



CHAPTER 10

Establishing, developing and managing buyer–seller relationships

LEARNING OBJECTIVES

After studying this chapter you should be able to:

- understand the stages in the development of a dyadic buyer–seller relationship (acts, episodes, sequences and relationships)
- explain the importance of loyalty
- identify the different categories (segments) of loyalty
- describe the steps in building a loyalty-based, relationship-based strategy
- explain how to create e-loyalty
- understand the importance of customer lifetime value and how it is calculated
- develop ideas for creating customer loyalty programmes
- describe the stages in the KAM relationship development model
- explain the purpose of a customer complaint management system

10.1 INTRODUCTION

Relationships in marketing encompass a range of exchange phenomena, from relationships between firms (B2B relationships) to relationships between firms and individual consumers.

Managing relationships with customers, suppliers and competitors is now an integral part of a firm's strategic marketing agenda (Pass and Kuijlen, 2001; Thakur *et al.*, 2006). This criticality is reflected in the growth in the importance of relationships in the academic literature. Subject areas such as RM, networks, alliances, partnering and key account management encompass a

growing set of theories and normative approaches to managing relationships. This chapter will concentrate on the relationship between the buyer (customer) and the seller (supplier).

Managing buyer–supplier relationships involves a consideration of a multiplicity of different relationship types. Webster (1992) conceived these types as representing a continuum from a price-based transaction to close interactive relationships. Whether relationship types can be thought of as a continuum, or as radically different approaches, is a matter for debate. However, the close and distant opposites are two types that can readily be understood and managed. Jackson (1985) examined the difference between close (lost-for-good) and transaction (always-a-share) accounts and developed a framework for managing this difference (Figure 6.9).

Marketing executives need a more advanced tool for examining loyalty, and creating enthusiastic customers who come back to buy their product again and again – and are happy about doing it. It is about turning customers into advocates (Blasberg *et al.*, 2008).

10.2 BUILDING BUYER–SELLER RELATIONSHIPS IN B2B MARKETS

Why build a relationship in the first place? Relationships enhance value in several ways. The pooling of partners' knowledge may improve market vision. Combining the partners' unique competences and matching them to the most promising value opportunities may enhance customer value (Xevelonakis, 2008; Jackson, 2007; Bhalla, 2004).

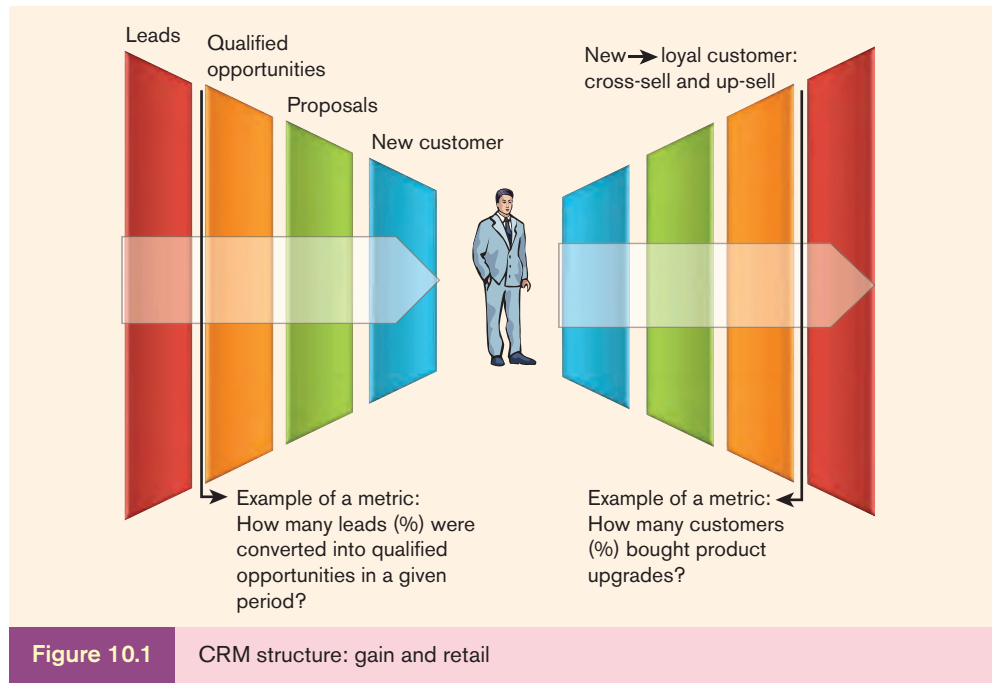
In most business-to-business situations, especially where the benefits exceed the risks, it is desirable for both the seller and the customer to maintain a long-term relationship. A relationship is warranted in a situation where there is congruence between goals of the the seller and the customer, meaning where the organisation and the customer realise that the potential gains from acting cooperatively will exceed the gains from acting opportunistically. From a strategic perspective, the seller wants to maintain a long-term relationship with a customer because it is generally much cheaper to keep an existing customer than to attract a new customer; a long-term customer can provide feedback on existing products and insights into new or re-engineered products; and a long-term customer almost becomes part of the selling team because it can provide recommendations and encourage new business. Also, as time passes and experience steps in, a long-term customer becomes easy to work with because communication channels will usually open and expand, the customer's needs and problems are known, and a comfortable working, and sometimes personal, relationship exists between personnel in both firms.

Before any vendor can develop a relationship with another company, the selling organisation must focus internally. The selling organisation must determine its marketing goals and strategy, analyse its current culture, ensure that the strategy and culture match, and, if necessary, activate a customer service-oriented culture.

There seem to be different phases in the development of a customer relationship, as illustrated in Figure 10.1.

Many salespeople waste a great deal of time cold-calling or trying to breathe life into old customer leads. That is because they cannot see clearly into prospective firms to know when the companies are getting ready to buy. The right screening process of finding new qualified opportunities and proposals can make the process of finding a new customer much easier (left side of Figure 10.1). A salesperson's network for finding new leads in the marketplace can be made up of contacts who know different people. In that way, each direct contact in the network can connect the salesperson to other contacts, creating a wider network (Üstüner and Godes, 2006; Rese, 2006; Mouzas *et al.*, 2008). Once the salesperson has identified a new customer, and this customer has actually bought something, the new challenge is to turn this customer into a loyal customer by cross-selling and up-selling.

Cross-selling is defined as selling an additional product or service to an existing customer. In practice businesses define cross-selling in many different ways. Elements that might influence



the definition might include: the size of the business, the industry sector it operates within and the financial motivations of those required to define the term. The objectives of cross-selling can be either to increase the income derived from the client(s) or to protect the relationship with the client(s). The approach to the process of cross-selling can be varied. Unlike the acquiring of new business, cross-selling involves an element of risk that existing relationships with the client could be disrupted. For this reason it is important to ensure that the additional product or service being sold to the client(s) enhances the value the client(s) get from the organisation.

There are three forms of cross-selling:

- 1 Additional needs:** the seller of product or service provider may hear of an additional need, unrelated to the first, that the customer has and offer to meet it. For example, in conducting an audit, an accountant is likely to learn about a range of needs for tax services, for valuation services and others. To the degree that regulations allow, the accounts may be able to sell services that meet these needs. This kind of cross-selling helped major accounting firms to expand their businesses considerably.
- 2 Add-on services:** this is another form of cross-selling. This happens when a supplier shows a customer that it can enhance the value of its service by buying another product or service from a different part of the supplier's company. When you buy a product, the salesperson will offer to sell you insurance beyond the terms of the warranty. Though common, this kind of cross-selling can leave a customer feeling strange. The customer might well ask the salesperson why he needs insurance on a new product. Is it really likely to break in just 12 months?
- 3 Solution selling:** in this case, the customer buying air conditioners is sold a package of both the air conditioners and installation services. The customer can be considered buying relief from the heat, contrary to just air conditioners.

Up-selling

A sales technique whereby a salesperson attempts to have the customer purchase more expensive items, upgrades or other add-ons in an attempt to make a more profitable sale.

Up-selling is a sales technique whereby a salesperson attempts to have the customer purchase more expensive items, upgrades or other add-ons in an attempt to make a more profitable sale. Up-selling usually involves marketing more profitable services or products, but up-selling

can also be simply exposing the customer to other options he or she may not have considered previously.

As indicated here, in practice there is often an overlap between the two concepts of cross-selling and upselling.

10.3 RELATIONSHIP QUALITY

In any commercial relationship between two parties, interaction is the key concept. Interactions are the basic phenomena in quality and value creation. The perception of relationship quality occurs in ongoing interactions, which may be either continuous, such as in security and cleaning services, or discrete, such as in bank services or goods transportation. Holmlund (2000) has developed a framework for understanding and analysing ongoing interactions. These interactions may be very different depending on the type of marketing situation involved. Some contacts are between people, some between customers and machines and systems, and some between systems of the supplier and customer respectively. In every case interactions are involved. The framework is equally valid for describing and analysing relationships in consumer markets and relationships between organisations. Originally, the framework was developed for services, but it may also be used for suppliers of physical goods, but with some services involved.

The framework consists of a continuous flow of acts, episodes and sequences, which form the relationships. Figure 10.2 illustrates this relationship framework.

An act (A) is the smallest unit of analysis in the interaction process. Examples of acts include phone calls, plant visits, service calls and hotel registration. In service management literature they are often called *moments of truth*. Acts may be related to any kind of interaction elements, physical goods, services, information, financial aspects or social contacts.

Interrelated acts form a minor part of a relationship. These are called episodes (or service encounters, to use a concept frequently found in the service management literature) and examples of these include paying bills from a home computer, visiting a bank to withdraw money, a negotiation, a shipment of goods or dinner at a hotel restaurant during a stay at that hotel. Every episode includes a series of acts. For example, a shipment may include such acts as placing an order, assembling and packing the products, transporting the products, making a complaint and payment.

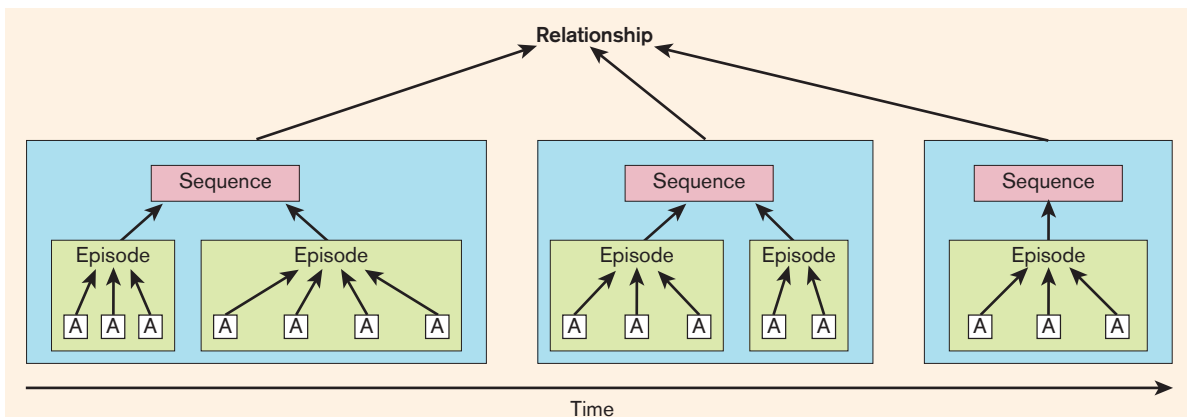


Figure 10.2 Interaction levels in a relationship: acts, episodes and sequences

Source: Adapted from Holmlund, M. (2000) *Perceived Quality in Business Relationships*, Hanken, School of Economics, Helsinki/Helsingfors, Finland, CERS, p. 96. Reproduced with permission from Maria Holmlund-Rytönen.

