11

Relationship marketing

Introduction

Organizations can grow business by attracting new customers, losing fewer customers and doing more business with existing customers. A combination of the latter two is generally a more efficient way of utilizing resources.[1]

Many studies have shown that marketing strategies that focus on customer retention, deliver improved profitability for the service provider.[2,3] This has resulted in a paradigm shift in the theory and practice of marketing, and a further branch of marketing known as relationship marketing has evolved.

The practice of relationship marketing relies on an organization's ability to identify, target, communicate and reward valuable customers, and is built from the foundations of quality service.

11.1 A twenty-first century approach to marketing

Such is the fiercely competitive nature of virtually all markets today that most companies operate in markets characterized by oversupply. Under these conditions, if a service does not satisfy, the customer can move on to find another company whose service does. In recent years there has been a refocusing of marketing away from customer acquisition to that of customer retention. If the company is to benefit from retaining customers, customers will also seek to benefit from giving their loyalty to the company. The refocusing on retention is predicated in the belief that improved economic benefits will be delivered.[4] Furthermore, in order to build retention the service provider must build relationships with those who consume the service. The practice of relationship marketing is designed to deliver retention through the development of a number of 'bonds' between organization and customer.

11.2 What is relationship marketing?

For starters, it is more than retention marketing. It is an approach to the practice of marketing that should be adopted right at the beginning of the service life cycle. So, in the early years where trial and acquisition of customers are usually the goals uppermost in the marketing manager's mind, it would be shortsighted to miss the opportunities for relationship-building even then. Zeithaml *et al*.[5] state:

> Relationship marketing is a philosophy of doing business, a strategic orientation, that focuses on keeping and improving current customers rather than on acquiring new customers.

We, however, do not advocate the *either* acquisition *or* retention position. A company following a relationship marketing approach does not imply it is no longer interested in customer acquisition. What it means is that in seeking to acquire new customers the company should target those individuals/companies that it expects to want to do business with over time – and then begin to build a relationship from day 1. This is not a one-night stand.

11.2.1 Relationship marketing: a historical context

If one looks at the parallel developments of marketing thought with the economic situation in the second half of the twentieth century, the evolution to a relationship marketing paradigm is not unexpected.

After the end of the Second World War, most markets were characterized by a lack of supply and excess demand. Companies sold what they could make. There was no listening to the 'voice of the consumer' and adapting product/service offerings to satisfy their requirements. This approach is known as **product orientation** and is typified by Henry Ford the American car manufacturer's famous statement: 'They can have any colour as long as it's black.'

By the time we get to the 1970s many markets are exhibiting excess supply. To survive, companies now have to fight for customers. They have to listen to and meet customers' needs/wants. They learn how to segment and differentiate their offerings. This is **market orientation**.

However, by the 1980s, most companies had adopted a market orientation and the plethora of similar products/services offering often indistinguishable benefits led companies to seek other means of securing an advantage over competitors. Companies developed a **competition orientation**, where they sought to outperform competitors through value-chain savings, a differentiated route to market, etc.

Increasing variety-seeking behaviour from consumers and an expectation of a continual stream of service innovations coupled with advances in technology lead to

