consumers and public interest groups are scrutinizing—and sometimes criticizing—the privacy policies of firms and raising concerns about potential theft of online credit card information or other potentially sensitive or confidential financial information. Others maintain online privacy fears are unfounded and that security issues are as much a concern offline. They argue that the opportunity to steal information exists virtually everywhere, and it's up to consumers to protect their interests.

**Take a position: Privacy is a bigger issue online than offline *versus* Privacy is no different online than offline.**

## Marketing Discussion

### Using CLV

Consider customer lifetime value (CLV). Choose a business and show how you would go about developing a quantitative formulation that captures the concept. How would that business change if it totally embraced the customer equity concept and maximized CLV?

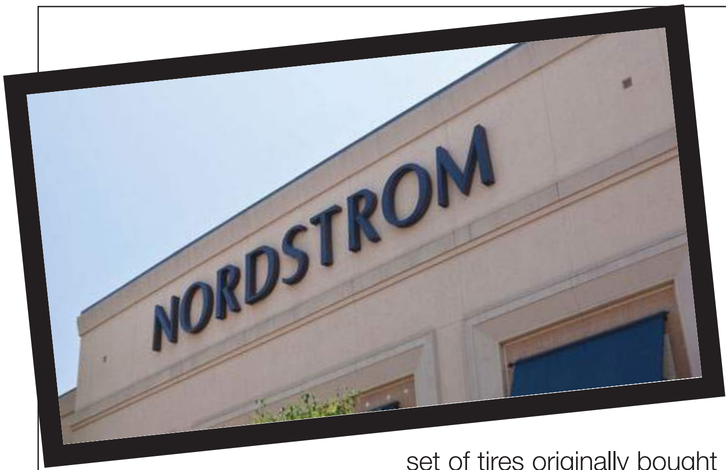
## Marketing Excellence

### >>Nordstrom

Nordstrom is an upscale U.S. department store chain with sales that topped $8 billion in 2009. John W. Nordstrom originally started the company as a shoe store but grew it over the years into a fashion specialty chain store selling top-quality, brand-name clothing, accessories, jewelry, cosmetics, and fragrances.

From the beginning, Nordstrom has believed in and stressed the importance of providing the highest level of customer service possible along with top-of-the-line, high-quality merchandise. As a shoe retailer, the company offered a wide range of products to fit most everyone's needs and price point. As it expanded into fashion and apparel, it maintained these goals.

Today, Nordstrom sets the standard in customer service and loyalty. In fact, the company is so well-known for this trait that urban legends of unusual acts of customer service still circulate today. One of the best-known tells how in 1975 a customer came into a Nordstrom store after Nordstrom had purchased a company called Northern Commercial Company. The customer wanted to return a




set of tires originally bought at Northern Commercial. Although Nordstrom has never carried or sold tires, it happily accepted the return and instantly provided the customer cash for his purchase.

While Nordstrom's "no questions asked" return policy remains intact today, there are many other examples of its exceptional customer service. Its sales representatives send thank-you cards to customers who shop there and have hand-delivered special orders to customers' homes. Nordstrom installed a tool called Personal Book at its registers that allow salespeople to enter and recall customers' specific preferences in order to better personalize their shopping experiences. Nordstrom also provides customers with multichannels for shopping, allowing them to buy something online and pick it up at a store within an hour.

Nordstrom's customer loyalty program, Fashion Rewards Program, rewards customers on four different levels based on their annual spending. Customers who spend $10,000 annually receive complimentary alterations, free shipping, a 24-hour fashion emergency hotline, and access to a personal concierge service. Customers at the highest rewards level ($20,000 spent annually) also receive private shopping trips complete with prestocked dressing rooms in the customers' specific size, champagne, and live piano music; tickets to Nordstrom's runway fashion shows; and access to exclusive travel and fashion packages, including red carpet events.