Interrelated episodes form the next level of analysis in the interaction process, a sequence. Sequences can be defined in terms of a time period, a product introduction, a campaign or a project, or a combination of these. The analysis of a sequence may contain all kind of interactions related to a particular project, which may take up to a year or even longer. As an example, in a hotel context a sequence comprises everything that takes place during one stay at a particular hotel, including episodes such as accommodation, eating in the hotel restaurant, etc. Sequences may naturally overlap, so that episodes belonging to one sequence may also be part of another sequence.

The final and most aggregated level of analysis is the relationship. Several sequences form a relationship. Sequences may follow each other directly, may overlap or may follow after longer or shorter intervals depending, for example, on the type of business or on whether the service is of a continuous or discrete nature. This way of dividing the interaction process into several layers on different levels of aggregation gives the marketer a detailed enough instrument to be used in the analysis of interactions between a supplier or service provider and the customers.

All different types of element in the interaction process – goods and service outcomes, service processes, information, social contacts, financial activities, etc. – can be identified and put into their correct perspective in the formation of a relationship over time.

The relationship between a customer and a salesperson is like a marriage. It starts with a courtship period, when both parties begin to know each other. Next a ceremony, or contract to do business, binds both parties to certain terms. The relationship is then maintained by developing high levels of trust and service norms that guide future interactions. If the relationship becomes unsatisfactory for either party, they divorce.

Developing strong relationships with customers gives a salesperson a sustainable competitive advantage in the marketplace. If a customer feels a certain level of commitment to the relationship, which has been fostered by the salesperson's attention to detail and willingness to do that bit extra in after-sales service, then, when a problem does occur, the customer will not immediately seek another supplier. Even though the marketplace may have many attractive potential partners, the customer will be loyal to a salesperson who has shown commitment and dedication over the long term.

To develop a long-term relationship, it is important for the salesperson to first understand the customer's needs and then to adapt selling techniques to those needs. However, the relationship has to be sustained, and it is sustained through attention to service, such as promptly returning calls, making special deliveries quickly and personally, seeking out answers to technical questions, and working with the customer to design the next generation of products and services.

10.4 BUILDING BUYER–SELLER RELATIONSHIPS IN B2C MARKETS

Firms that practise customer focus shift the power from the seller to the customer. Once the basic principle of shifting the power to customers is accepted, Internet technology makes it more achievable.

Customer focus promises to provide something that traditional strategies never could – increasing return. The value an organisation derives from products diminishes over time, but the value of locking customers in can increase (Vandermerwe, 2000).

When a customer is locked in, it has no choice. There may be only one supplier with a monopoly for as long as its particular technology wave lasts. Or customers may have invested in one product and then find that the switching costs are too high. The customers are locked in a continuous relationship life cycle until an alternative comes along.

In Figure 10.3 a customer relationship life cycle of an airline transportation service is shown.

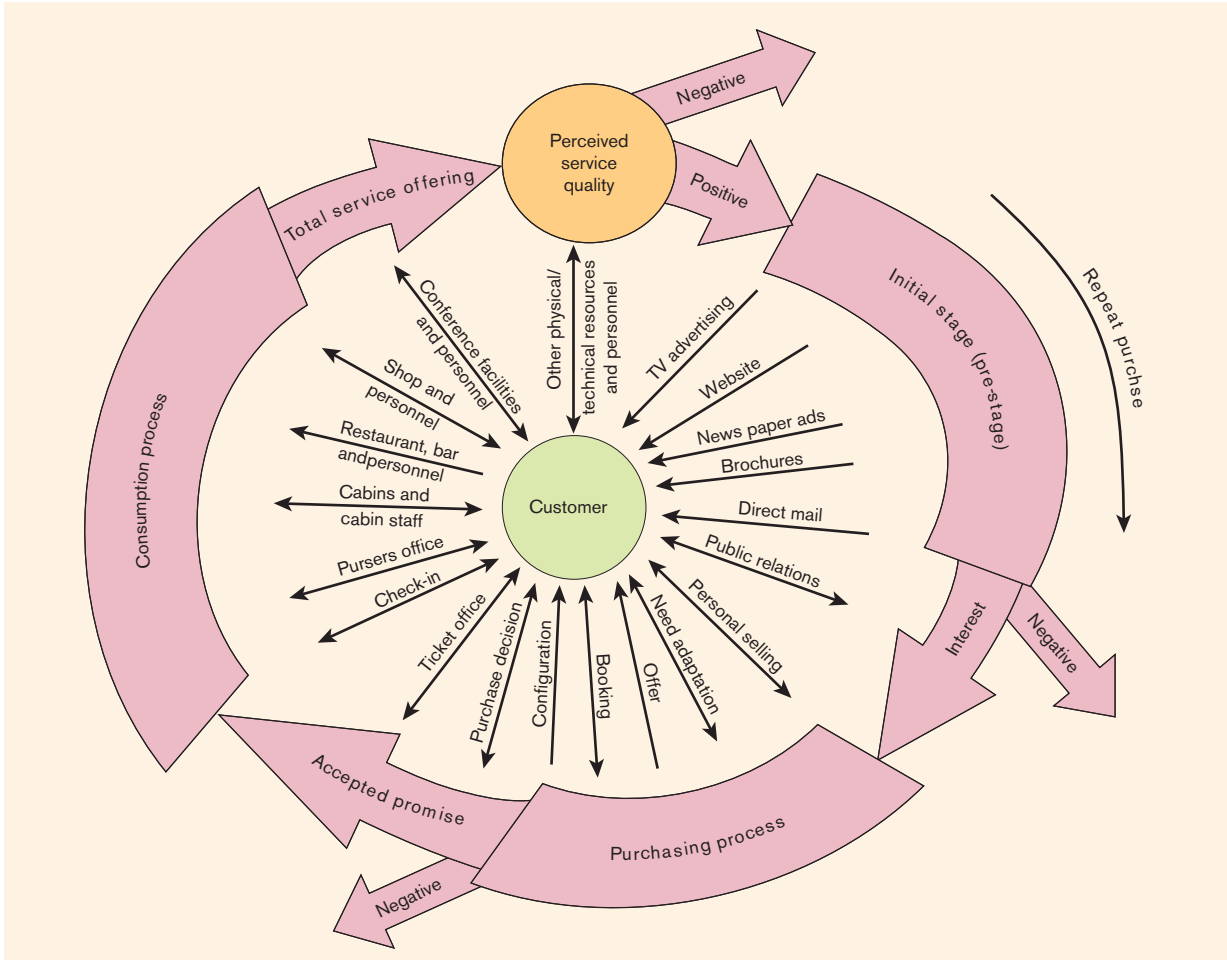


Figure 10.3

The customer relationship life cycle in the airline business

Source: Grönroos, C. (1983) *Strategic Marketing and Marketing in the Service Sector*, Marketing Science Institute, Cambridge, MA, p. 75. Reproduced with permission.

Market space

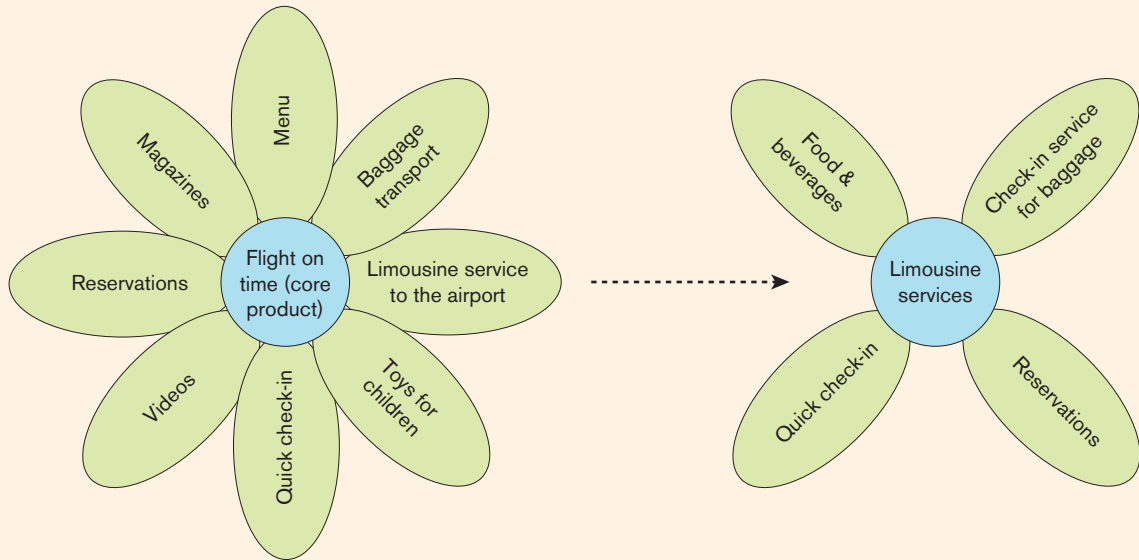
A virtual marketplace such as the Internet in which no direct contact occurs between buyers and sellers.

Vandermerwe (2000) has expanded the product or service space into a **market space**, which is an aggregation of all the customer-activity cycles in a particular segment. For example, in the air travel industry, the pre, during, and post phases of a customer-activity cycle might include: first deciding where to go and how, booking flights and getting to the airport; second, taking the trip, getting to and experiencing the destination; and, finally, leaving the destination, finding transport, coming home and paying the bills. Customer-activity cycle methodology can help managers assess opportunities for providing new kinds of value to customers at each critical experience.

Any interruption in the flow of the customer-activity cycle creates value gaps, or discontinuities, that open access to competitors, unless the company fills the gaps first with added value services.

In air travel, the British airline Virgin Atlantic challenged the diminishing returns, capacity-managing thinking of conventional airlines by merging travel and leisure into one integrated customer experience (see Figure 10.4).

Virgin Atlantic has succeeded in turning a value added service into a strong competitive element. Virgin is always exploring new ways of increasing passenger comfort and offers superior service and quality. The price of an upper-class ticket (comparable to business class on other airlines) includes a luxury limousine service that picks up passengers from their



(a) Limousine service as add-on

(b) Limousine service as core product that encompasses different value added services

Figure 10.4 Virgin Atlantic's add-on service

Source: Hennig-Thurau, T. and Hansen, U. (2000) *Relationship Marketing: Gaining Competitive Advantage Through Customer Satisfaction and Consumer Retention*, Springer Verlag, Berlin-Heidelberg, p. 121. Reproduced with permission from T. Hennig-Thurau and U. Hansen.

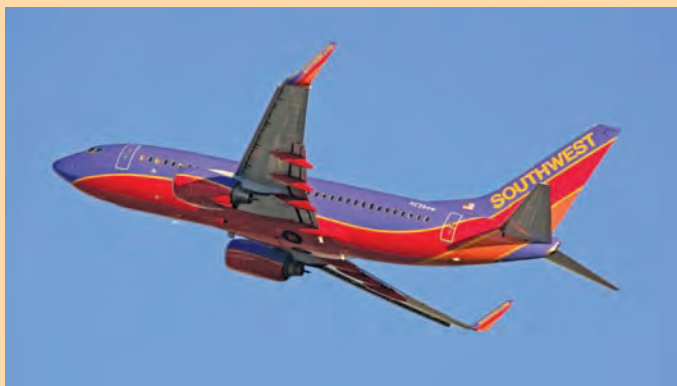
home, an on-board entertainment centre with a selection of videos, comfortable reclining seats, and masseurs who help passengers to relax on even the longest flights.

Other services are also incorporated, such as help with baggage at the check-in counter.

Virgin Atlantic creates value gaps in the customer-activity cycle and then fills them with added value services. Virgin's goal is to redistribute value for business-class and first-class customers over the whole activity cycle.

