CHAPTER 19

Building Customer Loyalty

Building a community and creating an emotional attachment with customers have fueled SoulCycle's expansion.

Source: Noam Galai/Getty Images

Generating a sale is not the ultimate goal of the marketing process. It is the beginning of building and managing customer relationships for the purpose of creating a loyal customer base. Cultivating loyal customers is a priority for market-driven companies that seek to gain and defend their market position. Indeed, without building customer loyalty, a company will have to constantly invest in acquiring new customers to replace disloyal customers who have switched to competitive offerings in search of a better deal.

Customer loyalty is the result of a company's efforts to consistently deliver a positive product, service, and brand experience. Although their enhanced capabilities can help companies earn strong customer loyalty, increased consumer capabilities pose challenges. Regardless, marketers must connect with customers—informing, engaging, and maybe even energizing them in the process. Customer-centered companies are adept at building customer relationships in addition to products; they are skilled in market engineering as well as product engineering. Creating user communities plays an increasing role for many companies and industries that seek new ways to satisfy customer needs and build loyalty. SoulCycle is a vivid example of a company that has achieved market success by building a loyal customer base.

>>> Co-founded by Elizabeth Cutler and Julie Rice in 2006, SoulCycle had the vision to create an alternative to the traditional fitness routines that lacked passion and felt too much like work. Together, Cutler and Rice developed a 45-minute indoor cycling class that features high-intensity cardio, muscle-sculpting strength training, and rhythm-based choreography. Designed to be much more than just a workout, SoulCycle aims to create a shared experience for riders and build a community that motivates members, inspiring them to unlock their full potential. The first SoulCycle studio, located on West 72nd Street in Manhattan, featured 33 bikes placed in a darkened room where energetic instructors led riding sessions to the rhythm of customized playlists. The SoulCycle concept struck a chord with riders, and during the next few years, Cutler and Rice opened several additional studios in the New York City area. Despite its expansion to multiple locations, Soul Cycle was able to stay true to its mission—to create a community of riders around its unique "body-and-soul" workout concept. Attracted by the boutique cycling concept and its loyal customer base, Equinox—an operator of upscale fitness clubs—acquired 75 percent of SoulCycle in 2011. Following the Equinox acquisition, SoulCycle continued its rapid expansion and by 2018 was operating 88 studios in the United States and Canada. From its humble beginnings, SoulCycle was able to scale up its business model by relentlessly focusing on creating a unique workout routine that builds an emotional bond with its customers.[1]

Successful marketers are those who carefully cultivate customer satisfaction and loyalty. In this chapter, we spell out the some of the ways they can go about winning customers and beating competitors.

Managing Customer Acquisition and Retention

The ability to effectively acquire new customers and retain existing ones has a direct impact on the company's bottom line. To achieve success in acquiring and retaining customers, a company must have a clear understanding of the customer acquisition funnel and effectively balance its customer acquisition and retention efforts.

THE CUSTOMER ACQUISITION FUNNEL

The main steps in attracting customers can be imagined in terms of a funnel that depicts the phases in the customer acquisition process, from merely being aware of an offering to becoming loyal advocates. The **customer acquisition funnel** can be represented in terms of five relatively distinct phases: awareness, appeal, ask, act, and advocate.[2] This five-phase (or 5-A), narrowing approach to evaluating the customer acquisition process is depicted in Figure 19.1.

Learning Objectives After studying this chapter you should be able to:

19.1 Explain how a company should balance its acquisition and retention efforts.

19.2 Discuss how a company can manage customer satisfaction and loyalty.

19.3 Describe how companies manage customer relationships.

19.4 Discuss how a company should manage customer lifetime value.

FIGURE **19.1**
The 5-A Customer Acquisition Funnel

The *awareness* phase is the gateway to customers' interaction with the company's offering. It is in this phase that target customers encounter the company's offering. This encounter can be driven by the company's marketing communication, can occur at the point of sale, or may stem from advocacy by other customers and collaborators.

Awareness usually is not limited to a single offering. Often customers become aware of multiple offerings that could potentially meet their active need. This can happen when customers seek information on the different means to fulfill their need at the point of purchase or when they are exposed to the company's or competitors' marketing communication campaigns. It can also happen without any external influence when, based on prior experience, customers recall a set of available offerings.

The *appeal* phase reflects the fact that although customers might become aware of multiple offerings, they do not actively consider all of them. Instead, they tend to shortlist the most appealing offerings in order to form a consideration set composed of offerings that are most likely to fulfill their need. Thus, the appeal phase of the decision process can be viewed as a process of selective elimination, paring down the initial set of offerings that came to customers' minds.

During the *ask* phase, customers seek additional information about the offerings in their consideration set. This additional information can come from external sources such as friends and family, the media, and/or the company and its collaborators. For example, customers might call friends for advice, contact the company for more information, browse online reviews, use an app to compare prices, and even try out products at stores.

The *act* phase marks a transition from information gathering and evaluation to an action typically directed at a particular offering. Customer actions are not limited to purchase: They reflect the total ownership and usage experience, which also includes actual consumption of the product or service as well as the post-consumption experience.

The *advocate* phase reflects customers' reactions following their consumption experience. Ideally, customers' reactions will involve a certain level of loyalty to the company and its offering. These reactions can range from simply repurchasing the offering to ultimately advocating the offering to others. Active advocates recommend products, services, and brands they love without even being asked. They share positive experiences with others and often become evangelists.

The different steps of the decision funnel do not always occur in the linear process depicted in Figure 19.1; they can involve multiple iterations, reconsidering and reevaluating the available data, and gathering new information. And customers do not necessarily go through all of the Five A's; they might skip one or more of the five phases. For example, a customer might make an impulsive purchase without forming a consideration set and gathering additional information about the alternative options. Likewise, loyal advocates might not be actual purchasers of the company's offering. Apple products, such as the iPhone, iPad, and Apple Watch, for example, are often advocated by non-buyers.

BALANCING CUSTOMER ACQUISITION AND CUSTOMER RETENTION

Effective management of customer acquisition and retention involves clear understanding and accurate estimation of customer conversion and retention rates. By calculating **conversion rates**—the percentages of customers at the different stages who move to the next stage—managers can identify any bottleneck stage or barrier to building a loyal customer base. If the percentage of recent users is significantly lower than that of triers, for instance, something might be wrong with the product or service that prevents repeat buying.

The customer acquisition funnel also emphasizes how important it is not just to attract new customers but also to retain and cultivate existing ones. Research on customer retention suggests that acquiring new customers can cost several as much as satisfying and retaining current ones.