This strategic and often costly customer-focus approach has reaped great benefits for the company. Not only has Nordstrom emerged over the past 100+ years as a luxury brand known for quality, trust, and service, but its customers stay loyal even in hard times. During the economic crisis in 2008 and 2009, many customers chose to shop at Nordstrom over its competitors due to their existing relationship and hassle-free return policy.

Nordstrom currently operates 112 full-line stores, 69 Nordstrom Rack clearance stores, two Jeffrey Boutiques, and one clearance store, with plans to open 50 new stores over the next 10 years. When a new store opens, Nordstrom connects with the surrounding community by hosting an opening night gala complete with live entertainment, a runway fashion show, and the ultimate shopping experience to help raise money for local charities.

As Nordstrom moves forward, the company continues to be flexible and look for new tools and means to help deepen and develop its customer-salesperson relationship.

### Questions

1. How else can Nordstrom continue to provide exceptional customer service and increase brand loyalty?
2. What are Nordstrom's greatest risks, and who are its biggest competitors?

**Sources:** "Annual Reports," Nordstrom.com; "Company History," Nordstrom.com; Chantal Todé, "Nordstrom Loyalty Program Experience," *DMNews*, May 4, 2007; Melissa Allison and Amy Martinez, "Nordstrom's Solid December Showing Suggests Some Shoppers Eager to Spend." *Seattle Times*, January 7, 2010.

## Marketing Excellence

## >>Tesco

If you asked a customer of UK supermarket chain Tesco what the shopping experience there was like in the early 1980s, "customer friendly" would probably not be the answer. Though it began upgrading its stores and product selection in 1983, Tesco continued to suffer from a reputation as a "pile it high and sell it cheap" mass market retailer, lagging behind Sainsbury's, the more upscale market leader. To gain share against Sainsbury's, Tesco needed to reverse the public perception of its stores. It decided to improve the shopping experience and highlight improvements with an image campaign to "lift us out of the mold in our particular sector," as its 1989 agency brief put it.

Between 1990 and 1992, Tesco launched 114 separate initiatives to improve the quality of its stores, including adding baby-changing rooms, stocking specialty items such as French free-range chickens, and introducing a value-priced line of products. It developed a campaign entitled "Every Little Helps" to communicate these improvements with 20 ads, each focused on a different aspect of its approach: "doing right by the customer." As a result, between 1990 and 1995, Tesco attracted 1.3 million new customers, who helped increase revenues and market share until Tesco surpassed Sainsbury's as the market leader in 1995.

Tesco then introduced an initiative that would make it a world-class example of how to build lasting relationships with customers: the Tesco Clubcard frequent-shopper program. The Clubcard not only offered discounts and special offers tailored to individual shoppers but also acted as a powerful data-gathering tool, enabling Tesco to understand the shopping patterns and preferences of its customers better than any competitor could. Using Clubcard data, Tesco created a unique "DNA profile" for each customer


based on shopping habits. To build this profile, it classified each product purchased by a customer on a set of up to 40 dimensions, including price, size, brand, eco-friendliness, convenience, and healthiness. Based on their DNA profile, Tesco shoppers received one of 4 million different variations of the quarterly Clubcard statement, which contained targeted special offers and other promotions. The company also installed kiosks in its stores where Clubcard shoppers could get customized coupons.

The Clubcard data helped Tesco run its business more efficiently. Tracking Clubcard purchases helped uncover each product's price elasticity and helped set promotional schedules, which saved Tesco over $500 million. Tesco used its customer data to determine the range of products and the nature of merchandising for each store, and even the location of new stores. Within 15 months of introduction, more than 8 million Clubcards had been issued, of which 5 million were used regularly. Tesco's customer focus strategies enhanced by the Clubcard helped propel Tesco to even greater success than in the early 1990s. The company's market share in the United Kingdom rose to 15 percent by 1999, and that year other British companies voted Tesco Britain's most admired company for the second year in a row.