EXHIBIT 10.1

Employee commitment drives value at Southwest Airlines



A Southwest Airlines Boeing B737

Source: © David Osborn/Alamy

At Southwest Airlines, the seventh largest US domestic carrier, positions are designed so that employees can perform several jobs if necessary. Schedules, routes and company practices – such as open seating and the use of simple, colour-coded, reusable boarding passes – enable the boarding of three and four times more passengers per day than competing airlines. In fact, Southwest deplanes and reloads two-thirds of flights in 15 minutes or less. Because of aircraft availability and short-haul routes that don't require long layovers for flight crews, Southwest has roughly 40 per cent more



EXHIBIT 10.1**Employee commitment drives value at Southwest Airlines (*continued*)**

pilot and aircraft utilisation than its major competitors: its pilots fly on average 70 hours per month versus 50 hours at other airlines. These factors explain how the company can charge fares from 60 per cent to 70 per cent lower than existing fares in markets it enters. At Southwest, customer perceptions of value are very high, even though the airline does not assign seats, offer meals or integrate its reservation system with other airlines. Customers place high value on Southwest's frequent departures, on-time service, friendly employees and very low fares. Southwest's management knows this because its 14,000 employees are in daily contact with customers and reports its findings back to management. In addition, the Federal Aviation Administration's performance measures show that Southwest, of all the major airlines, regularly achieves the highest level of on-time arrivals, the lowest number of complaints, and the fewest lost-baggage claims per 1,000 passengers. When combined with Southwest's low fares per seat-mile, these indicators show the higher value delivered by Southwest's employees compared with most domestic competitors. Southwest has been profitable for 23 consecutive years.

Source: Adapted from Heskett *et al.* (2008).

10.5 MANAGING LOYALTY

Managing loyalty means not only managing behaviour but also managing a state of mind. It means affecting the customer's attitude to doing business with the supplier over the long term – not merely until the next visit or the next purchase. This means that a properly managed approach to loyalty must make the customer want to do more business with the supplier over the long term or, at least, sustain its existing level of business.

Steps in a loyalty-based relationship strategy

Customer retention for all customers is key. There are six steps in a retention strategy, as illustrated in Figure 10.5.

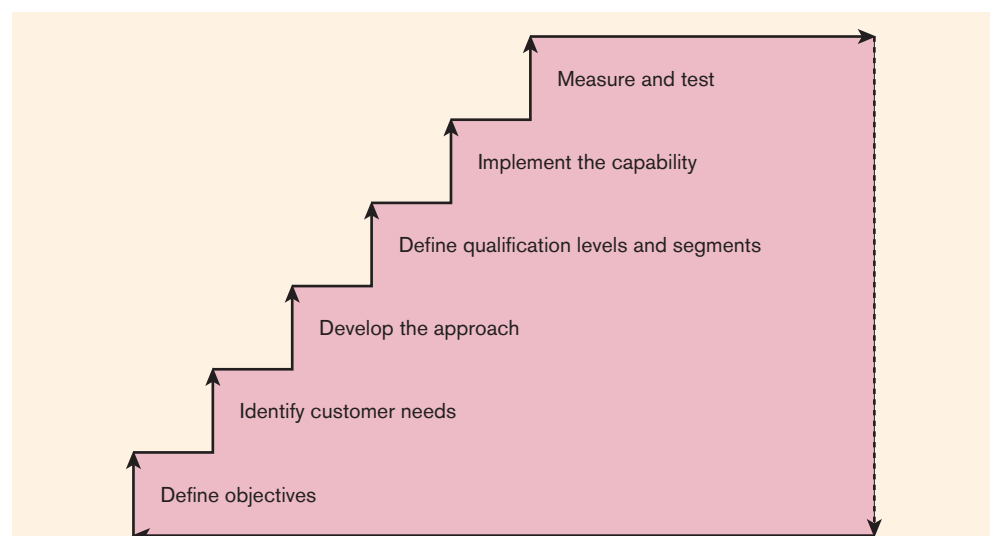


Figure 10.5 Steps in a relationship strategy

Define objectives

The need to develop a loyalty approach over and above existing marketing, sales and service approaches should be identified as part of an overall audit of customer management. Such an audit might reveal, for example:

- competitive attempts to target precisely your best customers;
- falling repurchase rate among your best customers;
- falling levels of state-of-mind loyalty;
- increasing numbers of customers switching away from your products and services.

Your objectives for the loyalty approach should be set in quantifiable terms or else the approach will be impossible to evaluate, whether by research or through business performance. These objectives should always contain some financial component or else the loyalty approach may be vulnerable to the criticism that it makes your customers feel good but has no effect on profits.

Identify your customers' needs (and their propensities to be loyal)

If you are considering introducing a loyalty approach, you must establish, usually through research and/or testing, the following:

- Which groups of customers are strategically important to you?
- What is the propensity of these groups to respond to different marketing, sales and service approaches?
- How, and by how much, do they respond and, in particular, how does their loyalty increase mentally (as measured by research, perhaps) and behaviourally?

Remember that the customer base of the firm is the greatest potential market research tool. It can provide market researchers with an excellent sampling frame, which is why the formal research process should be built into marketing contacts, involving where possible the use of questionnaires and structured telephone interviews. If executed properly, research will reinforce the brand and values you wish to transmit to customers.

Develop the approach

This involves the following. Find the best loyalty reinforcers. Identify those aspects of the marketing and service mix that can be deployed most effectively (taking into account the nature of your target customers for the loyalty approach) to reinforce and build loyalty.

There is a tendency to focus first on promotional incentives (discounts, free or low-cost promotional products and services, etc.), but these have the disadvantage of focusing on specific behaviours, as the qualification to receive the incentive is usually fixed in terms of those behaviours. A key area of focus should be the interface with the customer. Put simply, how you deal with your customers, in terms of managing their requirements and exchanging information with them, should hold the key to sustaining and building their loyalty.

You should find the most valued reinforcers. Find those elements of the product or service mix that have the highest perceived value to your customers, but relatively low costs of provision. This may seem a strange point, but it is the key to most schemes that work in the long term. The justification of loyalty schemes is that they reduce marketing costs because:

- less has to be spent on acquiring new customers;
- it costs less to sell more to existing customers, because we already know them and have access to them.

Loyalty schemes can also reduce service costs, partly because existing customers have learnt how to work with you. But these financial benefits may take some time to emerge.

Define qualification levels and segments

This is a detailed analysis of the profile of your best customers. We advise starting with a broad definition of best, rather than just the ones who buy the most.

A thorough profiling and tracking of purchase histories, transactional values, promotional responses and sources is vital here. It also helps identify the potential market size of similar customers for the acquisition programme. This is sometimes referred to as a relationship marketing audit. Many financial institutions, when they have undertaken this activity, have been surprised to learn how many customers are multiple purchasers of the products.

You must work out to which groups of customers you wish to provide the benefits of your loyalty approach, and the divisions between these groups of customers. Conventionally, this is done in terms of how much they buy from you, but there are many other approaches:

- how much they buy of a key product or service;
- how often they buy;
- the spread of their purchases;
- their potential future purchases;
- their actual or potential importance as a recommender of your services;
- how much you buy from them (for reciprocal approaches);
- how much information they give you.

It is common to set tiered qualification levels, with increasing loyalty commitment from customers matched by increasing service levels and bonuses from you.

This makes sense provided that the customer's movement between tiers is normally upwards. Being downgraded is not a pleasant experience for customers in any context, but particularly disappointing for those who have been 'nurtured upwards' for a long period. One demotion can destroy a relationship built up over years.

Also it is important not to let temporary reductions in purchasing (which may be totally uncorrelated with loyalty) lead to downgrading. For example, a member of a frequent flyer scheme may temporarily fly less overall, rather than fly more with another airline. Demotivating them by downgrading them immediately makes little sense.

Implement the capability

Capability is defined as the support infrastructure necessary to deliver relationship marketing. It includes:

- briefing marketing service suppliers such as advertising and direct marketing agencies, in-house magazine publishers, etc.;
- customer service definition;
- staff training and motivation approaches;
- acquisitions, adaptations and development of customer-facing information systems;
- setting pricing and terms of payment;
- policy and process development.

The workload involved in all these is, of course, significant, but the point is that if your approach is developed logically, starting with proper strategic evaluation and with the right analysis of customer needs, behaviour and experience, then the follow-through should be relatively straightforward, based on a phased approach.

Measure effectiveness

Loyalty approaches must in the end pay by producing better sales and profits than would have been yielded without the approach.

On a more detailed level, whatever stage of the life cycle a customer is at, it is always worth having a continued series of tests to establish optimum timing, frequency, offer and creative treatments.

Wansink and Seed (2001) researched the effectiveness of different loyalty programmes in the B2C market and found that marketers need to understand that for a loyalty programme to be successful, it must offer obvious benefits to the consumer.

EXHIBIT 10.2

Developing service loyalty at Volkswagen

Volkswagen AG is the largest car manufacturer in Europe. Worldwide, there are more than 36 million Volkswagen vehicles on the road. In an increasingly competitive market, direct contact with customers takes on vital importance. In recent years, therefore, Volkswagen has been developing and extending its relationship management activities, as part of a strategic customer bonding concept. So what does relationship marketing mean for a company like Volkswagen?

The development of service loyalty is shown in Figure 10.6. It shows that the older a vehicle, the greater the demand for related services. However, loyalty to Volkswagen dealerships decreases over the same time period. A car has US\$160–210 a year spent on it (for vehicle-related services) in the first few years after purchase, and VW has a market share of about 85 per cent. Eleven years after purchase, annual spending rises to US\$810, but VW's market share falls to only 25 per cent. This means that VW is losing contact with the car owner after the first change of ownership (after an average 3.7 years). In reality, this means VW has no real information on many of its customers.

What is VW doing to give customers reasons to stay loyal towards VW services? For many years, VW has been a trendsetter in terms of service development in the car industry. It has developed services that have not been offered by competitors, and these services have often been the reason why a customer has chosen to

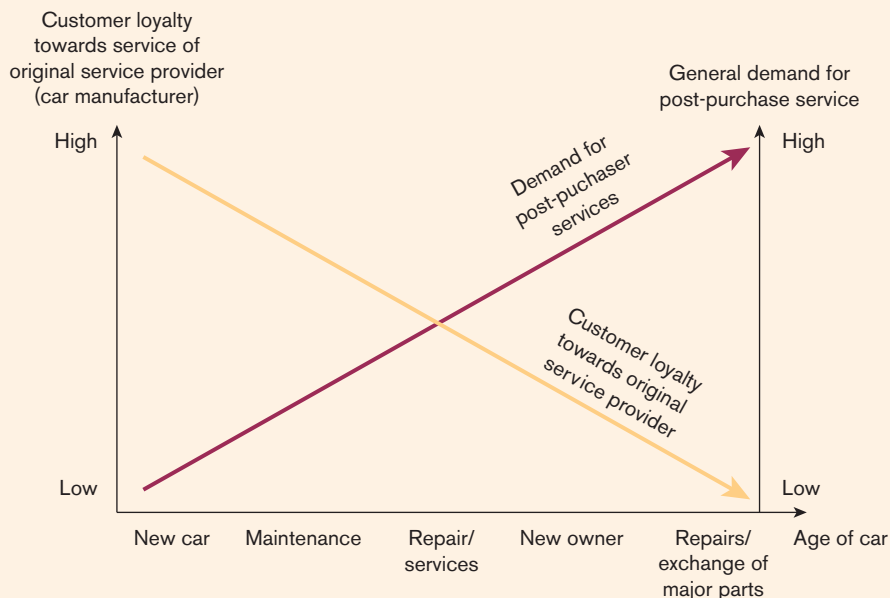


Figure 10.6

The development of service loyalty

Source: Hennig-Thurau, T. and Hansen, U. (2000) *Relationship Marketing: Gaining Competitive Advantage Through Customer Satisfaction and Consumer Retention*, Springer Verlag, Berlin-Heidelberg, p. 52. Reproduced with permission from T. Hennig-Thurau and U. Hansen.



EXHIBIT 10.2Developing service loyalty at Volkswagen (*continued*)

purchase their products. The services include a service guarantee, an emergency plan, a mobility guarantee, a customer club and a toll-free service telephone.