Data further indicate that a 5 percent reduction in the customer defection rate can increase profits by 25 percent to 85 percent, depending on the industry. It has further been suggested that profit rate tends to increase over the life of the retained customer because of increased purchases, referrals, price premiums, and the reduced ratio of operating costs to service.[3]

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

Some service providers are plagued by "spinners," customers who switch carriers at least three times a year looking for the best deal. Many mobile carriers and cable TV operators lose 25 percent of their subscribers each year at the cost of billions of dollars. Defecting customers cite unmet needs and expectations, poor product/service quality and high complexity, and billing errors. Different acquisition methods yield customers with varying levels of loyalty. One study showed that customers acquired through the offer of a 35 percent discount had about one-half the long-term value of customers acquired without any discount.[4] Many of these customers were more interested in the offer than in the product itself.

To reduce the defection rate, the company must define and measure its **retention rate**. For a magazine, a good measure of retention is its subscription renewal rate. Next, the company must identify the actionable causes of customer defection. For example, poor service, shoddy products, and high prices can all be addressed by the company, whereas issues such as customers moving out of the geographic area served by the company cannot be addressed. Finally, a company must compare the lost customer's lifetime value to the costs of reducing the defection rate. As long as the cost to discourage defection is lower than the lost profit potential, a company should spend the money to try to retain the customer.

Service outcome and customer loyalty are influenced by a host of variables. One study identified more than 800 critical factors that cause customers to switch services.[5] Among the key factors are pricing issues (high price, price increases, unfair pricing, deceptive pricing); convenience issues (location/hours, wait time for appointment and service); core service failure (service mistakes, billing errors, service catastrophes); service encounter failures (uncaring, impolite, unresponsive, unknowledgeable); response to service failure (negative response, no response, reluctant response); competition (found better service); ethical problems (cheat, hard sell, unsafe, conflict of interest); involuntary switching (customer moved, provider closed).

Regardless of how hard companies may try, some customers inevitably become inactive or drop out. The challenge is to reactivate them through win-back strategies.[6] It's often easier to reattract ex-customers (because the company knows their names and histories) than to find new ones. Exit interviews and lost-customer surveys can uncover sources of dissatisfaction and help win back only those with strong profit potential.[7]

Managing Customer Satisfaction and Loyalty

Loyalty has been defined as "a deeply held commitment to rebuy or repatronize a preferred product or service in the future despite situational influences and marketing efforts having the potential to cause switching behavior."[8] Customer loyalty can be thought of as a continuum, with different levels of loyalty varying in strength. Loyalty can range from satisfaction with the company's offering to advocacy and evangelism from customers who think of the offering as a part of their own identify and feel responsible for its success.

Wegmans When drama teacher Maura Morrison and her students at Algonquin Regional High School in Northborough, Massachusetts, put on *The Musical* in homage to Wegmans, it featured uniforms donated by the local store and the chain's eclectic decorations such as Casanova, an animatronic rooster that crows every hour. No other U.S. grocery chain evokes the dedicated fervor of Wegmaniacs, its self-named superfans. Morrison recalls her neighbor becoming tearful when learning a Wegmans was coming to town. "I found out she almost didn't move here because there wasn't a Wegmans . . . people are connected to this store almost spiritually." Nearly 25,000 people came to the 2011 opening of the Wegmans in Northborough, whose population barely exceeded 14,000. Such opening-day mania is par for the course. In 2015 alone, more than

4,000 people requested that Wegmans build a store near them. Wegmans has succeeded at transforming a boring task into a social happening. Each location is laid out to feel like a European open-air market, replacing the grocery store vibe with mini-shops staffed by dedicated experts and customer service that has been described as "telepathic." Stores regularly host music events, culinary demos, and tastings with local farmers. Customers love the model trains that whirr and whistle around each store. As it grew, Wegmans invested millions to build kitchens and hire professional chefs for all locations, enabling its patron-attracting in-store cafeterias to rival restaurant fare. Wegmans strategically targets a wide range of customers from students to families, building lifelong loyalty that has propelled an entity that sprang from a produce pushcart started by brothers John and Walter Wegman in 1921 into a $7.9 billion business.[9]

Customer satisfaction is the key to building customer loyalty. Without fulfilling customer needs, a company would find it challenging to create a loyal customer base. The essence of customer satisfaction, the role of product and service quality as a driver of customer satisfaction, and the different approaches to measuring customer satisfaction are discussed in the following sections.

UNDERSTANDING CUSTOMER SATISFACTION

Satisfaction is a person's feelings of pleasure or disappointment that result from comparing the perceived performance (or outcome) of a product or service with expectations.[10] If the performance or experience falls short of expectations, the customer is dissatisfied. If it matches expectations, the customer is satisfied. If it exceeds expectations, the customer is highly satisfied or delighted.

Customer assessments of product or service performance depend on many factors, including the type of loyalty relationship the customer has with the brand.[11] Consumers often form more favorable perceptions of a product with a brand they already feel positive about. Research has also shown an asymmetric effect of product performance and expectations on satisfaction: The negative effect on customer satisfaction produced by failure to meet expectations is disproportionately stronger than the positive effect of exceeding expectations.[12]

Although the customer-centered firm seeks to create high customer satisfaction, that is often not its ultimate goal. Increasing customer satisfaction by lowering price or increasing services may result in lower profits. Alternatively, a company might be able to increase its profitability by means other than increased satisfaction (for example, by improving the efficiency of the manufacturing processes). Furthermore, because a company typically has many stakeholders—including employees, dealers, suppliers, and stockholders—spending more to increase customer satisfaction might divert funds from increasing the satisfaction of these stakeholders. Ultimately, the company must try to deliver a high level of customer satisfaction, while also delivering acceptable levels of satisfaction to its stakeholders, given its total resources.

How do customers form expectations? Expectations result from past buying experience, the advice of friends and associates, public information and discourse, and information and promises from marketers and competitors. If a company raises expectations too high, the buyer is likely to be disappointed. If it sets expectations too low, it won't attract enough buyers (although it will satisfy those who do buy).

Some of today's most successful companies are raising expectations and delivering performances to match. Korean automaker Kia found success in the United States by launching low-cost, high-quality cars reliable enough for Kia to offer 10-year, 100,000-mile warranties. Amazon's consistency in order fulfillment and on-time delivery has raised customer expectations of its future performance.