In the following years, Tesco continued to apply its winning formula of using customer data to dominate the British retail landscape. Tesco moved beyond supermarkets to "big-box" retailing of general merchandise, or nonfood products. This strategic growth not only provided additional convenience to consumers who preferred shopping under one roof but also improved overall profitability. In 2003, the average profit margin was 9 percent for nonfood products versus 5 percent for food and nearly 20 percent of Tesco's revenues came from nonfood items. That year, the company sold more CDs than Virgin Megastores and its apparel line, Cherokee, was the fastest-growing brand in the United Kingdom.

Tesco continued to conduct extensive customer research with telephone, written surveys, and customer panels to extend its lead in the grocery market. By 2005, the company had a 35 percent share of supermarket spending in the United Kingdom, almost twice that of its nearest competitor, and a 14 percent share of total retail sales. Tesco sought growth overseas in the mid-2000s and today, the company operates 4,300 stores in 14 countries, with a strong focus on high-growth markets in Asia. The company has used the same customer-centered strategies that worked in the United Kingdom to expand into these new markets.

Tesco continues to diversify its product and service offerings in order to reach more consumers. In the late 1990s, Tesco launched its own ISP service, Tesco Broadband, to provide Internet access to homes and businesses. During the 2000s, the company partnered with existing telecoms to create Tesco Mobile and Tesco Home Phone, a service now used by over 2 million UK residents. Recently, Tesco joined forces with the Royal Bank of Scotland to create a banking division, Tesco Bank. In addition, Tesco offers insurance policies, dental plans, music downloads, and financial services. One Citigroup analyst said the chain had, "pulled off a trick that I'm not aware of any other retailer achieving. That is to appeal to all segments of the market." Tesco has accomplished this feat by creating three distinctive Tesco-branded price ranges in order to appeal to everyone: "Finest," "Mid-range," and "Value." In addition, Tesco has categorized its stores into six different formats, depending on where they are located and whom they are targeting. From largest to smallest, these stores include Tesco Extra, Tesco Superstores, Tesco Metro, Tesco Express, One Stop, and Tesco Homeplus.

Throughout Tesco's massive expansion, both globally and through its product and service offerings, Tesco has stayed true to the importance of its Clubcard loyalty program. Consumers can now earn points on their Clubcard every time they shop at a Tesco store, use one of Tesco's services (Tesco Mobile, Tesco Home Phone, Tesco Broadband, Tesco Credit Card, or Tesco Financial), or use one of Tesco's partners' services. During the recent worldwide recession, Tesco helped trigger spending through special loyalty promotions such as double reward points. During a double points promotion, consumers receive 2 points for every £1 spent. For every 100 points, consumers receive a £1 voucher good for any Tesco product or service.

In 2009, Tesco's profits reached £3 billion, which resulted in £59 billion in revenues. Today, it is the largest British retailer measured by both sales and market share (30 percent). Based on profit, it is the second largest retailer in the world after Walmart.

## Questions

1. What's next for Tesco? Where and how can it grow? Who will it target?
2. How can Tesco take its customer loyalty programs to the next level?

**Sources:** Richard Fletcher, "Leahy Shrugs Off Talk of a 'Brain Drain,'" *Sunday Times* (London), January 29, 2006; Elizabeth Rigby, "Prosperous Tesco Takes Retailing to a New Level," *Financial Times*, September 21, 2005, p. 23; Laura Cohn, "A Grocery War That's Not about Food," *BusinessWeek*, October 20, 2003, p. 30; "The Prime Minister Launches the 10th Tesco Computers for Schools Scheme," *M2 Presswire*, January 26, 2001; Ashleye Sharpe and Joanna Bamford, "Tesco Stores Ltd," paper presented at Advertising Effectiveness Awards, 2000; Hamish Pringle and Marjorie Thompson, *Brand Spirit* (New York: John Wiley & Sons, 1999); Hannah Liptrot, "Tesco: Supermarket Superpower," *BBC*, June 3, 2005.