Volkswagen has bundled some service options into a premium concept called the Volkswagen Exclusive Service. This special service concept includes a mobility guarantee, service telephone hotline, a pick-up and delivery service and finally a courtesy car. These kinds of activity will be well known to experienced service marketers, but Volkswagen has now decided to go one important step further by extending these measures into a comprehensive club card concept.

The club card is a membership card which gives the customer out-of-hours access to the reception area of a Volkswagen dealership. The card also carries the mobility guarantee seal and is the first stage toward receiving a service card.

The bonus programme rewards customer loyalty by letting him or her collect bonus points every time he or she purchases something from Volkswagen (e.g. a car, accessory or service) or from one of the partner organisations (e.g. Deutsche Bundesbahn). These bonus points can then only be exchanged for products and services from the Volkswagen organisation. Research has shown that customers have a very positive impression of the programme; it strengthens the contact between customer and dealer and is an excellent instrument for binding customers to the dealer organisation.

None of these programmes is able to help increase customer satisfaction and loyalty if customers are not aware that they exist. Database management is therefore the starting point for managing customer relations and is something which will grow in importance in the future. The only companies able to construct lasting relationships with their customers are those that properly process and maintain a customer database.

Key information for this database resource includes data on the customers themselves, the relevant dealer, the customer's present vehicle, the customer's use of the Volkswagen service card and the products that have already been offered to him or her.

VW also considers including information about the customer's hobbies. If VW knows that a customer's hobby is winter sports and it knows that the customer travels by car to his or her chosen winter resort, then VW can offer him or her snow tyres, snow chains, a roof rack (for skis) and more.

Source: Adapted from Hennig-Thurau and Hansen (2000), Chapter 3.

Creating e-loyalty

E-commerce companies care deeply about customer retention and consider it vital to the success of their online operations. They know that loyalty is an economic necessity: acquiring customers on the Internet is enormously expensive, and unless those customers remain loyal and make lots of repeat purchases over the years, profits will remain elusive. They also know it is a competitive necessity: in every industry some company will figure out how to harness the potential of the Web to create exceptional value for customers, and that company is going to lock in many profitable relationships at the expense of slow rivals. Without loyalty stickiness, even the best-designed e-business model will collapse.

Reichheld and Scheffer (2000) and Hoffman and Lowitt (2008) studied e-loyalty and they found out that the Web is actually a very sticky space in both the business-to-consumer and the business-to-business spheres. Most of today's online customers exhibit a clear proclivity towards loyalty, and Web technologies, used correctly, reinforce that inherent loyalty. If executives do not quickly gain the loyalty of their most profitable existing customers and acquire the right new customers, they will face a dismal future left with only the most price-sensitive buyers.

It was shown that in e-industry after e-industry, the high cost of acquiring customers renders many customer relationships unprofitable during their early years. Only in later years, when the cost of serving loyal customers falls and the volume of their purchases rises, do relationships generate big returns.

At the beginning of a relationship, the outlays needed to acquire a customer are often considerably higher in e-commerce than in traditional retail channels. In clothing e-tailing, Reichheld and Scheffer (2000) found that new customers cost 20–40 per cent more for pure Internet companies than for traditional retailers with both physical and online stores. That means that the losses in the early stages of relationships are larger.

However, Web customers tend to consolidate their purchases with one primary supplier, to the extent that purchasing from the supplier's site becomes part of their daily routine. This phenomenon is particularly apparent in the business-to-business sector.

In the end, loyalty is not won with Web technology. It is won through the delivery of a consistently superior customer experience. The Internet is a powerful tool for strengthening relationships, but the basic laws and rewards of building loyalty have not changed.

EXHIBIT 10.3

Best Buy's approach to loyalty, compared to competitor Circuit City



Central to the growth of Best Buy, the US electronics retail giant, has been its decision to embrace customer centricity. As part of the customer centricity strategy, Best Buy overhauled its customer loyalty programme, called Rewards Zone. After soliciting and receiving feedback from customers, the company realised that its loyalty programme wasn't aligned with what mattered most to its customers – savings and rewards. The customers told Best Buy that they wanted a rewards programme that was free. They were also looking to accelerate their reward potential. The changes that Best Buy made to the Reward Zone programme directly addressed their requests. So Best Buy eliminated its initiation fee to join Reward



Best Buy store, Ohio
Source: © Todd Muskopf/Alamy

Zone, added a Best Buy credit card to speed rewards accumulation and enabled customers to interact with their Reward Zone account online. As a result of these and other actions to make its offering more attractive, Reward Zone membership has nearly quadrupled from 7 million members at the time that Best Buy adjusted its loyalty programme (2003) to 25 million members by the end of 2008.

Compare Best Buy's actions with Circuit City's efforts to cultivate loyal customers. Whereas Best Buy has had a loyalty programme since 2001, Circuit City launched its loyalty campaign in 2006. While the benefits of the two programmes don't appear to differ greatly, consider this – in 2007 Circuit City replaced its most highly paid sales associates with lower paid associates. From the outside looking in, Circuit City hasn't embraced the concept of relying on service to retain loyal customers. And some of its recent actions are consistent with a defensive, not offensive, loyalty strategy posture.

Source: Adapted from Hoffman and Lowitt (2008).

10.6 THE CRM PATH TO LONG-TERM CUSTOMER LOYALTY

The customer relationship management (CRM) loyalty development process is illustrated in Figure 10.7.

Stage 1: Customer acquisition (the courtship)

Before acquiring a customer, the firm must first get to know the potential customer. In this phase, loyalty is considered very weak because it is not based on relationships, but solely on look and feel – products and prices. In fact, the customer may switch to a competitor if its products and prices are better. The attitude is summed up as, ‘What have you done for me lately?’ A good example of this is the fierce competition in the mobile telephone market.

In stage 1, a company’s main focus is customer acquisition. Attention is directed towards building a customer base through the use of technology and initiative-specific training to increase the effectiveness of salespeople. Stage 1 companies also spend a significant amount of time on best-practice benchmarking, analysing customer care processes and conducting initial customer research.

Stage 2: Customer retention (the relationship)

At this stage affection grows and a solid relationship is created. The firm engages with customer attitudes both before and after the purchase. It listens to the customer who is gradually getting to know the enterprise. Loyalty is no longer based on price and product alone. The relationship is also becoming a factor, even though there is no guarantee the customer will not go elsewhere. But the relationship is solid enough for loyalty to no longer be seen as fleeting. A mutual desire exists, and both parties begin to see a benefit in continuing to grow the relationship (Laaksonen *et al.*, 2008).

When a company enters stage 2, the focus has shifted to maximising the customer relationships. A stage 2 company distinguishes itself from its stage 1 colleagues by beginning to segment its customers into groups with similar needs in order to serve each client group more effectively.

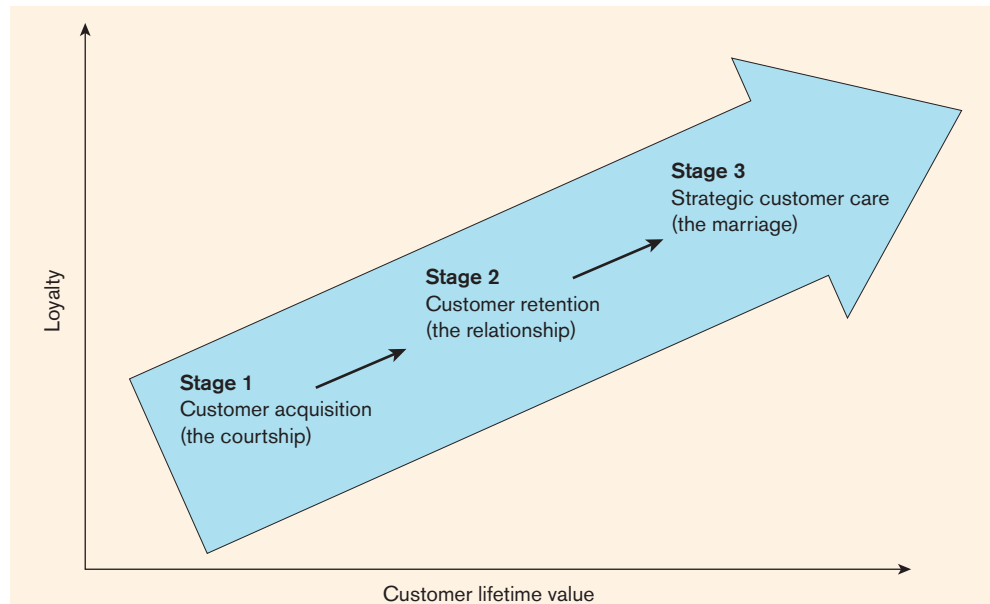


Figure 10.7

Loyalty development in customer relationship management

Stage 3: Strategic customer care (the marriage)

At this stage a long-lasting relationship is mutually agreeable, and both parties become inextricably linked. At this stage, loyalty is based on a high degree of satisfaction and the customer will get personally involved with the enterprise. As the marriage continues, the bonds between customer and enterprise are gradually strengthened. Here the feeling of customer satisfaction increases and with it loyalty to the enterprise. On the basis of such a relationship, one can speak of true loyalty and the beginning of customer dependency.

For the marriage or relationship to continue both the enterprise and customer must receive a positive benefit even though both parties will inevitably experience disappointments on the way to their final goal.

Stage 3 organisations have realised that they cannot be all things to all people. While most customers are potentially profitable, some hold more long-term promise than others. The ability to predict who these customers are is a necessary skill on the upward path to strategic customer care. By wisely applying the right technology and information tools (technology is not a solution on its own), companies at the stage of strategic customer care deliver a core level of service for all their customers and a distinctive, optimised level for their best customers. Equally important, stage 3 businesses have orchestrated a winning situation for both their clients and for themselves: the clients are dependent on the business for their success and vice versa (Stace and Bhalla, 2008; Mascarenhas, 2006).

10.7 KEY ACCOUNT MANAGEMENT (KAM)

Key account management (KAM)

An approach to selling which focuses resources on major customers and uses a team selling approach in taking care of the total relationship with such an important customer.

KAM can be understood as a relationship-oriented marketing management approach focusing on dealing with major customers in the business-to-business market. Key accounts are customers in a business-to-business market identified by selling companies to be of strategic importance.

KAM is a management concept, including both organisational and selling strategies, to achieve long-lasting customer relationships. Key account manager is one of the most popular job titles today in the area of marketing management in companies operating in the business-to-business market. It has been used in several contexts, but the nature of this approach is very unclear and requires further conceptualisation.

A key account manager is the person in the selling organisation who represents the seller's capabilities to the buying company, the buyer's needs to the seller, and brings the two together. Successful KAM often requires an understanding of the logic of both product and service management. Moreover, excellent operational level capabilities are useless if strategic level management is inferior, and vice versa – the KAM approach combines strategic and operational level marketing management.

The starting point for the following is the firm that wishes to implement KAM. The development of KAM is examined from a dyadic perspective.

Implementation of KAM

The firm that wants to implement successful KAM with suitable key accounts may go through the following four steps (Ojasalo, 2001):

- 1 identifying the selling firm's key accounts;
- 2 analysing the key accounts;
- 3 selecting suitable strategies for the key accounts;
- 4 developing operational level capabilities to build, grow and maintain profitable and long-lasting relationships with key accounts.

1 Identifying the selling firm's key accounts

This means answering the following question: which existing or potential accounts are of strategic importance to us now and in the future?

The following criteria can be used to determine strategically important customers:

- sales volume;
- age of the relationship;
- the selling firm's share of customers' purchase: the new RM paradigm measures success in terms of long-term gains in its share of its customers' business, unlike mass marketing which counts wins or losses in terms of market share increases that may well be temporary (Peppers and Rogers, 1995);
- profitability of the customer to seller;
- use of strategic resources: extent of executive/management commitment.

There is a positive correlation between the criteria and the likelihood of customers being identified as key accounts (strategic customers).