For customer-centric companies, customer satisfaction is both a goal and a marketing tool. Companies need to be especially concerned with their customer satisfaction level today, because the internet allows consumers to quickly spread both good and bad word of mouth to the rest of the world. Some customers set up their own websites to air grievances and galvanize protests, targeting high-profile brands such as United Airlines, Walmart, Home Depot, and Mercedes-Benz.[13]

PRODUCT AND SERVICE QUALITY AS A DRIVER OF CUSTOMER SATISFACTION

Satisfaction will also depend on product and service quality. **Quality** is often described as "fitness for use," "conformance to requirements," and "freedom from variation." A popular definition describes quality as the totality of features and characteristics of a product or service that bear on its ability to satisfy stated or implied needs.[14] This is clearly a customer-centered definition. We can say the seller has delivered quality whenever its product or service meets or exceeds customers' expectations.

A company that satisfies most of its customers' needs most of the time is called a high-quality company, but we need to distinguish between *performance* and *consistency*. Performance reflects the overall functionality of a company's products and services. Consistency, on the other hand, reflects the degree to which a company's performance remains at the same level over time. A Lexus automobile provides higher performance than a Hyundai: The Lexus rides more smoothly, accelerates faster, and runs problem-free longer. Yet both Lexus and Hyundai deliver consistency if all the units deliver their promised quality.

Product and service quality, customer satisfaction, and company profitability are intimately connected. Higher levels of quality result in higher levels of customer satisfaction, which, in turn, support higher prices. Studies have shown a high correlation between relative product quality and company profitability.[15] The drive to produce goods that are superior in world markets has led some countries to recognize or award prizes to companies that exemplify the best quality practices, such as the Deming Prize in Japan, the Malcolm Baldrige National Quality Award in the United States, and the European Quality Award.

Some companies are tempted to increase short-run profits by lowering costs and cutting corners. This may boost profits in the short run, but if quality declines as a result of these measures, customer experience and longer-term profits will suffer. Home Depot ran into trouble when it became overly focused on cost cutting.

Home Depot When Home Depot decided to expand into the contractor supply business, while also cutting costs and streamlining operations in its 1,800+ U.S. stores, it replaced many full-time workers with part-timers who soon made up about 40 percent of store staff. The chain's customer satisfaction rating dropped to the bottom among major U.S. retailers (11 points behind customer-friendly competitor Lowe's), and its share price slid 24 percent during the biggest home improvement boom in U.S. history. To turn the company around, new management set three main goals that all employees should strive to achieve—cleaner warehouses, stocked shelves, and top customer service. During new "power hours," on weekdays from 10 AM to 2 PM and all day Saturday and Sunday, employees were to do nothing but serve customers. To make sure the new strategy stuck, performance reviews were changed so that store employees were evaluated almost entirely on customer service. These and other customer-service initiatives increased store labor hours dedicated to customer interaction from 40 percent to 53 percent. Improved customer service, along with new product-assortment practices and centralized distribution centers, helped Home Depot reestablish its market leadership and distance itself from Lowe's.[16]

Source: REUTERS/Alamy Stock Photo

<< Home Depot reclaimed its market leadership position by focusing on policies geared to improving sagging customer service ratings throughout its network of stores.

Total quality is everyone's job, just as marketing is everyone's job. Nevertheless, marketing plays an especially important role in helping companies identify and deliver high-quality goods and services to target customers. How do marketers help? They correctly identify customer needs and requirements. They communicate customer expectations properly to product designers. They make sure customer orders are filled correctly and on time. They check that customers have received proper instructions, training, and technical assistance in the use of the product. They stay in touch with customers after the sale to ensure that they are, and remain, satisfied. They gather customer ideas for product and service improvements and convey them to the appropriate departments. When marketers do all this, they make substantial contributions to total quality management and customer satisfaction, as well as to customer and company profitability.

MEASURING CUSTOMER SATISFACTION

Many companies systematically measure how well they treat customers, identify the factors shaping satisfaction, and change operations and marketing as a result.[17]

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

The company needs to recognize, however, that customers define good performance differently. Good delivery could mean early delivery, on-time delivery, or order completeness, and two customers can report being "highly satisfied" for different reasons. One may be easily satisfied most of the time, and the other might be hard to please but was pleased on this occasion. It is also important to know how satisfied customers are with competitors in order to assess "share of wallet" or how much of the customer's spending the company's brand enjoys: The more highly the consumer ranks the company's brand in terms of satisfaction and loyalty, the more the customer is likely to spend on the brand.[18]

Periodic surveys can track customers' overall satisfaction directly and ask additional questions to measure repurchase intention, likelihood or willingness to recommend the company and brand to others, and specific attribute or benefit perceptions likely to be related to customer satisfaction.

Companies that do achieve high customer satisfaction ratings make sure their target market knows it. Once they achieved number-one status in their category on J. D. Power's customer satisfaction ratings, General Motors, Hyundai, American Express, and Alaska Airways (among others) communicated that fact.

Companies need to monitor their competitors' performance too. They can monitor their *customer loss rate* and contact those who have stopped buying or who have switched to another supplier to find out why. Companies can also hire *mystery shoppers* to pose as potential buyers and report on strong and weak points experienced in buying the company's and competitors' products.

Managers themselves can enter company and competitor sales situations where they are unknown and experience firsthand the treatment they receive, or they can phone their own company with questions and complaints to see how employees handle the calls. For example, IKEA's founder Ingvar Kamprad made frequent incognito visits to his own stores to ensure consistency of operations and superior service delivery.

The University of Michigan has developed the American Customer Satisfaction Index (ACSI) to measure consumers' perceived satisfaction with different firms, industries, economic sectors, and national economies.[19] Research has shown a strong and consistent association between customer satisfaction, as measured by ACSI, and a firm's financial performance in terms of ROI, sales, long-term firm value, and other metrics.[20] "Marketing Insight: Net Promoter Score and Customer Satisfaction" explains why some companies believe just one well-designed question is all that is necessary to assess customer satisfaction.[21]

BUILDING CUSTOMER LOYALTY

It is not enough to attract new customers; the company must also keep them and increase their business. Too many companies suffer from high customer defection. Yet many still focus the majority of their promotional efforts on acquiring new customers rather than on trying to retain existing ones, despite the high costs associated with the need to constantly counteract customer churn. Prioritizing customer retention by building customer loyalty is by far the more effective approach to long-term profitability than trying to acquire customers who are likely to leave the company as soon as they catch sight of a better deal.

Three of the most effective strategies for building customer loyalty include interacting closely with customers, developing loyalty programs, and building brand communities. These strategies are discussed next.

Interact Closely with Customers. Connecting customers, clients, patients, and others directly with company employees can be highly motivating and informative for the company employees. End users can offer tangible proof of the positive impact of the company's products and services, express appreciation for employee contributions, and elicit empathy. A brief visit from a student who had received a scholarship motivated university fundraisers to increase their weekly productivity by 400 percent; a patient's photograph inspired radiologists to improve the accuracy of their diagnostic findings by 46 percent.[22]

In addition to informing and motivating company employees, maintaining close relationships and interacting with customers often benefit these customers. Interacting with the company helps keep customers engaged with the company's products, services, and brands, which, in turn, helps create customers who are loyal to the company. Customers who believe that the company is listening to their concerns and is trying to fulfill their needs are more likely to stay loyal and are less likely to switch to a competitor offering a better deal.