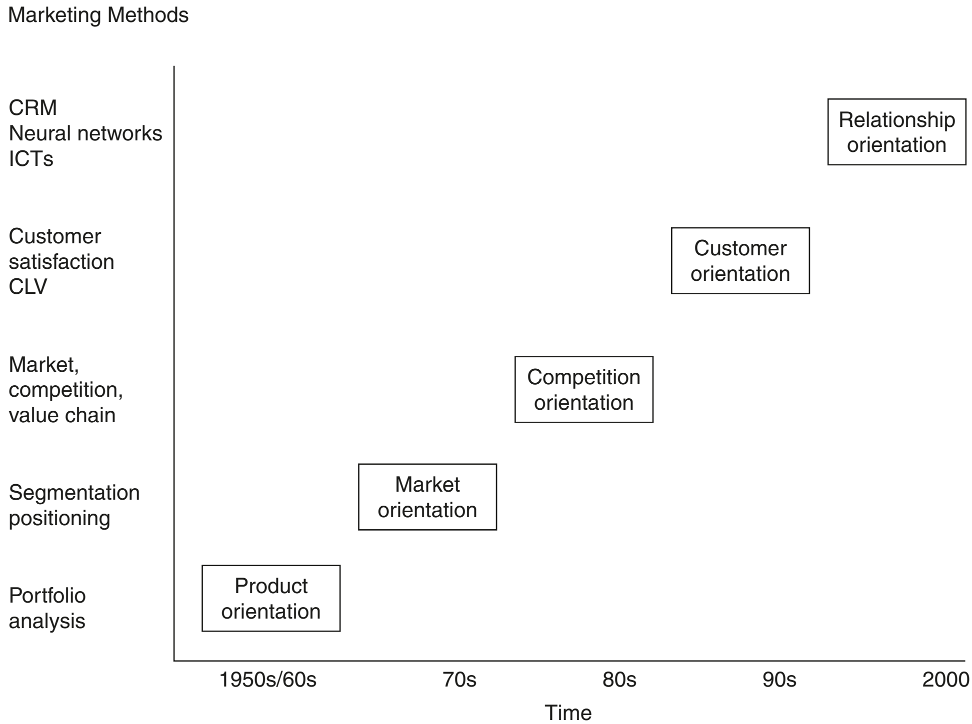

Figure 11.1 Evolution of relationship marketing paradigm

the 1990s being characterized by a renewed marketing focus on the customer. This **customer orientation** was driven by a desire to fulfil the expectations of homogenous groups of customers, often resulting in marketing to increasingly smaller groups of buyers.

The **relationship orientation** is a natural extension to that of customer orientation. For many companies, they have so much invested in strategies designed to meet a customer orientation that they want to hold on to these customers and optimize their relationships. In many cases technology is allowing marketers to engage in 24/7, real-time dialogue with customers – a far cry from the 9 to 5 monologue of the 1950s.

11.3 Why follow a relationship marketing approach?

Many benefits have been shown to accrue to those companies that adopt a relational approach. For one, there are the economic benefits. Such benefits arise from either *increased revenue* or *lower costs*. In a seminal study, Reichheld and Sasser[6] analysed the profit per customer over time in several service industries. Their findings demonstrated that the longer a customer was with a service provider the more profitable they became. Four key reasons for this profit improvement were identified in their study.

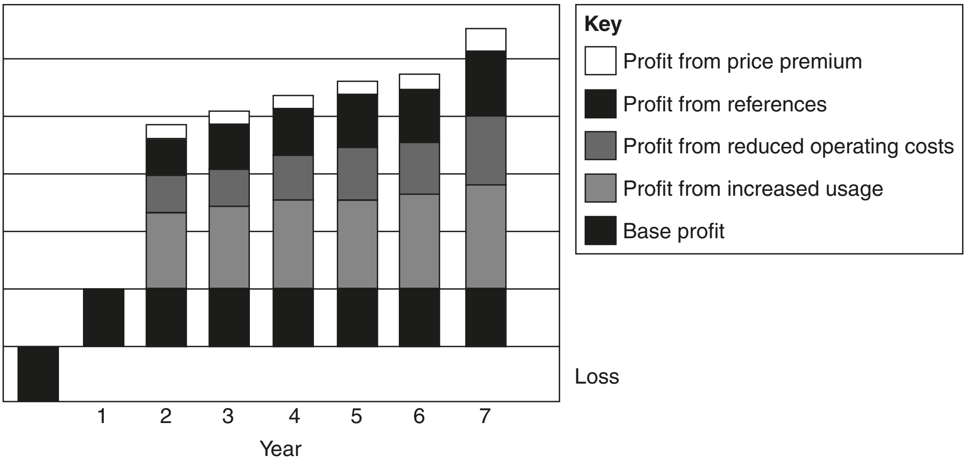

Figure 11.2 Development of value categories in the course of customer relationship
Source: Reichheld and Sasser (1990).[2] Reprinted with permission from *Harvard Business Review*

11.3.1 Benefits to the service provider

- Relational customers tend to increase their purchases over time, either because they are consolidating their purchasing onto a preferred supplier or because their own business/family has grown and there is a need for more.
- Experienced customers tend to make fewer demands on the supplier and fewer mistakes in their operation of the service. So productivity is improved and operating costs are reduced.
- Long-term satisfied customers will engage in positive word-of-mouth recommendation, thereby reducing the marketing spend necessary to attract new buyers.
- There is less need to offer price promotions to this group. Indeed these customers are likely to be less price-sensitive than others (which does not mean they have no price sensitivities).