2 Analysing the key accounts

This includes activities such as analysing:

- *Basic characteristics of a key account*: includes assessing the relevant economic and activity aspects of their internal and external environment. This, for example, includes the account's internal value chain inputs, markets, suppliers, products and economic situation.
- *Relationship history*: involves assessing the relevant economic and activity aspects of the relationship history. This includes volume of sales, profitability, key account's objectives, buying behaviour (the account's decision-making process), information exchange, special needs, buying frequency and complaints. Among these aspects, knowing or estimating relationship value plays a particularly important role. The revenues from each key account (customer lifetime value) should exceed the costs of establishing and maintaining the relationship within a certain time span.
- *Level and development of commitment to the relationship*: the account's present and anticipated commitment to the relationship is important, since the extent of the business with the account depends on that.
- *Goal congruence*: or commonality of interests between buyer and seller, greatly affects their cooperation both at the strategic and operational levels. Common interests and relationship value together determine whether two companies can be partners, friends or rivals. A seller that aims its sights lower than the sort of partnership relationship an account is looking for risks losing long-term share of that account's business.
- *Switching costs*: it is useful to estimate both the key account's and the selling company's **switching costs** in the event that the relationship dissolves. Switching costs are the costs of replacing an existing partner with another. These may be very different for the two parties and thus affect the power position in the relationship. Switching costs are also called transaction costs (Williamson, 1979), and they are affected by irretrievable investments in the relationship, the adaptations made, and the bonds that have developed. High switching costs may prevent a relationship from ending even though the key account's accumulated satisfaction with the selling company may be non-existent or negative.

Switching costs

The costs to a buying organisation of changing from one supplier to another.

3 Selecting suitable strategies for the key accounts

This depends greatly on the relative positions of the seller and the key account. The power structure within different accounts may vary significantly. Thus, the seller may typically not freely select the strategy – there is often only one strategic alternative to be chosen if there is a desire to retain the account.

Perhaps the seller might prefer to avoid very powerful accounts. Sometimes the seller realises that accounts which are less attractive today may become attractive in the future. Thus, with certain accounts, the objective of the strategy may be merely to keep the relationship alive for future opportunities.

4 Developing operational level capabilities

This refers to customisation and development of capabilities related to the following.

Product/service development and performance

Joint R&D projects are typical between a selling company and a key account in industrial and high-technology markets. In addition, information technology (IT) applied in just-in-time production and distribution channels increases the possibilities of customising the offering in consumer markets as well.

New products developed in a partnership are not automatically more successful than those developed in-house. However, R&D projects may bring other kinds of long-term benefits, such as access to account organisation and learning. Improving capabilities for providing services to key accounts is extremely important, because even when the core product is a tangible good, it is often the related services that differentiate the seller from its competitors and provide competitive advantage.

Organisational structure

The seller's organisational ability to meet the key account's needs can be developed, for example by adjusting the organisational structure to correspond to the key account's global and local needs and by increasing the number of interfaces between the seller and the account, and thus also the number of people interacting. Organisational capabilities can also be developed by organising teams, consisting of people with the necessary competences and authorities, to take care of key accounts.

Individuals (human resources)

A company's capabilities related to individuals can be developed by selecting the right people for key account managers and key account teams, and by developing the skills of these people. The key account manager's responsibilities are often complex and varied, and therefore require a large number of skills and qualifications, which should be taken into account in the selection and development of key account managers.

It is quite common to find that the current set of key account managers may be good at maintaining their own relationships with their existing contacts but lack the skills required to lead an account team through a transition in the account relationship.

Therefore, an assessment of the total desired interfaces between the seller and the customer needs to be considered. It may be that a change is required by moving the relationship from a dependency on a one-to-one relationship (between the key account manager and the chief buyer) to a network of organisational relationships spanning many different projects, functions and countries.

Information exchange

Information exchange between the seller and a key account is particularly important in KAM. An important relationship-specific task is to search, filter, judge and store information about the organisation, strategies, goals, potentials and problems of the partners. However, this mainly depends on the mutual trust and attitudes of the parties, and on the technical arrangements. A key account's trust is something that the seller has to earn over time by its performance, whereas the technical side can be developed, e.g. with IT.

Company and individual level benefits

Successful long-term KAM in a business-to-business context always requires the ability to offer both company and individual level benefits to key accounts.

Company level benefits are rational and may be either short or long term, direct or indirect, and typically contribute to the key account's turnover, profitability, cost savings, organisational efficiency and effectiveness, and image. Individual level benefits in turn may be rational or emotional. From the relationship management point of view, the key individuals are the ones with the power to continue or terminate the relationship. Rational individual level benefits contribute, for example, to the individual's own career, income and ease of job. Emotional individual level benefits include friendship, a sense of caring and ego enhancement.

Customer complaint management in KAM

Complaint management means satisfying the customer who has voiced the complaint and binding him or her to the company for the long term. Many firms have negative feelings about complaints. However, firms stand to benefit if the personnel in contact with the dissatisfied customer handle the process skilfully, achieve the desired outcome, and also derive personal satisfaction from the relevant tasks.

Customer complaints involve much more than just customers taking the initiative to articulate their dissatisfaction with products or services. They are complex psycho-sociological conflict management processes bounded by the relationship of the market partners. Within the framework of these processes, the qualifications required of contact personnel (in the form of appropriate interpersonal skills, for example) are of central importance.

Service personnel should be trained to handle complaints, so that they have consideration in the case of a service failure and allow customers to express frustration freely. Furthermore, service personnel should have the autonomy to help customers in real time. This means that service personnel must have the authority to offer a form of compensation without interference from management (Ruyter and Wetzels, 2000).

Therefore, internal marketing plays a key role here, creating the necessary psychological conditions for both the individual employee and the organisation, and thereby ensuring the successful implementation and acceptance of an effective complaint management system.

It is not always advisable to handle the customer complaint on the spot because it is relatively resource demanding. The specific situation determines the most appropriate structural and operating organisations for complaint management. Relevant factors could include the nature of the product, the frequency and manner of customer contacts, and the business form of the firm. From a structural standpoint, one can differentiate between centralised, decentralised and dual complaint management systems (Thurau and Hansen, 2000).

Centralised complaint management is advisable when a business has no personal contact with its customers, the complaint volume is relatively high, the types of complaints encountered are relatively simple and homogeneous, and changes in these conditions seldom occur. A key advantage is the routine nature of the work performed by the employees responsible for handling the complaints. Additionally, the employees are not subjected to those psychological pressure mechanisms associated with dealing with complaints, which they themselves have caused; the complaint handlers only deal with written or telephone complaints assigned to them by a centralised complaint management system.

Decentralised complaint management is advantageous when the relationships between the firm and customer are characterised by personal interactions distributed over a large number of customer contact points, and when the customer complaints are complex and less predictable. The biggest advantage of decentralisation is the direct, prompt, appropriate and on-the-spot resolution of the problem. The main disadvantage is that it requires more human resources. Furthermore, employees are directly confronted with mistakes they themselves have made or which were caused at an earlier stage in the value chain (e.g. delivery delays).

Decentralised complaint management also makes it difficult to motivate employees to take a proactive role in stimulating customers to lodge complaints.

In order to achieve a rapid resolution of complaints with a focus on pinpointing the underlying causes, employees have to be given wide-ranging authority in terms of decision-making responsibility, access to information and task assignment. This should ensure rapid and comprehensive solutions for the customers.

Dual complaint management combines the advantages of the centralised and decentralised approaches. It is appropriate for complex products and services, as well as for businesses featuring broad-based direct contact with customers (such as dealer networks).

Direct decentralised complaint management involves an interaction between employees and customers. It encompasses tasks related to the input, case handling and feedback functions. The quality and outcome of these processes is largely determined by the competences of the customer contact personnel. This is itself reflected in terms of how these staff perceive themselves and others, in their ability to engage in suitable interactions with customers, and in willingness to assume responsibility for complaints.

The effect of complaint management is at its greatest when management's existing external market orientation is expanded to include internal goals and, in particular, employee-related goals. In addition, internal marketing goes beyond the traditional goal-oriented interpretation of customer complaints to incorporate a relationship-oriented approach.

A lack of expertise and competence on the part of contact personnel can activate the latent potential for conflict and lead to an escalation of the complaint. This may not only lead to the termination of the relationship, but also to loss of sales and to damage to the company image through negative word of mouth spread by the dissatisfied customer.

The dyadic development of KAM

The model in Figure 10.8 describes and demonstrates the typical dyadic progression of a relationship between buyer and seller through five stages – pre-KAM, early KAM, mid-KAM, partnership KAM and synergistic KAM (Cheverton, 1999; McDonald *et al.*, 1997).

Pre-KAM stage

This describes preparation for KAM. A buyer is identified as having key account potential, and the seller starts to focus resources on winning some business with that prospect. Both seller and buyer are sending out signals (factual information) and exchanging messages (interactions) prior to the decision to engage in transactions.

Early KAM stage

At this stage, the seller is concerned with identifying the opportunities for account penetration once the account has been won. This is probably the most typical sales relationship, the classic bow-tie.

Adapted solutions are needed, and the key account manager will focus on understanding more about the customer and the market in which that customer is competing. The buyer will still be market testing other sellers. The seller must concentrate hard on product, service and intangibles – the buyer wants recognition that the product offering is the prime reason for the relationship – and expects it to work.

Mid-KAM stage

This is a transition stage between the classic bow-tie and the diamond of the partnership KAM stage.

At this stage the seller has established credibility with the buyer. Contacts between the two organisations increase at all levels and assume greater importance. Nevertheless, buyers still feel the need for alternative sources of supply. This may be driven by their own customers' desire for choice. The seller's offering is still periodically market tested, but is reliably perceived to be good value. The seller is now a preferred supplier.

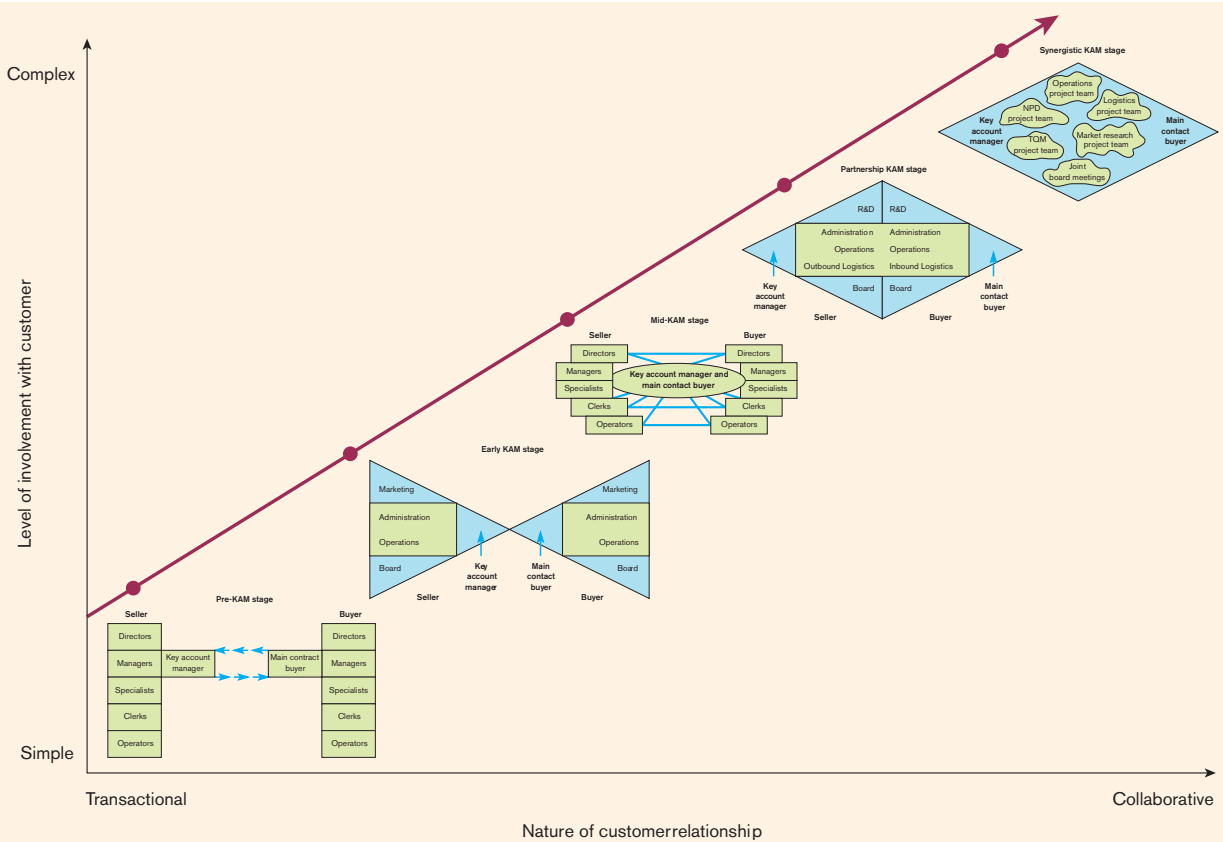


Figure 10.8 Key account relationship development model
 Sources: Adapted from Millman and Wilson (1994); and McDonald *et al.* (1996).