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

> Deere & Company, which makes John Deere tractors and has a superb record of customer loyalty—nearly 98 percent annual retention in some product areas—has used retired employees to interview defectors and customers.[23]
>
> Chicken of the Sea has 80,000 members in its Mermaid Club, a core-customer group that receives special offers, health tips and articles, new-product updates, and an informative e-newsletter. In return, club members provide valuable feedback on what the company is doing and thinking of doing. Their input has helped design the brand's website, develop messages for TV advertising, and craft the packaging.
>
> Build-A-Bear Workshop uses a "Cub Advisory Board" for feedback and input to decisions. The board is made up of twenty 5- to 16-year-olds who review new-product ideas and give a "paws up or down" verdict. Many products in the stores are customer ideas.[24]

But listening is only part of the story. It is also important to be a customer advocate and, as much as possible, to take the customers' side, understand their point of view, and, when appropriate, modify the company's offering to create greater customer value.

Develop Loyalty Programs. Loyalty programs are a type of promotional incentive designed by companies to encourage customers to continue to patronize their business and, in some case, to increase the frequency and quantity of the products and services they purchase from the company. Loyalty programs are designed to reward customers who buy frequently and in substantial amounts. They can help build long-term loyalty with high-value customers, creating cross-selling opportunities in the process. Pioneered by airlines, hotels, and credit card companies, loyalty programs now exist in many other industries. Most supermarket and drug store chains offer price club cards that grant discounts on certain items.

Typically, the first company to introduce a loyalty program in an industry gains the most benefit, especially if competitors are slow to respond. After competitors react, loyalty programs can become a financial burden to all the offering companies, but some companies are more efficient and creative in managing them. Some loyalty programs generate rewards in a way that locks customers in and creates significant switching costs. Loyalty programs can also produce a psychological boost and a feeling of being special and elite that customers value.[25] Designer Shoe Warehouse is one firm that recognized the need to keep customers engaged in its loyalty reward program.

> **Designer Shoe Warehouse (DSW)** Although the long-time loyalty program at DSW was running seamlessly, the shoe retailer realized the inherent danger of complacency. The online program gives customers points for each purchase and opens up levels of rewards to customers

>> To keep its long-time loyalty program fresh in the minds of customers, DSW initiated a personalized email campaign to inform customers of current deals and motivate them to earn future rewards.

Source: JHVEPhoto/Shutterstock

as they spend more. The problem with automatic rewards is that customers can easily forget about the program, which then instills no incentive to spend more and earn more points. As a way to keep its customers engaged and motivated, DSW inaugurated an active e-mail campaign to send regular reminders to customers about its loyalty reward program. Highly personalized e-mails inform customers about current deals, the number of points needed to earn a certificate for $10 off on a future purchase, the length of time they've been enrolled in the loyalty program, the number of points earned, and the amount they've saved during the past two years. Leveraging its trove of customer data enables DSW to create deeply personal e-mails that enhance the relevancy of its ongoing communication efforts and keep DSW and its loyalty program fresh in customers' minds.[26]

Club memberships, a popular form of loyalty program, aim to attract and keep those customers responsible for the largest portion of a company's business. Clubs can be open to everyone who purchases a product or service or can be limited to an affinity group or those willing to pay a small fee. Although open clubs are good for building a database or snagging customers from competitors, limited membership is often a more powerful long-term loyalty builder. Fees and membership conditions discourage those with only a fleeting interest in a company's products from joining. For example, to build loyalty, American Express offers its global Platinum Card members complimentary access to the network of The Centurion Lounges in major airports around the world.

Build Brand Communities. A **brand community** is a specialized community of consumers and employees whose identification and activities center revolve around the brand.[27] Three characteristics identify brand communities. First, they share a sense of connection to the brand, company, product, or other community members. Second, they share rituals, stories, and traditions that help convey the meaning of the community. Finally, they share a moral responsibility or duty both to the community as a whole and to individual community members.

Brand communities come in many different forms. Some arise organically from brand users, such as the Lugnet (LEGO) and Porsche Rennlist online discussion groups. Others are company sponsored and facilitated, such as SAP Community Network, My Starbucks Idea, Sephora Beauty Talk, Microsoft Xbox Ambassadors, and the Harley Owners Group (H.O.G.).

Harley-Davidson Founded in 1903 in Milwaukee, Wisconsin, Harley-Davidson has twice narrowly escaped bankruptcy to become one of the most widely recognized motor vehicle brands in the world. Harley keeps in touch with its customers by developing a strong brand community in the form of an inclusive owners' club, called the Harley Owners Group (H.O.G.). The group sponsors bike rallies, charity rides, and other motorcycle events and now numbers more than a million members in some 1,400 chapters. H.O.G. benefits include a magazine called *Hog Tales*, a touring handbook, emergency road service, a specially designed insurance program, theft reward service, discount hotel rates, and a Fly & Ride program enabling members to rent Harleys on vacation. The company also maintains an extensive website devoted to H.O.G., with information about club chapters and events and a special members-only section. Harley is also active with social media and boasts over 7.8 million Facebook fans. One fan inspired a digital video and Twitter campaign dubbed E Pluribus Unum—"Out of Many, One"—where Harley riders from all walks of life show their diversity and their pride in their bikes.[28]

Companies large and small can build brand communities. When New York's Signature Theatre Company built a new 70,000-square-foot facility for its shows, it made sure there was a central hub where casts, crews, playwrights, and audiences for all productions could mingle and interact.[29] Online, marketers can tap into social media networks such as Facebook, Twitter, Instagram, YouTube, and WeChat or create their own online community. Members can recommend products, share reviews, create lists of recommendations and favorites, or socialize together online.

A brand community can be a constant source of inspiration and feedback for product improvements or innovations. The activities and advocacy of brand community members can also substitute to some degree for activities the firm would otherwise have to engage in, creating greater marketing effectiveness and efficiency as a result.[30]

Building a positive, productive brand community requires careful thought and implementation. One set of researchers offers the following recommendations for making online brand communities more effective.[31]

- *Enhance the timeliness of information exchanged.* Set appointed times for topic discussion; give rewards for timely, helpful responses; increase access points to the community.
- *Enhance the relevance of information posted.* Keep the focus on topic; divide the forum into categories; encourage users to preselect interests.
- *Extend the conversation.* Make it easier for users to express themselves; don't set limits on the length of responses; allow user evaluation of the relevance of posts.
- *Increase the frequency of information exchanged.* Launch contests; use familiar social networking tools; create special opportunities for visitors; acknowledge helpful members.