Using Reichheld's categories, Bain & Co., the international management consultancy, tracked the growth in profit attributed to each of these four factors over a 7-year period[7] (see Chapter 10). Further proof of the economic impact of a relationship strategy can also be found in a further study conducted by Bain & Co. which analysed the impact on profit from a 5% increase in the retention or loyalty rate. Profit impact was calculated by comparing the net present value (NPV) of the profit stream from the average customer life at current retention rates, and then the NPV for the average customer with 5% higher retention rates.

Enormous variations between markets were evident, with an estimated 95% profit improvement in advertising agencies, down to a more modest 35% increase in the software market.

In addition to economic benefits, establishing long-term relationships with customers leads to improved levels of trust and commitment.[8] These can play a powerful role in consumer acceptance of new service initiatives, and also in increased tolerance of occasional services failures.[9]

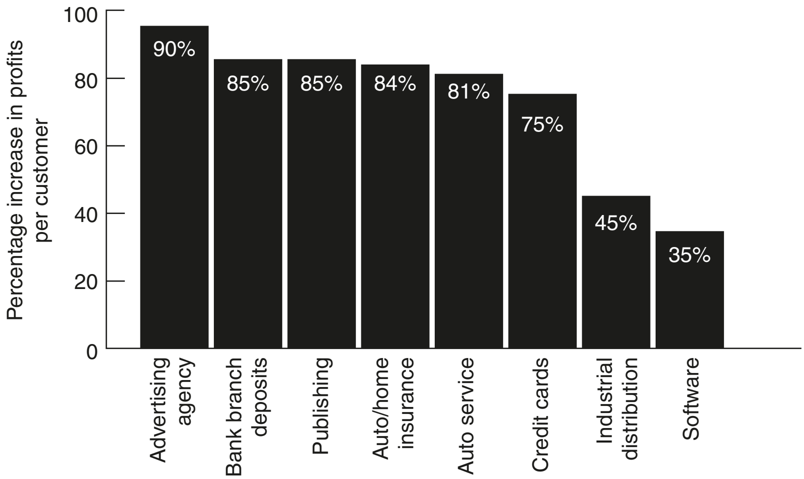

Figure 11.3 Profit impact of a 5% increase in customer retention
Source: Reichheld (1994).[3] Reprinted with permission from *The American Marketing Association*

11.4 Benefits to the customer

The benefits arising from a relational approach do not solely accrue to the service provider. There are also customer benefits. These fall under three main headings: confidence benefits, social benefits and special treatment benefits:

- **Confidence benefits** arise from feelings of trust or comfort, or conversely from fewer feelings of anxiety, with the service provider. Of the three types of benefit, confidence benefits have been found to be the most important to customers.[10]
- **Social benefits** often arise when the customer receives more than the technical benefits of the service: the local restaurant that remembers where you like to sit, the hairdresser that knows (and asks after) your family. In such cases, there is a more intimate dimension to the customer's relationship with the service provider than with many others. The service provider has become part of the customer's (life) support system. Such relationships are not confined to consumer services. They can also be present in business-to-business markets. Indeed it has been suggested that professional service companies need to be careful not to let staff form specific intimate relationships with clients since they could be vulnerable to customer attrition if they lose these members of staff.[11,12]
- **Special treatment benefits** include such things as getting preferential treatment, as with the loyalty schemes operated by most major airlines. A Silver or a Gold Card holder with British Airways, for example, is much more likely to get a seat upgrade than a passenger with either a Blue Card or no card at all. Upgrades are also used by car hire companies to reward their relational customers. The service provider may make concessions that would not be made otherwise – late drop-off at the dry cleaner, no bank charge for exceeding an overdraft limit. Interestingly, of the three categories of customer benefit, special treatment benefits are regarded as least important by consumers.

11.4.1 Customer loyalty

It would be misleading to suggest that until the concept of relationship marketing emerged, marketers were solely focused on one-off transactions. The majority were also interested in fostering customer loyalty.

Loyalty is more than repeat purchasing. Organizations can often (certainly in the short-term) bind customers through economic and structural bonds that make it costly for a customer to switch. In recent years many players in the financial services industry, particularly mortgage companies, have been accused of making the process of switching to another lender both expensive in terms of early redemption payments, and also costly in terms of time spent filling out lengthy paperwork. On occasion, the customer faced with such obstacles may simply opt to continue to patronize the original company, but it would be wrong to consider this repeat/continuing purchasing to be evidence of loyalty. Such a state has come to be known as spurious loyalty.