Partnership KAM stage

This is the stage where benefits should start to flow. When partnership KAM is reached, the seller is seen by the buyer as a strategic external resource. The two companies will be sharing sensitive information and solving problems jointly. Pricing will be long term and stable, but it will have been established that each side will allow the other to make a profit.

If a major disadvantage of the bow-tie of early relationship KAM was the denial of access to customers’ internal processes and to their market, the main advantage of the diamond relationship is in seeing those barriers of understanding opening up (Leavy, 2004; McKenzie and Winkelen, 2006).

Key accounts will test all the seller’s innovations so that they have first access to, and first benefit from, the latest technology. The buyer will expect to be guaranteed continuity of supply and access to the best material. Expertise will be shared. The buying company will also expect to gain from continuous improvement. There may be joint promotions, where appropriate.

Synergistic KAM stage

This stage is the ultimate stage in the relationship development model. The experience gained at the partnership stage – coordinating the team-sell, coaching the team on their interface roles – will be a good starting point for moving to synergistic KAM.

The seller understands that it still does not have an automatic right to the customer’s business. Nevertheless, exit barriers have been built up. The buyer is confident that the relationship with the seller is delivering improved quality and reduced cost. Costing systems become transparent. Joint research and development will take place. There will be interfaces at every level and function between the organisations. Senior management commitment will be fulfilled

through joint board meetings and reviews. There will be a joint business plan, joint strategies and joint market research. Information flow should be streamlined and information systems integration will be planned or in place as a consequence. Transaction costs will be reduced.

Though there are clear advantages for both partners in moving through the different KAM stages, there are also pitfalls. As the contacts proliferate through the stages, so does the speed of activity, and the risk of saying and doing the wrong things. Through the stages the key account manager changes from super salesperson to super-coach. In the last two stages the key account manager moves on to be a super-coordinator, who oversees everything.

If the key account manager does not move along, then the potential of losing control is great, resulting in well-meaning, but misdirected, individuals following their own quite separate courses.

Key account management requires process excellence and highly skilled professionals to manage relationships with strategic customers. For most companies, this represents a number of changes. A change is needed in the way activity is costed and costs are attributed, from product or geographical focus to customer focus. Currently, few financial or information systems in companies are sophisticated enough to support the higher levels of KAM. A transformation is needed in the way the person with responsibility for a customer relationship is developed, from an emphasis on selling skills to management skills, including cross-cultural management skills (McDonald *et al.*, 1997).

10.8 SUMMARY

The future cash flow of a firm is generated by purchases from existing customers and purchases from new customers. Hence, if a firm makes sound investments in acquiring only the right customers and in developing existing customers it should, over time, continually enhance its value. This chapter has shown that both acquisition and retention are important for survival, and that marketers who focus only on the former are ignoring exciting opportunities and essential information.

In order to achieve customer loyalty you must start with a holistic picture of the customer. Remember, the customer is a strategic asset, one that is in short supply, one that must be treated with care. Therefore, regard customer information as a strategic asset. Once you have a customer, surround him or her with care. Establish team-based selling as the rule rather than the exception, and use each customer contact as an opportunity to create loyalty.

A loyalty programme is a long-term proposition, not a short-term promotion. Management has to be committed to a programme that will last for years, not months. Such commitment will help develop and maintain a strong lifetime relationship with customers. The result of such a close connection will bring many rewards to both sides.

KAM is the development towards customer focus and RM in business-to-business markets. It offers critical benefits and opportunities for profit enhancement to both sides of the seller–buyer relationship.

The scope of KAM is widening and becoming more complex. The skills of professionals involved in it at strategic and operational levels need to be constantly updated and developed.

Customer complaints are latent conflicts between customers and employees. The psychosociological dimension of the customer complaint is determined through the personality structures of the partners and the relationship itself.

Internal marketing provides a wide range of instruments for supporting the customer complaint management process.

The basic task of internal marketing is to convince staff of the economic benefits to be derived from effective complaint management and to overcome preconceived notions of how to handle dissatisfied customers. The associated business principles can be conveyed through specific internal communications instruments such as the employee newsletter, intranet messages or staff meetings.

The goal of internal marketing is to positively influence internal relationships, thereby guaranteeing a positive external relationship experience for the employee and customer. One of the fundamental purposes of internal interactions between management and employees relates to the sensitivity of customer contact personnel to the important role they play in the interface between the firm and the customer.

CASE STUDY 10.1

Dassault Falcon

The private business jet, Falcon, is navigating in the global corporate business sector

Dassault Aviation is a French aircraft manufacturer of military, regional and business jets, a subsidiary of Dassault Group. Dassault Aviation is the only aircraft company that designs, manufactures and sells both combat aircraft, instruments of political independence, and executive jets, work and economic development tools. By the end of 2009, nearly 8,000 aircraft had been sold.

History of Dassault Aviation

It was founded in 1930 by Marcel Bloch as Société des Avions Marcel Bloch or 'MB'. During the occupation of France the country's aviation industry was virtually disbanded. Marcel Bloch was imprisoned by the Vichy government in October 1940. In 1944 Bloch (as a Jew) was deported to the Buchenwald concentration camp by the German occupiers, where he remained until it was liberated on 11 April 1945. After the Second World War, Marcel Bloch changed his name to Marcel Dassault. 'Dassault' was the pseudonym of his brother, General Darius Paul Bloch, in the French resistance and means 'for assault', originally from '*char d'assaut*', French for tank. Marcel Dassault converted to Catholicism in 1950. The name of the company was changed to Avions Marcel Dassault on 20 December 1947. In 1971, Dassault acquired Breguet, forming Avions Marcel Dassault-Breguet Aviation (AMD-BA). In 1990, the company was renamed Dassault Aviation.

Today's Falcon jets are designed and manufactured alongside Dassault Aviation's famous fighter aircraft, the Mirage and the Rafale. Dassault's military aircraft account for 40 per cent of Dassault Aviation's total yearly sales – the business jets account for the majority of the company's sales (60 per cent).

History of Falcon

The jet business of Dassault Aviation (Falcon) (www.dassaultfalcon.com) started in 1963, when Charles Lindbergh visited the Avions Marcel Dassault factory in

Mérignac, France. He was part of a team sent by Pan American World Airways Inc. seeking a business aircraft to market in the United States. Lindbergh relayed his unequivocally positive impressions of the Mystère 20 directly to then-Pan Am Chairman Juan Trippe.

On that recommendation, Pan Am's newly created business jet division was established to market and support the Falcon 20, then known as the 'Fan Jet Falcon'. As sales grew and the number of Falcons in service increased, the need for closer coordination between the manufacturer and its marketing organisation soon became apparent. In 1972, Dassault and Pan Am formed a joint venture company, Falcon Jet Corporation, and assigned it the sales and support duties previously held by Pan Am. In October 1980, Dassault purchased Pan Am's interest in the joint venture, making Falcon Jet a wholly owned subsidiary.

On 1 January 1995, Dassault Aviation and Falcon Jet merged certain worldwide operations and renamed the US company Dassault Falcon Jet Corp. Today Dassault Falcon Jet is responsible for selling and supporting Falcon business jets in North, South and Central America as well as Asia and the Pacific Rim. It employs a total workforce of more than 2,300 persons in its three facilities, Teterboro, Wilmington and Little Rock. Little Rock facility is the biggest facility of the Dassault Group with 1,800 employees. It is also one of the biggest completion centres in the world.

The Dassault Falcon business today

Dassault Falcon is responsible for selling and supporting Falcon business jets throughout the world. It is part of Dassault Aviation, a leading aerospace company with a presence in over 70 countries across 5 continents. Dassault Aviation produces the renowned Mirage and Rafale fighter jets as well as a complete line of Falcon business jets. The company has assembly and production plants in both France and the United States and



service facilities on both continents. It employs a total workforce of over 12,000.

Since the rollout of the first Falcon 20 in 1963, over 1,700 Falcon jets have been delivered to more than 65 countries worldwide. Since 1975, Falcon export sales exceed 90 per cent.

The Falcon family of jets encompasses distinct aircraft, all positioned at the top end of the business jet market. Currently in production are the tri-jets – the Falcon 50EX, 900DX, 900EX EASy and the new 7X – as well as the twin-engine Falcon 2000 and 2000EX EASy.

The founding Dassault family owns 50 per cent of the company; aerospace group EADS owns about 46 per cent. The rest is divided among some smaller investors.

Dassault had been hurt by the ailing commercial flight sector, but in 2006 sales of commercial aircraft rebounded back to levels not seen since 2002.

The company opened a new technological research centre, named the Jacques-Louis Lions Cooperation Center in 2003.

Dassault Aviation launched the Falconcare service in June 2005, which offered a transfer of the financial

exposure of maintenance for all scheduled and unscheduled maintenance operations of new Falcons.

Seven major European aerospace manufacturers – Airbus, Dassault Aviation, Eurocopter, Liebherr-Aerospace Lindenberg, Rolls-Royce, Safran and Thales – signed a letter of intent on a Clean Sky Joint Technology Initiative in July 2006.

NetJets Europe signed an order with Dassault Aviation for 24 Falcon 7X jets valued at US\$1.1 billion in September 2006. The company is looking to its new Falcon 7X corporate jets as a potential cash cow in the future.

Falcon 7X

The Dassault Falcon 7X is the large-cabin, long-range business jet manufactured by Dassault Aviation, the flagship offering of their business jet line. It was first presented to the public at the 2005 Paris Air Show.

As of 2009 the approximate unit price of the 7X is US\$45 million, but still this is a little cheaper than its nearest competitors in the long-range, large-cabin market segment, e.g. the Gulfstream G550 and Bombardier Global Express.



The Falcon 7X in the air

Source: Courtesy of Dassault Aviation



Interior of Falcon 7X

Source: Courtesy of Dassault Aviation

General characteristics

- Necessary crew: 3 (pilot, co-pilot and 1 cabin crew)
- Capacity: up to 12 passengers (not including crew)
- Length: 23.19 m
- Empty weight: 15,456 kg
- Max take-off weight: 31,299 kg
- Maximum speed: 953 km/h
- Cruise speed: 900 km/h

- Range: 11,019 km 8 passengers – e.g. it will be able to fly directly from London to Los Angeles

Segmentation of the business jet market

The business jet market can be segmented according to the different criteria such as the flight performance, range in kilometres, characteristics such as avionics, cabin size and equipment, fuel consumption and maintenance costs, noise level and of course the price for the aircraft. In Table 10.1 the total market is divided into six categories.