Managing Customer Relationships

Companies are using information about customers to build long-term relationships.[32] **Customer relationship management (CRM)** is the process of carefully managing detailed information about individual customers and all customer touch points to maximize loyalty. Managing customer relationships is important because a major driver of company profitability is the aggregate value of the company's customer base. A related concept, customer value management, describes the company's optimization of the value of its customer base. **Customer value management** focuses on the analysis of individual data on prospects and customers to develop marketing strategies to acquire and retain customers and drive customer behavior.[33] Consider the experience of Dunnhumby.

Dunnhumby British customer data science company Dunnhumby (formed by husband and wife team Edwina Dunn and Clive Humby) has increased the profitability of retailers and other firms by gleaning insights from their loyalty program data and credit card transactions. The firm has helped British supermarket giant Tesco manage different aspects of its business: creating new shop formats, arranging store layouts, developing private-label products, and tailoring coupons and special discounts to its loyalty card shoppers. Tesco decided against dropping a poor-selling type of bread after Dunnhumby's analysis revealed it was a "destination product" for a loyal cohort that would shop elsewhere if it disappeared. Based on data from over 350 million people across the globe, Dunnhumby's insights have contributed to decisions about product range, availability, space planning, and new-product innovations. For a major European catalog company, Dunnhumby found that shoppers with different body types not only prefer different clothing styles, but also shop at different times of the year: Slimmer consumers tended to buy early in a new season, whereas larger folks tended to take fewer risks and wait until later in the season to see which styles proved popular.[34]

Customer relationship management enables companies to provide excellent real-time customer service through the effective use of individual account information. Based on what they know about each valued customer, they can customize market offerings, services, programs, messages, and media.

Popular strategies for enhancing customer relationship management include customization, customer empowerment, managing customer word of mouth, and dealing with customer complaints. We discuss these strategies in the following sections.

CUSTOMIZATION

Customization can encompass adapting the actual physical product and modifying the service experience. Customization involves making the company's offering as personally relevant as possible to as many customers as possible—a challenge, given that no two customers are identical. Customization calls on marketers to abandon the mass market practices that built brand powerhouses in the 20th century for new approaches that are a throwback to marketing practices from a century ago, when merchants literally knew their customers by name and designed unique products for each of them.

To customize the consumer experience, companies are using call centers, along with online, digital, and mobile tools complemented by artificial intelligence and data analytics to foster continuous contact between company and customer. Although technology can help with customer relationship management, firms have to be careful not to roll out too many automated-response phone systems or social-networking tools as ways to satisfy customer service requests. Many customers still prefer to talk to a live representative to receive more personal service—an ongoing priority in building lasting customer relationships.

Companies are recognizing the role of the personal component in customer relationship management and its influence once customers make actual contact with the company. Employees can create strong bonds with customers by individualizing and personalizing relationships. Consider the lengths to which British Airways is going to satisfy its valued customers.

British Airways British Airways took personalization to a higher level with its "Know Me" program. One goal was to centralize information about frequent fliers from all of the company's service channels—website, call center, e-mail, on board planes, and inside airports—into a single database. For any given passenger booked on a flight, British Airways knows his or her current seating location, previous flights and meal choices, and even prior complaint history. It also distributed iPads to crew members and ground staff, allowing them to access the database as well as to receive personal recognition messages about passengers on any flight. To facilitate VIP passenger identification, British Airways uses stored photos of fliers downloaded from Google Image searches. One company representative described the program as aiming to "recreate the feeling of recognition you get in a favorite restaurant when you're welcomed there, but in our case, it will be delivered by thousands of staff to millions of customers." Although some observers raised privacy concerns—even calling it "creepy"—British Airways noted that the passenger information was already available or was viewed as helpful by its most valuable fliers.[35]

While British Airways is personalizing its service experiences, BMW is figuring out ways to personalize its products. The company offers 500 side-mirror combinations, 1,300 front-bumper combinations, and 9,000 center-console combinations and provides new buyers with a video link to watch their car being "born" while waiting for delivery. Its detailed manufacturing and procurement system

Source: Kristoffer Tripplaar/Alamy Stock Photo

<< Centralizing information about frequent fliers from all sources into a single database and giving iPads to crew members and ground staff enabled British Airways to take personalized service to new heights.

takes the slack out of the production process, reduces inventory carrying costs, and avoids rebates on slow-moving sellers. Loyal customers tend to load up with options—generating more profitability for BMW and its dealers. Even Coca-Cola is getting in on the customization action. The Coca-Cola Freestyle dispensing machine can dispense 125 sparkling and still brands that consumers can mix via a touchscreen, creating a beverage to suit their particular taste.

To develop an effective customer relationship management program, marketers must know their customers.[36] The foundation of a customer relationship management program is the customer database, an organized collection of comprehensive information about individual customers or prospects that is current, accessible, and actionable for lead generation, lead qualification, sale of a product or service, or maintenance of customer relationships. In this context, customer relationship management can be viewed as a process of building, maintaining, and using customer-related data to contact customers, transact with them, and build long-term customer relationships.

Online retailers often add their own recommendations to consumer selections or purchases: "If you like that black handbag, you'll love this red top." One source estimated that recommendation systems contribute 10 percent to 30 percent of an online retailer's sales. Specialized software tools help facilitate customer "discovery" or unplanned purchases. At the same time, online companies need to make sure their attempts to create relationships with customers don't backfire, as happens when customers are bombarded by computer-generated recommendations that consistently miss the mark. Buy a few baby gifts on Amazon.com, and your personalized recommendations suddenly don't look so personal! Online retailers need to recognize the limitations of online personalization while searching for technology and processes that really work.

To adapt to customers' increased desire for personalization, while considering that not all customers want a relationship with the company and that many have privacy concerns, marketers have embraced concepts such as permission marketing. **Permission marketing**, the practice of marketing to consumers only after gaining their expressed permission, is based on the premise that marketers can no longer use "interruption marketing" via mass media campaigns. Perhaps one of the most common formats of permission marketing are newsletters sent to readers who have chosen to subscribe and thus have granted the publisher permission to send them relevant information.

Permission marketing implies that marketers can develop stronger consumer relationships by respecting consumers' wishes and sending messages only when the consumers have expressed a willingness to become more engaged with the brand. This approach can help make a company's interactions with its customers more meaningful.[37]

Permission marketing, like other personalization approaches, presumes that consumers know what they want, even though they often have undefined, ambiguous, or conflicting preferences.