Customers with true, premium or intentional loyalty have in addition to repeat purchasing behaviour a strong positive attitude/attachment to the company. Such people will be advocates of the company and will exhibit a level of immunity to competitors' efforts to lure them away.[13] Their loyalty is also difficult to dislodge and often requires a considerable negative experience to get them to re-evaluate the service provider.[14] Consequently, they are considerably more tolerant of mistakes than the average customer.[15]

11.5 Building a relationship marketing strategy

Before a company begins to design and implement a relationship marketing strategy it has to have some fundamental building blocks in place. Without these any relationship marketing strategy has a high likelihood of failure.[16]

For starters, there has to be a *good level of quality* in the core service that is being offered. There is little point in designing relationship marketing strategies for inferior services, since there is little likelihood that there will be a core group of customers interested in forming a lasting relationship.

11.5.1 Market segmentation

Additionally, it is fundamental that the marketer can *identify and segment the customer base*. Until a few years ago this was a challenging task for most mass consumer services companies. However, data capture and manipulation technology ease this considerably. The loyalty cards issued by UK high street supermarkets would not deliver the benefits to consumers and supermarkets if there was not a sophisticated technological infrastructure supporting the scheme.

Segmentation is not a new marketing tool. However, we would suggest that the development of a winning relationship marketing strategy in services requires the marketer to go beyond the traditional approach where markets are segmented along the lines of (geo)demographics, behaviour and possibly psychographic variables.

The purpose of the segmentation is to design and deliver a service tailored for the segment. In tailoring the service, a company should attempt to quantify the value of

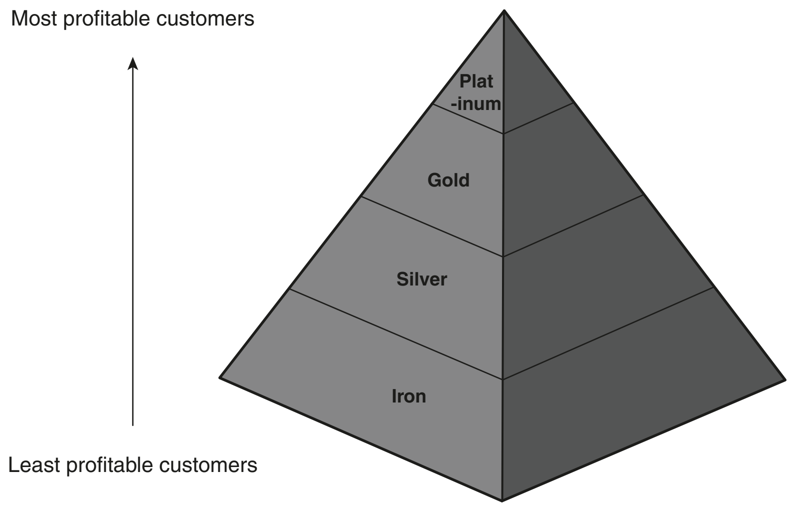

Figure 11.4 CLV segmentation hierarchy

a particular customer/segment. This involves estimating customer lifetime value (see Chapter 10 for a fuller explanation). By doing so, the company is then able to determine the value of the relationship and, further, the value it can afford to put into any benefits designed to foster the relationship.

In addition, it will help shape the relationship marketing strategy as the company designs programmes for moving customers from less profitable to more profitable segments.

This analysis of customer lifetime value may highlight the fact that it is not profitable for the company to meet or exceed the expectations of all of its customers. Indeed it has been suggested that in some cases the service provider might need to 'fire' customers.[17] Many UK high street banks have recently segmented their personal banking customer base to provide more 'privileges' for their high net worth individuals. These customers have a personal banker whom they can contact at any time (during business hours) with any request relating to their banking: no call centres for them. Those with whom the bank is less interested in maintaining a relationship, on the other hand, will experience a significantly less responsive operation, one that asks them to be more involved in their own service delivery.

11.5.2 Monitoring the relationship

Finally, a successful relationship marketing strategy needs to have a robust means of monitoring and evaluating the relationship over time. Customer satisfaction studies are helpful in this regard (see Chapter 12 for a fuller discussion). Once again the evaluation programme should be designed with the particular segment in mind. So British Airways regularly takes premium customers away for a 'workshop' weekend. They go to an exotic location, customers take their partners and in addition to the fact-finding on the part of the company there are lots of opportunities for British Airways to deliver a 'wow' factor – famous after-dinner speakers, first to trial new cars, premiere tickets, etc., all of which help to cement the relationship. The company would not consider doing this for its economy passengers.