Table 10.1 Different business jet segments (2008 figures)

Segment	Seats	Range km	Price US\$m
Very light jet (VLJ)	4–7	2,400–4,000	3–5
Light	6–8	2,600–4,500	5–10
Light medium	7–9	3,500–5,000	10–15
Medium	8–12	3,700–6,300	15–25
Long range	5–19	5,700–8,300	25–35
Very long range	8–19	8,000–13,000	> 35

Source: Adapted from HSH Nordbank (2005) *Sector Report: Business Jets Market, Operator Models, Owners, Market Trends, Secondary Market*, March, p. 5.

The very light jet (VLJ) market

This segment is emerging at the lower end of the market, i.e. smaller planes and shorter range. This large market segment in terms of fleet numbers and number of units comprises affordable, tried-and-tested models that offer a flexibility advantage over larger models as they are able to take off on short runways. The leading manufacturers in this segment are Cessna and Raytheon. However, in market value, the VLJ market is only expected to be about US\$250 million in 2008, less than 2 per cent of the total market size (in value) in Table 10.2.

Light market segment

The largest market segment in terms of fleet numbers comprises affordable, tried-and-tested models, which offer a flexibility advantage over larger models as they are able to take off on short runways. The leading manufactures in this segment are Cessna, Bombardier and Raytheon.

Light medium market segment

The light medium segment is the second largest in terms of fleet numbers and will see the addition of new models in the coming years. Cessna plans to launch the Citation XLS and Sovereign, while Gulfstream will launch the G150. This segment is considered to have a big growth potential.

Medium market segment

This segment of relatively small intercontinental jets costing between US\$15 and 25 million is comparatively small. It is therefore surprising to see the host of new models that compete in this segment. If the market is weak, low sales figures represent a major risk for

manufacturers in this segment. If the market develops positively, all models are expected to be produced in acceptable numbers.

Long range market segment

This segment is dominated by Dessault Falcon, Gulfstream and Bombardier. Bombardier and Gulfstream have launched their G350, G450 and Challenger 800 models and Dessault Falcon has launched its 7X. This segment has good growth potential thanks to the new models and growing demand for larger jets.

The world market for business jets

The business jet fleet (in the world market) has increased from around 5,000 aircraft in 1981 to about 14,000 in 2008 (see also Table 10.2), corresponding with a CAGR of approximately 6 per cent.

The yearly deliveries (units sold) have increased from 200 units in 1985 to approximately 900 in 2008 (see also Table 10.2) and 70 per cent of the whole fleet is located in United States.

The vast majority (95 per cent) of the business jet market is controlled by five competitors: Cessna (TXT), Dassault Falcon, Gulfstream (General Dynamics), Bombardier and the former Raytheon (Hawker/Premier), which was acquired by Goldman Sachs Capital Partners and Onex in late 2006, both private equity firms. We restrict our analysis here to these five competitors. There are other manufacturers serving the high-end including Boeing and Airbus.

In 2009 several of the business jet manufacturers had problems because of the global financial crisis. For

Table 10.2

The world market for business jets, 2008

Manufacturer	Current business jet fleet	Unit sales	Value sales
Total	14,000	900	US\$16 billion
	%	%	%
Cessna (Textron) (USA)	30	35	20
Bombardier (Canada)	15	15	30
Gulfstream (General Dynamics) (USA)	15	25	25
Dassault Falcon (France)	10	10	15
Raytheon (USA)	30	15	10
Total	100	100	100

Source: Different public sources.

example, in April 2009 Bombardier had a 40 per cent drop in deliveries compared to the same time in 2008.

According to *Aviation Week*, some 13,300 business jets are in operation throughout the world; 25 per cent of the total are older than 25 years. Assuming that they have a useful life of 25 to 30 years, one can expect substantial demand for replacements in the coming years. About one-third of yearly unit sales is attributable to replacements for business jets taken out of service and two-thirds to market growth.

The secondary market for used business jets is very well organised. If we regard the older jets as 'sediment', there is only a relatively limited number of young business jets for sale. These are marketed by a small number of dealers and brokers. Databases such as JetNet help bring buyers and sellers together and provide access to the specifications of nearly all jets available for sale worldwide, such as flight hours of the individual turbines, location of the jet, maintenance information and so on.

Nevertheless, the average number of years a used business jet stays in the market has reached a historical high.

Competition among manufacturers of business jets – Dassault Falcon's competitors

Cessna (Textron) is the clear leader on a unit basis followed by Bombardier and Raytheon. On a revenue basis, Bombardier and Gulfstream are the leaders.

Cessna (Textron) (USA)

Thanks to their ability to combine the fuselages, wings and engines in different ways, Cessna has traditionally had one of the largest product ranges behind Bombardier. Given that a large part of the range was launched in the past decade, Cessna is under no pressure to develop new models. Cessna's strengths also include the broad customer base and the established service network. Cessna models account for about one-third of the global business jet fleet.

One of the company's weaknesses is the fact that it has no high-end model and therefore no presence in the upper market segment.

Key models in production: CJ1, CJ2, CJ3, Citation Bravo, Encore, Excel, Citation X, Citation Mustang, Sovereign, XLS.

Bombardier (Canada)

Bombardier has the largest range of jets and mainly operates in the medium and upper market segment with the Learjet and Canadair (Challenger) series. According to industry experts Bombardier will have difficulties in keeping its market share. This is primarily attributable to the strategy of the new CEO, Paul Tellier, who attaches

greater importance to profits than to market share. Accordingly, the main focus is no longer on the variety of models in the medium price segment.

Key models in production: Learjet 31A, 40, 45/XR, 60, Challenger 300, 604, Global Express, Challenger 800, Global 5000.

Gulfstream (General Dynamics) (USA)

General Dynamics' acquisition of Galaxy Aerospace helped Gulfstream more or less catch up with Bombardier. Gulfstream had a market share of around 25 per cent in the last decade and may even expand this share in coming years. Good business jet sales are expected, especially in the government and defence sector.

Gulfstream's wide range of business jets are mainly positioned in the upper market segments. Besides the refinement of existing models, Gulfstream is also working on the design of a 'silent' supersonic jet.

Key models in production: G100, G200, G300, G400, G500, G550, G150, G350, G450.

Raytheon (USA)

The very small product range and a current market share of about 10 per cent makes Raytheon the smallest of the Big 5. While the Hawker Horizon was added to the product range in 2004, the company still lacks a business jet in the high-end segment. The company's future will largely depend on the success of the tried-and-tested models.

Key models in production: Premier I, Hawker 400 XP, 800 XP, Hawker Horizon.

Figure 10.9 illustrates the structuring of the main actors within the commercial jet industry, thus revealing the total value chain.

Commercial jet operators/intermediaries

As seen in Figure 10.9, the different operator models can generally be classified into four groups: charter/air taxi, fractional ownership, full ownership and jet membership programme/private jet cards. The choice of a concept mainly depends on the estimated annual flight volume (in hours). Another aspect is whether the number of passengers is the same for each flight or whether it varies strongly. If transport requirements vary strongly (passenger numbers, distance between destinations), usage concepts with a free choice of the business jet type are preferable (see Figure 10.10).

Charter/air taxi

Charter/air taxi is recommendable for companies travelling less than 100 flight hours per year. There should be

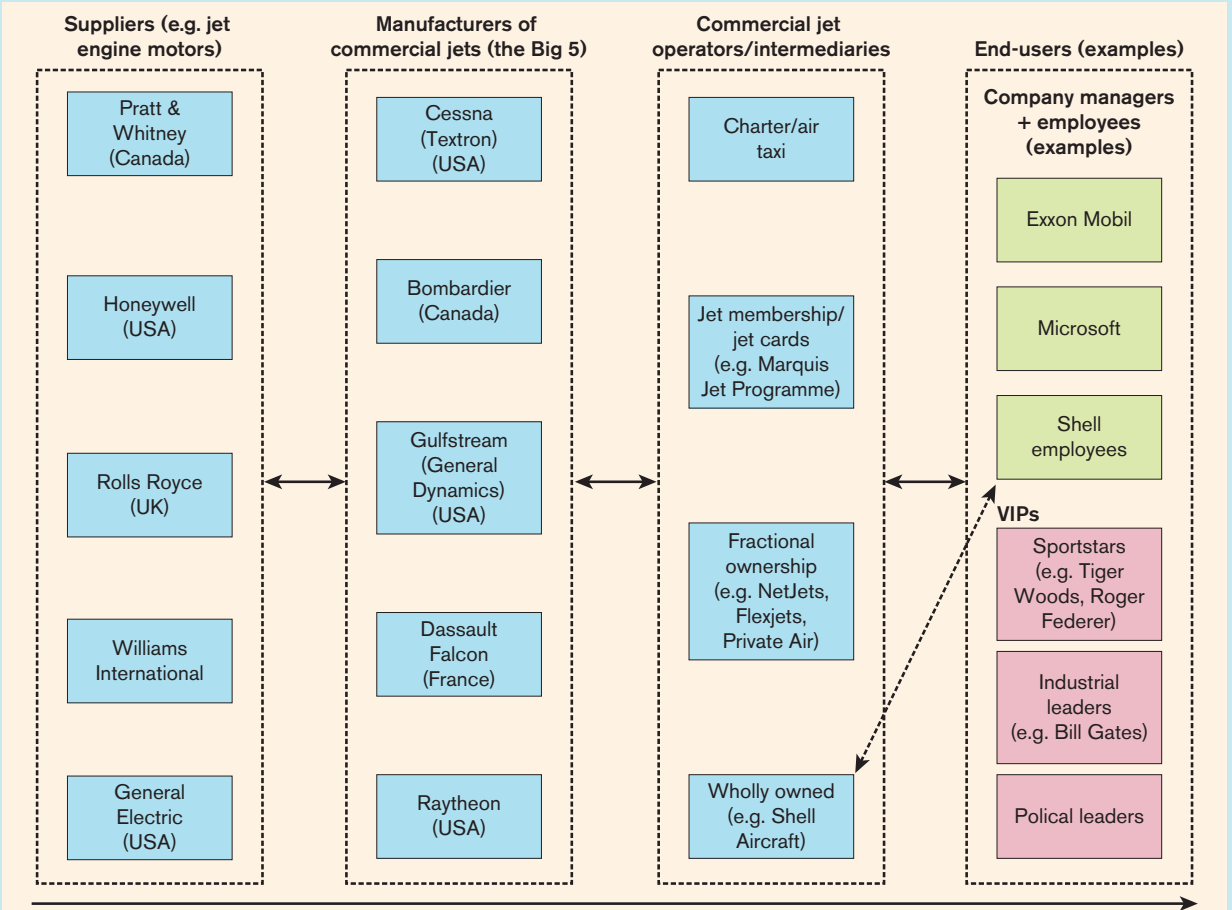


Figure 10.9 The value chain in the business jet industry

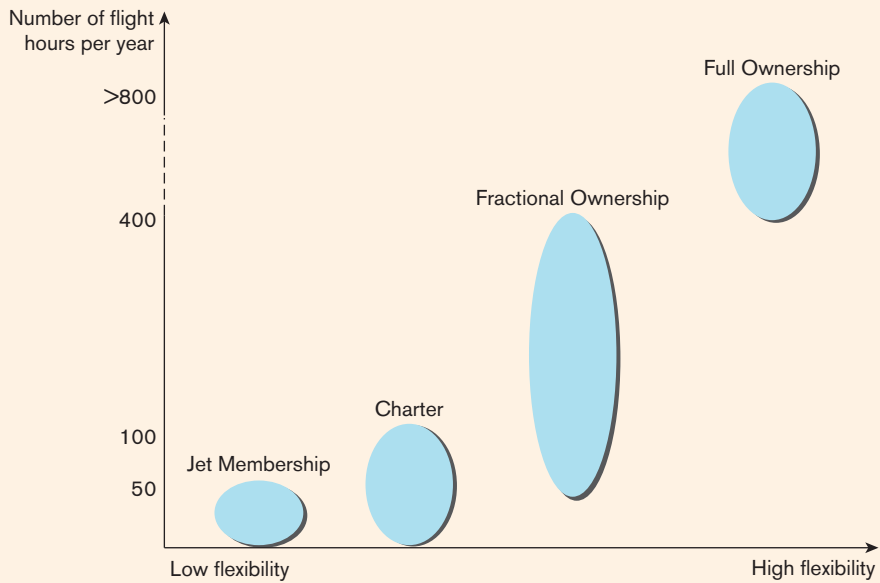


Figure 10.10 Different business jet operator models

Source: HSH Nordbank (2005) *Sector Report: Business Jets Market, Operator Models, Owners, Market Trends, Secondary Market*, HSH Nordbank, March, p. 5.

at least four passengers per flight though. This relatively low travelling volume would make (fractional) ownership of a jet uneconomical.