"Engagement marketing" might be a more appropriate concept than permission marketing because marketers and consumers should work together to find out how the firm can best satisfy consumers.

CUSTOMER EMPOWERMENT

In recent years customers have had an increasing opportunity to control how they interact with a company. In the past, customers were often passive consumers of marketing messages, but today they are able to choose whether and how they want to engage with company marketing. This phenomenon, called **customer empowerment**, means that companies must strengthen their relationship with customers and engage with them in new ways. Because company empowerment has been matched by customer empowerment, companies have to adjust to changes in the nature of their customer relationships. To strengthen customer relationships, marketers are helping customers become evangelists for brands by providing them with resources and opportunities to demonstrate their passion. Doritos held a contest to let consumers name its next flavor. Converse asked amateur filmmakers to submit 30-second films that demonstrated how the iconic sneaker brand inspired them. The best submissions were showcased in the Converse Gallery website, and the best of the best became TV commercials.[38]

Although new technologies help customers assist or become involved in a brand's marketing, they can also help them avoid marketing. For example, many web browsers feature ad-blocking and popup-blocking software, e-mail servers offer spam filters, and mobile phones offer call-blocking options.

Although much has been made of the newly empowered consumer—in charge, setting the direction of the brand, and playing a much bigger role in how it is marketed—it's still true that only *some consumers* want to get involved with *some of the brands* they use, and even then, only *some of the time*. Consumers have lives, jobs, families, hobbies, goals, and commitments, and many things matter more to them than the brands they purchase and consume. Understanding how to best market a brand given such diversity in customer interests is crucially important.[39]

When will consumers choose to engage with a brand? Many factors can come into play, but one study revealed the following about customer pragmatism: "…most do not engage with companies via social media simply to feel connected.… To successfully exploit the potential of social media, companies need to design experiences that deliver tangible value in return for customers' time, attention, endorsement and data."[40] That "tangible value" includes discounts, coupons, and information to facilitate purchase. Many businesses overlook social media's capabilities for delivering customer value while capturing customer insights, monitoring the brand, conducting research, and soliciting new-product ideas.

MANAGING CUSTOMER WORD OF MOUTH

Although the strongest influence on consumer choice remains recommendations from friends and relatives, recommendations from other consumers are becoming an increasingly important decision factor. In an atmosphere of heightening mistrust of some companies and their advertising, online customer ratings and reviews are playing a growing role in the customer buying process.[41]

A Forrester research study, for example, found that about half of consumers won't book a hotel that does not have online reviews. Thus it's not surprising that more hotels are launching their own program to post reviews (Starwood places independent, authenticated reviews on individual hotel sites) or are using travel review sites (Wyndham streams its five most recent reviews from TripAdvisor on its site, leading to a 30 percent increase in bookings).[42] TripAdvisor has quickly become a valuable online resource for travelers.

TripAdvisor After being frustrated by the lack of detailed, reliable, and up-to-date information available to help him decide where to go on a Mexican holiday, Stephen Kaufer founded TripAdvisor in 2001. The pioneer in online consumer travel reviews, the company grew quickly and is now the world's largest travel website. It allows users to collect and share information and make bookings for a wide variety of hotels, vacation rentals, airlines, restaurants, and other travel-related locations or businesses through its hotel and air booking partners. Users can post reviews, photos, and opinions and participate in discussions on a variety of different topics. To improve the quality and accuracy of its content, TripAdvisor reviews content both manually and with advanced computer algorithms, including a verification and fraud detection system that considers the IP and e-mail address of reviewers (as well as other review attributes) and monitors suspicious patterns of postings as well as inappropriate language. TripAdvisor has more than 490 million unique visitors monthly and features over 700 million reviews. Hundreds of millions of people each month view its content on hundreds of other sites, including Hotels.com, Expedia, and Thomas Cook. TripAdvisor has innovated to improve the personalization and social nature of its services; in fact, it was one of Facebook's initial launch partners for its "Instant Personalization" project, which enables users to personalize their TripAdvisor experience by letting them see TripAdvisor content posted by their Facebook friends, subject to the friends' privacy elections. Local Picks is a Facebook app that allows users to localize TripAdvisor restaurant reviews and auto-share user reviews on Facebook.[43]

Brick-and-mortar retailers such as Best Buy, Staples, and Bass Pro Shops recognize the power of consumer reviews and have begun to display them in their stores. Despite consumer acceptance of such reviews, however, their quality and integrity can be in question.[44] In one famous example, over a period of seven years, the cofounder and CEO of Whole Foods Market posted more than 1,100 entries on Yahoo! Finance's online bulletin board under a pseudonym, praising his company and criticizing competitors. Some companies offer computer-recognition technology to monitor for fraud. Bazaarvoice helps companies such as Walmart and Best Buy manage and monitor online reviews using a process called device fingerprinting. The company caught one firm posting hundreds of positive reviews of one of its products and negative reviews of its competitor's products.[45]

Online reviews and blogging sites have struggled to police comments. To avoid attracting anonymous or biased reviews, Angie's List allowed only paid and registered subscribers to access its website. Users rate providers on price, quality, responsiveness, punctuality, and professionalism, using a report card–style scale of A to F. Other sites offer summaries of professional third-party reviews. Metacritic aggregates music, game, TV, and movie reviews from leading critics from multiple publications and combines them into a single 1-to-100 score. In the gaming industry, some game companies tie bonuses for their developers to game scores on the more popular sites. If a major new release doesn't make the 85-plus cutoff based on user reviews, the publisher's stock price may even drop.[46]

Marketers may benefit from tracking social media traffic to identify popular blogs. Bloggers who review products or services are influential because they may have thousands of followers; blogs are often among the top links returned in online searches for certain brands or categories. Firms also court the favor of key bloggers via free samples and advance information. Many bloggers disclose this special treatment from the companies they write about.

For smaller brands with limited media budgets, online word of mouth is critical. To generate prelaunch buzz for one of its new hot cereals, organic food maker Amy's Kitchen shipped out samples before its release to several of the 50 or so vegan, gluten-free, or vegetarian food bloggers that the company tracks. When favorable reviews appeared on these blogs, the company was besieged by e-mails asking where to buy the cereal.[47]

As it turns out, even negative reviews can sometimes be surprisingly impactful. For one thing, although they can hurt a well-known brand, they can create awareness about an unknown or overlooked one. They can also provide valued information. A Forrester study of 10,000 consumers of Amazon.com's electronics and home and garden products found that 50 percent found negative reviews helpful. When consumers can better learn the advantages and disadvantages of products through negative reviews, fewer product returns may result, saving retailers and producers money.[48]

DEALING WITH CUSTOMER COMPLAINTS

Some companies think they're getting a sense of customer satisfaction by tallying complaints, but studies show that even though customers are dissatisfied with their purchases about 25 percent of the time, only about 5 percent of dissatisfied customers complain. The other 95 percent either feel complaining is not worth the effort or don't know how or to whom to complain. They just stop buying.[49]

Of the customers who register a complaint, 50 percent to 70 percent might do business with the organization again if their complaint is resolved. The figure goes up to a staggering 95 percent if the customer feels the complaint was resolved *quickly*. Customers whose complaints are satisfactorily resolved tell an average of five people about the good treatment they received. The average dissatisfied customer, however, gripes to 11 people! Each person who is told about a negative experience will tell other people, so the number exposed to bad word of mouth may grow exponentially.