The company should actively seek feedback and be responsive to this feedback. Remember in relationships the evaluation should appear more like a dialogue than a monologue.

11.5.3 Customer relationship management (CRM) systems

Indeed, the whole approach to monitoring and evaluating customers' services experience should be undertaken in a radically different way to the traditional approach to market research.

In the late 1990s a whole new industry sector developed out of the market research industry and computer software industry. Some companies in these industries saw that many organizations had a need to understand and monitor their customers' behaviour in real time (or as near to this as possible). So there was a desire for this type of system, and now there was technology that could deliver it.

CRM systems (see Table 11.1) are designed to keep a history of all contacts a customer has had with the service provider. So even in mass marketed services where there is little chance that customers will be 'served' by the same employee in the service company on repeated occasions, the company can pick up with the customer where they last left off. Gone are the days of customers having to explain everything from scratch because they happen to make contact with a different employee.

Table 11.1 Common CRM applications

Data collection
Data analysis
Sales force automation
Marketing automation
Call centre automation

Early proponents of such CRM systems considered their implementation would deliver a competitive advantage. Such rewards were often short-lived since such systems were easy to copy. More frequently the expected benefits were never realized. Since many failed to realize that it was not the possession of a CRM system that would deliver the advantage, it was what was done with the information that such systems generated. The CRM system is only a tool to drive the strategy, it does not design, and can only help deliver the strategy.

11.6 Relationship marketing strategies

With the key building blocks of relationship marketing in place, the company is ready to design its relationship strategy. Leonard Berry and A. Parasuraman[18] have developed a framework to assist in the design of relationship strategies. This framework depicts four levels of bond that the service provider can deploy: financial, social, customization and structural.

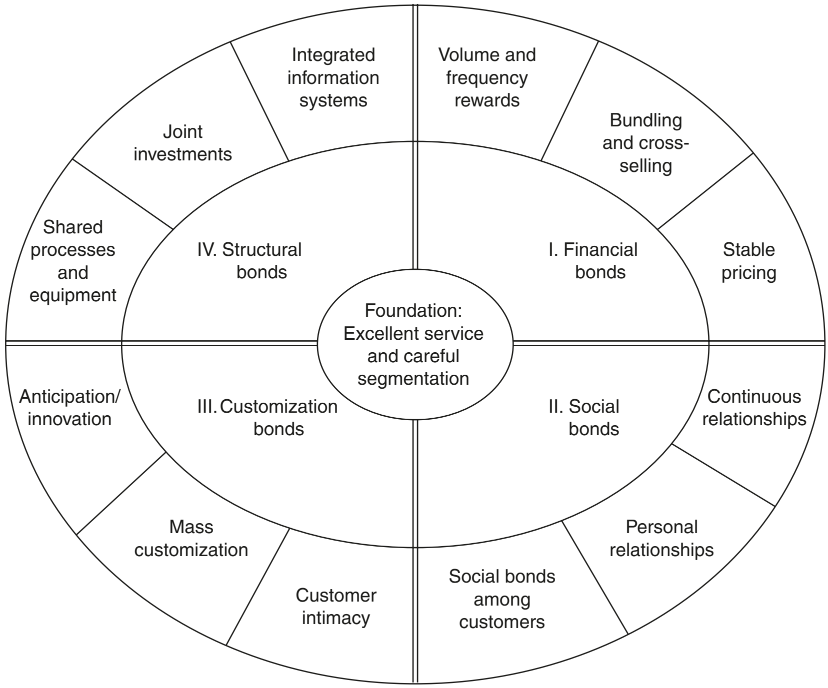

Figure 11.5 Levels of relationship strategies
Source: Zeithaml *et al*. (2006).[5] Reprinted with permission from the authors

11.6.1 Financial bonds

For many, this type of bond represents the starter pack in terms of building customer relationships. Basically the customer is incentivized with reduced prices over time for remaining with the company. Or some sort of volume discount can be offered – for taking a larger share of the customer's business or merely increasing the volume or value of the business that is done. We do not have to look far to find examples of this type of bond – no claims discounts offered by the insurance companies, frequent flyer programmes offered by most of the large airlines, coffee shops that offer to stamp loyalty cards so that a free cup of coffee is given after a certain number have been bought.