Charter concepts comprise on-demand charters and contract charters. In the case of on-demand (ad hoc) charters, availability of the jets is not guaranteed and prices are somewhat higher than for contract (block) charters. Contract charters are based on a longer-term contract stipulating a defined flight volume (in hours) for the term of the contract. Charter customers are charged for positioning costs and empty flights.

Corporate shuttles are a special form of contract chartering and allow a company's employees to travel between different production plants or branches. The time savings and the productivity of employees during the flights more than offsets the costs of a corporate shuttle, making them an attractive alternative to scheduled flights. To make a corporate shuttle profitable, some companies share the flight services, which would otherwise be too costly for a single company.

Private jet membership/jet cards

Jet membership models are derived from fractional ownership schemes and ad hoc charter programmes. Such models typically allow customers to use a defined number of flight hours in a certain jet type within a defined period of time. Unused hours usually lapse at the end of the agreed utilisation period.

Jet membership cards enable customers to use several jets at the same time. Such systems are therefore recommendable for travellers who have several destinations at the same time or overlapping flight schedules. The total flight volume should not exceed 50 hours p.a. as otherwise other usage concepts would be more favourable. Should the aircraft 'booked' by jet card not be available, another jet will be provided. If required, a larger jet or an aircraft with a larger range can be used – the costs will be charged in accordance with the exact number of hours travelled; if higher-quality models are used, the hours on the jet card will be used up quicker (or slower if aircraft models of a smaller category are used). This is based on a defined translation factor. The flight hours must be paid in advance. Marquis Jet Europe's programme starts at 25 flight hours at €126,000. Private jet memberships avoid the disadvantages of other usage concepts such as capital requirements, non-availability of charter jets and additional costs for empty flights. The special aspect of private jet memberships is that the price is fixed in advance. Compared to charters, where the price for the same route may fluctuate over time, the price for jet memberships is always the same. Moreover, some jet membership programmes offer

bonuses in the form of free flight hours for each return route. DeltaAirElite offers bonuses of up to 40 per cent (in flight hours). Nevertheless, jet membership cards have a relatively high fixed price and are rather recommendable for high net worth individuals than for corporations.

Fractional ownership

Fractional ownership shares (FO) are usually acquired by corporate customers who either wish to extend their own corporate flight service or who do not have the critical size to justify the use of their own corporate business jet. Fractional ownership concepts are suitable for flight volumes between 50 and 400 hours per year. Fractional ownership means that the user acquires a fraction of a certain jet. The minimum fraction to be acquired is 1/16 or 50 flight hours per year. Travellers with an annual volume of approximately 100 flight hours should acquire 1/8. Fractional ownership allows users to benefit from the advantages offered by a business jet without having to organise charter services on the one hand or having to perform the management tasks of a jet owner on the other hand. This task is performed by the operator of the FO programme.

Should a user's own jet (fraction) not be available at the desired time, another jet from the FO operator's fleet will be made available. This is made possible by exchange agreements with other FO owners, which aim to increase or guarantee jet availability. Most FO agreements have a term of five years. Some FO programmes require the FO to be repurchased by the FO operator every five years, while others merely require the operator contract to be renewed to reflect current monthly and hourly rates. Unused flight hours can be carried forward to the following years and do not expire. However, the maximum total number of flight hours per five-year term is limited to 1,000. The number of flight hours acquired may be exceeded by a maximum of 50 per cent per year. However, in this case, users will incur additional costs.

Fractional ownership can be acquired by way of a one-time payment. NetJets offers a 1/16 fraction at a price starting at only US\$200,000. Alternatively, this one-time payment can be refinanced via the FO company or the fraction can be leased. Monthly leasing fees are relatively high as they must compensate for the value impairment of the jet expected at the end of the term.

Different fractions available

In addition, the fractional owner pays a monthly fee to the FO operator, which covers all fixed costs such as pilot salaries and pilot training, hangar fees, regular maintenance, administrative expenses and insurance costs. The fixed costs are spread over the different

owners in accordance with their respective ownership fractions. The FO is capitalised as an asset by the owner's balance sheet, which means that it is subject to annual depreciation. In addition to the one-time payment and the monthly fees, users incur variable costs for the number of flight hours used. Variable costs include costs for fuel, maintenance costs, cabin crews, food, general tax on consumption, and airport fees. Under applicable laws, fractional owners are responsible for the safety of the passengers and should therefore have sufficient insurance cover.

Should a user sell their FO, they will be charged a resale fee of 5–7 per cent of the current market value. Another disadvantage is the fact that, if the FO is returned or sold, the loss is higher than if the jet were fully owned due to the higher utilisation rate.

The important aspect is that the buyer of an FO does not acquire the right to fly but rather actual fractional ownership of the jet. Nevertheless, fractional owners cannot use the whole jet as collateral. On the other hand, the rights of a fractional owner are not affected by the financial liabilities of other fractional owners. Fractional owners can pledge only their own share in the jet, and the continued operation of a partially pledged jet is guaranteed in the case of the realisation of collateral by a creditor. At the bottom line, fractional ownership is almost always more expensive for the user than jet charters or full ownership and operation of a business jet. FO is an interesting option only for annual flight requirements of between 50 and 400 hours.

NetJets Inc. (www.netjets.com), a Berkshire Hathaway company, is the worldwide leader in private aviation and provides the safest and most secure private aviation solutions. NetJets fractional aircraft ownership allows individuals and companies to buy a share of a private business jet at a fraction of the cost of whole aircraft ownership, and guarantees availability 365 days a year with just a few hours' notice. The NetJets programmes worldwide offer the largest and most diversified fleet in private aviation, which includes 15 of the most popular business jets in the world. Access to the NetJets fleet is also available in the form of a short-term lease, sold on an all-inclusive, pre-paid basis in 25-hour increments, through an exclusive alliance with Marquis Jet Partners. NetJets Inc. also offers aircraft management, charter management and on-demand charter services through its subsidiary Executive Jet Management.

The market for fractional aircraft ownership is growing quickly. Over the past decade, the total number of owner shares has grown from approximately 1,500 to over 7,000 expected this year. On average, the market has grown by 8.5 per cent annually.

For the last two years, NetJets' market share has been around 70 per cent based on net value of aircraft sold and leased. NetJets has flown more flights than all of its competitors combined and manages more than 390,000 flights annually.

FlightSafety is a sister company of NetJets through Berkshire Hathaway and is the world's largest provider of aviation training, educating more than 75,000 pilots annually across 43 Learning Centers in the United States, Canada, France and the United Kingdom.

FlightSafety will more than double the number of its existing simulators, creating its largest concentration of simulators in the United States.

In 2007, NetJets worldwide flew over 390,000 flights, 237,000,000 miles to more than 173 countries, employing nearly 7,300 worldwide (3,957 pilots, 400 flight attendants). In the US NetJets fractional programme alone spent over \$34 million on catering; arranged more than 100,000 cars and limos; landed at over 1,500 airports; spent \$66 million on pilot training at FlightSafety International; and required over 1.8 million maintenance work hours.

Full ownership

Full ownership is suitable for companies with more than 400 flight hours per year. The owner of the jet is also the operator and is therefore responsible for jet management; this task may also be assigned to an external service provider. Full ownership costs comprise the acquisition costs, annual depreciation and current operating expenses. When the jet is not needed, it may be chartered to other users, so that income is generated.

The end-users

In terms of the number of business registered jets, North America leads the other continents by a wide margin. This means that North America is the world's best developed business jet market, with 70 per cent of all registrations. Canada only accounts for a small fraction (approximately 2 per cent) of the total number.

The share of business jets used for corporate purposes is relatively high, at around 90 per cent. The rest is represented by the VIP segment (sports stars, rock stars, political leaders, etc.)

Reasons for using business jets

There are many reasons for companies, private individuals or the government to use business jets. Above all, there is the special flexibility offered by a business jet. These jets have a lower weight than scheduled aircraft and can therefore land on much shorter runways. This

allows the user to choose a destination airport that is closer to the final destination than the usual major airports. This results in a shorter ground transfer to the final destination, which, together with the shorter airport check-in times in dedicated business jet terminals, lead to substantial cost savings compared to scheduled flights. The departure time is determined by the passenger and not by the airline, and the passenger can fly straight to their desired destination, with no need to change flights and no risk of missing connecting flights. Moreover, as a result of the stricter safety standards introduced after the 9/11 terrorist attacks, more time is needed for scheduled flights. General safety concerns regarding scheduled flights have also increased demand for business jet transports. For business travellers, the greater productivity during the flight is also an important argument in favour of business jets. Business travellers can talk to their employees or read files without being watched or disturbed by other passengers. Some models feature a conference room, Internet connection and other communications facilities. Business jets also offer much greater travelling comfort than regular flights. In some cases, passengers can drive straight to the aircraft in their private cars and board it without having to wait – while their luggage is being safety checked. This way, they do not have to walk long distances as is the case in most major airports.

According to a Bombardier market study on European business jet customers, they attach importance to:

- time savings and convenience;
- direct access even to remote destinations;
- relatively new aircraft adapted to customers' personal tastes (colours, equipment);
- easy booking, payment and service provision;
- safety of the jets and quality of the operators;
- usage concepts that do not require users to own the jet;
- avoiding public attention or criticism for using business jets.

Future perspectives

Going forward, we will see a growing number of partnerships between jet operators and other service providers for effective marketing support. American Express is a pioneer in this area. Together with Le Bas International (a charter company that cooperates with over 5,000 jet operators and airlines), American Express offers a bonus programme to its Platinum Card or Centurion Card customers. These customers can charter business jets using their credit card and benefit from special advantages such as high jet availability and more bonus points for their credit card turnover.

Marquis Jet's partnerships go even one step further. Marquis Jet customers who buy a yacht from Sea Ray get a certain number of flight hours as an incentive, depending on the yacht model chosen. Marquis Jet has also entered partnerships to offer services such as private jet plus rental car and private jet plus holiday club. This shows that private jets are well suited for being marketed in combination with other high-end products.

QUESTIONS

- 1 Please explain which relationships in the total value chain would be most important for Dassault Falcon to focus on.
- 2 Please explain how Dassault Falcon can benefit from a collaboration with a complementor or (in)direct competitor.
- 3 Is key account management (KAM) relevant to use for Dassault Falcon? If yes, how?

SOURCES

Datamonitor (www.datamonitor.com); Euromonitor International (www.euromonitor.com); HSH Nordbank (2005) *Sector Report: Business Jets Market, Operator Models, Owners, Market Trends, Secondary Market*, March, p. 5.

QUESTIONS FOR DISCUSSION

- 1 Identify the measures that can be used to encourage long-term relationships with customers.
- 2 What specific segmentation criteria could be used to categorise different loyalty segments?
- 3 Evaluate the strengths and weaknesses of frequent user programmes.
- 4 What are the arguments for spending money to keep existing customers loyal (customer retention)?

- 5 Put the arguments for and against the statement that ‘the customer is always right’.
- 6 What are the motives for entering KAM?
- 7 Describe the different stages in KAM.
- 8 What is the purpose of implementing a customer complaint management system?

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