No matter how perfectly designed and implemented a marketing program is, mistakes will happen. The best thing a company can do—other than minimizing the chance of mistakes occurring in the first place—is make it easy for customers to complain. Suggestion forms, toll-free numbers, websites, apps, and e-mail addresses allow for quick, two-way communication. Enabling customers to provide feedback can not only help address their complaints; it can also help the company improve its products and services. The 3M Company claims that more than two-thirds of its product-improvement ideas come from listening to customer complaints.

Given that many customers may choose not to complain, companies should proactively monitor social media and other places where customer complaints and feedback may be aired. Along with its other responsibilities, Jet Blue's customer service team is charged with monitoring the airline's social media presence, including its Twitter account and Facebook page. When a customer's complaint about a fee for bringing a folded bike on board began to circulate online, Jet Blue quickly responded and decided this was not a service it should charge for.[50]

Given the potential downside of having an unhappy customer, it's critical that marketers deal with negative experiences properly and promptly. Although challenging, the following practices can help to recover customer goodwill.[51]

- Set up a seven-day, 24-hour toll-free hotline (by e-mail, online chat, phone, or fax) to make it easier for the customer to register complaints and for the company to act on them.
- Contact the complaining customer as quickly as possible. The slower the company is to respond, the more dissatisfaction may grow and lead to negative word of mouth.
- Identify the true source of customer dissatisfaction before seeking a solution. Some complaining customers are not looking for compensation so much as for a sign that the company cares.
- Accept responsibility for the customer's disappointment; do not shift the blame onto the customer.
- Resolve the complaint swiftly and to the customer's satisfaction, while taking into account the costs of resolving the complaint and the lifetime value of the customer.

Not all complaints, however, reflect actual deficiencies or problems with a company's product or service.[52] Big companies especially are targets for opportunistic customers who attempt to capitalize on even minor transgressions or generous compensation policies. Some firms fight back and even take an aggressive stance if they feel a criticism or complaint is unjustified. Others seek ways to find a silver lining in customer complaints and use them to improve the company's image and performance.

When Taco Bell began to attract negative buzz online, after rumors and a consumer lawsuit alleged that its taco mixture consisted of more filler than meat, it leaped into action with full-page newspaper ads headlined, "Thank you for suing us." In these ads, as well as in Facebook postings and a YouTube video, the company pointed out that its taco mixture was 88 percent beef, with ingredients such as water, oats, spices, and cocoa powder added only for flavor, texture, and moisture. To help spread the word, Taco Bell marketers bought the key words "taco," "bell," and "lawsuit" so that the company's official responses appeared as the first link on Google and the other search engines.[53]

Of course, a company can rarely achieve a zero level of complaints; there are always likely to be customers whose expectations surpass the benefits of a company's offerings. Instead, a company's goal

>> Taco Bell aggressively defends the quality of its products via social media.

Source: KENNELL KRISTA/SIPA/Newscom

is likely to be balancing customer satisfaction with the company's strategic and monetary goals, so that the company can create value for both its customers and its stakeholders.

Many senior executives worry about their firms using social media and the potential negative effects of cranky customers communicating online. Marketers, however, contend that the positives stemming from using social media outweigh the negatives and that steps can be taken to minimize the likelihood of such damage. One strategy for companies active in corporate social responsibility is to actively shape their public image during quiet times and then leverage that goodwill in paid or other media during difficult times. Nike was once a target of internet-savvy critics who skillfully used search engine optimization to populate unflattering portraits of the company. Now, searches for Nike yield links to sites that describe its many environmental and community initiatives (such as shoe recycling).

Managing Customer Lifetime Value

Marketing is often viewed as the art of attracting and keeping profitable customers. Yet every company loses money on some of its customers. The well-known 80/20 rule suggests that 80 percent or more of the company's profits come from the top 20 percent of its customers. Some cases may be more extreme: The most profitable 20 percent of customers (on a per capita basis) may account for over 100 percent of the company's profits. The least profitable 10 to 20 percent, on the other hand, can actually reduce profits, and the company breaks even with the middle 60 to 70 percent.[54] The implication is that a company could improve its profits by "firing" its worst customers.

Companies need to concern themselves with how efficiently they create value from the customers and prospects available. It's not always the company's largest customers who demand considerable service and deep discounts or who yield the most profit. The smallest customers pay full price and receive minimal service, but the costs of transacting with them can reduce their profitability. Midsize customers who receive good service and pay nearly full price are often the most profitable.

THE CONCEPT OF CUSTOMER LIFETIME VALUE

A key driver of shareholder value is the aggregate value of the customer base. The aim of customer relationship management is to produce high customer lifetime value.[55] **Customer lifetime value (CLV)** reflects the monetary equivalent of the value that customers will create for the company during their tenure with the company. CLV can refer to the value created by an individual customer, or it can refer to the cumulative value created by all of the company's customers—"the sum of lifetime values of all customers."[56] Customer lifetime value is also referred to as **customer equity**.

Customer lifetime value is affected by the revenue and the costs of customer acquisition, retention, and cross-selling. A profitable customer is a person, household, or company that, over time, yields a revenue stream exceeding by an acceptable amount the company's cost stream for attracting, selling, and serving that customer. Note that the emphasis is on the *lifetime* stream of revenue and cost. Indeed, from a company's perspective, what matters is the value that it receives over the course of all of its customer interactions, not on a particular transaction. Marketers can assess lifetime customer value individually, by market segment, or by channel.

To effectively manage its customer relationships, a company must be able to measure the value that each of its customers is likely to bring to the company over the course of that customer's tenure with the company. Yet, although many companies measure customer satisfaction, few measure individual customer profitability. Banks claim this is a difficult task because each customer uses different banking services, and the transactions are logged in different departments. However, the number of unprofitable customers in their customer database has appalled banks that have succeeded in linking customer transactions. Some report losing money on more than 45 percent of their retail customers.