In 2004 more than 50 million loyalty cards were issued in the UK – promising discounts, special prizes and exotic holidays for points collected. Eighteen million households include someone with a Boots Advantage Card, 12 million contain a Nectar Card and another 11 million have a Tesco Clubcard, which means that a substantial number of households have more than one card. However, many regard such loyalty card schemes as little more than a clumsy form of price promotion.[19]

These types of programmes are relatively easy to introduce and may even result in some short-term profit improvement. However, they are easily copied – the successful ones nearly always are. So if this is the only plank of a relationship strategy it is unlikely to result in raising retention/loyalty.[20] Further, through time, if financial bonds are used ubiquitously they come to be expected as part of the core service.

Sometimes the financial bond is linked to driving purchases in other markets. Cross-selling and bundling of services are the principle tools used. So mortgage providers will also try to sell household and buildings insurance. And many airlines and hotel chains have preferential rates arranged with car hire companies.

11.6.2 Social bonds

Companies seek to build more intimate relationships through social or interpersonal bonds. The customer is no longer faceless (sometimes even nameless). He is a 'client', 'partner' and in some cases even a 'stakeholder'. Historically this has been predominantly practised in business-to-business services. The advertising agency account manager will be charged by his or her agency with having a strong bond with the marketing director of the client company. The account manager will be expected to socialize with the client and listen to their worries. In return, the client is not expected to complain when the agency delivers late and over-budget.

Increasingly the use of CRM systems has enabled mass consumer services to approach the levels of social bonding previously considered out of reach. But companies rarely make use of the information collected to form social bonds.

Sometimes the social bond is not between the customer and the service employee but is formed between customers. These are the relationships that bind them to the service provider. So the health club that organizes social events at the club is attempting to get customers closer to one another.

11.6.3 Customization bonds

The service provider is attempting to create these type of bonds when it customizes the service that is delivered to particular groups of customers: in other words, the provider tailor-makes the service to the needs of the customer. In the arena of business-to-business services, the service provider may have no alternative other than to customize its offering. Consider the accountancy firm or the commercial law practice: the service they offer one particular client is unlikely to be identical to that offered to any other. The customer becomes bonded to the service provider through this customization. For many such services there is often a high cost for the customer of switching to another service provider. So where customizing the service becomes de facto a necessary component of service delivery, the service provider should also be monitoring the relationship to ensure the customer remains positively predisposed to the company.

Mass consumer marketing companies have also been trying to customize their offerings. This is known as mass customization, or one-to-one marketing.[21] There are reports of a bicycle manufacturer in China offering 80 000 different specifications on one model. In the UK customers using Tesco.com, the Internet shopping site from the high street retailer, will find that the site captures their shopping history and the next time the customer goes to shop online, their customized basket of goods will be offered for them to tailor. The site will also intelligently suggest both new and established products that the customer might like to try based on their known shopping behaviour.

11.6.4 Structural bonds

As with customization, these type of bonds are more prevalent in business-to-business markets. Structural bonds often occur where the services offered by the service provider are designed into the systems or processes of the client company. An example would be a research company that designs a system to gather electronic point of sale (EPOS) from every cash register of a high street retailer, and then feeds this information back in virtual real time to the retailer and their suppliers to ensure stores have the right stock on the shelves.

However, some companies that are serving the general public are also building structural bonds into their service delivery, although in many cases these are reserved for their business-to-business segments. British Airways offers its Executive Club holders the ability not only to book online (which would not be regarded as a structural bond these days), it also allows customers to check-in and select a seat online.

As with customization bonds, the service provider must monitor customers' perceptions of the service experience to make sure that they remain satisfied with the service they have received (see Chapter 12 for a fuller discussion of evaluation).

Summary

In the recent past there has been a paradigm shift in marketing practice from transactional marketing to relationship marketing. While customer acquisition remains important, increased efforts and resources are devoted to holding on to the customer a company has.

As a precursor to the development of a relationship strategy, service providers must establish a good quality service, develop a segmented customer base (preferably using a segmentation strategy that includes some measure of customer equity) and monitor/evaluate customer experience.

With these in place, a relationship strategy can be designed using a combination of financial, social, customization and structural bonds, all of which have the potential for improving the profitability of the service provider.

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