Customer profitability analysis is often conducted with the tools of an accounting technique called activity-based costing. **Activity-based costing** aims to identify the real costs associated with serving each customer—the costs of products and services based on the resources they consume. The company estimates all revenue coming from the customer, less all costs. With activity-based costing, the costs in a business-to-business setting should include the cost not only of making and distributing the products and services but also of taking phone calls from the customer, traveling to visit the customer, paying for entertainment and gifts—all the company resources that go into serving that customer. Activity-based costing also allocates indirect costs such as clerical costs, office expenses, and supplies to the activities that use them, rather than as a proportion of direct costs. Both variable and overhead costs are tagged back to each customer.

Companies that fail to measure their costs correctly are also fail to measuring their profit correctly and, therefore, are likely to misallocate their marketing effort. The key to effectively employing activity-based costing is to define and judge "activities" properly. One time-based solution calculates the cost of one minute of overhead and then decides how much of this cost each activity uses.[57]

CUSTOMER LIFETIME VALUE AND BRAND EQUITY

The customer lifetime value (customer equity) perspective and the brand equity perspective certainly share many common themes. Both emphasize the importance of customer loyalty and the notion that we create value by having as many customers as possible pay as high a price as possible.

In practice, however, the two perspectives emphasize different things. The customer equity perspective focuses on bottom-line financial value. The main benefit of customer equity is that it yields quantifiable measures of financial performance. At the same time, it does not fully account for some of the important advantages of creating a strong brand, such as the ability to attract higher-quality employees, elicit stronger support from channel and supply chain partners, and create growth opportunities through line and category extensions and licensing. The customer equity approach can benefit from more explicitly considering the "option value" of brands and their potential to affect future revenues and costs.

The brand equity perspective, on the other hand, tends to emphasize strategic issues in managing brands and creating and leveraging brand awareness and image with customers. It provides much practical guidance for specific marketing activities. However, managers who focus on brands do not always develop detailed customer analyses in terms of the brand equity they achieve or the resulting long-term profitability they create. Brand equity approaches could benefit from the sharper segmentation schemes afforded by customer-level analyses and from more consideration of how to develop personalized, customized marketing programs—whether for individuals or for organizations such as retailers. There are generally fewer financial considerations put into play with brand equity than with customer equity.

Researchers have argued that a focus on either brand equity or customer equity depends on the way a company creates market value. In general, product-centric companies (such as like Procter & Gamble, Coca-Cola, and PepsiCo) tend to focus on brand equity as a major source of value and a key asset for future growth. In contrast, service-centric companies (such as banks, airlines, credit card companies, and cable and internet providers) tend to focus on customer equity as a key asset and performance measure. Specifically, the distinction between focusing on brand or customer equity has been attributed to the following factors:

- Firms that utilize subscription models—such as health clubs, mobile operators, and movie streaming companies—are more likely to find value in customer equity; firms that do not utilize contractual services tend to focus on brand equity.
- Companies that can uniquely identify their customers and assess their profitability tend to focus on customer equity; companies that cannot establish a direct link between a customer's behavior and performance outcomes tend to focus more on brand equity.
- Companies that produce self-expressive products such as cars, apparel, and fashion accessories tend to focus on brand equity.
- Companies that cannot readily obtain customer-level data and/or do not have direct contact with their customers are more inclined to focus on brand equity.
- Service-oriented companies are more likely to focus on customer equity than are product-oriented firms.

Despite the tendency of some companies to focus on either customer equity or brand equity, both types of equity matter. There are no brands without customers and no customers without brands. Brands serve as the "bait" that retailers and other channel intermediaries use to attract customers from whom they extract value. Customers are the tangible profit engine for brands to monetize their brand value.[58]

BUILDING CUSTOMER LIFETIME VALUE

Customer profitability analysis and the customer acquisition funnel help marketers decide how to manage groups of customers who vary in loyalty, profitability, risk, and other factors.[59] Winning companies improve that value by excelling at strategies like the following:

- ***Improving customer service.*** Selecting and training employees to be knowledgeable and friendly increases the likelihood that customers' shopping questions will be answered satisfactorily. Whole Foods woos customers with a commitment to provide fresh, high-quality food and deliver a superior service experience.
- ***Engaging customers.*** The more engaged with the company, the more likely a customer is to stick around. A large percentage of new Honda purchases replace an older Honda. Drivers cited Honda's reputation for creating safe vehicles with high resale value. Seeking consumer advice can be an effective way to engage consumers with a brand and company.
- ***Enhancing the growth potential of each customer.*** Sales from existing customers can be increased with new offerings and opportunities. Harley-Davidson sells more than motorcycles and accessories like gloves, leather jackets, helmets, and sunglasses. Its dealerships sell more than 3,000 items of clothing, and some even have fitting rooms. Licensed goods sold by others range from the predictable (shot glasses, cue balls, and Zippo cigarette lighters) to the more surprising (cologne, dolls, and cell phones). Cross-selling isn't profitable if the targeted customer requires a lot of services for each product, generates a lot of product returns, cherry-picks promotions, or limits total spending across all products.[60]
- ***Managing unprofitable customers.*** Marketers can encourage unprofitable customers to buy more or in larger quantities, forgo certain features or services, or pay higher amounts or fees. Banks, phone companies, and travel agencies all now charge for once-free services to ensure minimum revenue levels from these customers. Firms can also discourage those with questionable profitability prospects. Progressive Insurance screens customers and diverts the potentially unprofitable ones to competitors. However, "free" customers who pay little or nothing and are subsidized by paying customers—as in print and online media, employment and dating services, and shopping malls—may still create useful direct and indirect network effects, an important function.[61]
- ***Rewarding the most profitable customers.*** The most profitable customers can be treated in a special way. Thoughtful gestures such as birthday greetings, small gifts, or invitations to special sports or arts events can send them a strong positive signal. Hotels, airlines, credit card companies, and rental car agencies typically offer superior service to their best customers to ensure their loyalty, while at the same time maximizing their profitability.

A company should aim to build customer value across all of its customer touch points. A **customer touch point** is any occasion when a customer encounters the brand and product—from actual experience to personal or mass communications to casual observation. For a hotel, the touch points include reservations, check-in and checkout, frequent-stay programs, room service, business services, exercise facilities, laundry service, restaurants, and bars. The Four Seasons relies on personal touches, such as a staff that always addresses guests by name, high-powered employees who understand the needs of sophisticated business travelers, and at least one best-in-region facility, such as a premier restaurant or spa.

CREATING CUSTOMER LOYALTY BY BUILDING TRUST

What does it mean to trust a company or a brand? Research over the past 30 years has shown that trust is established and maintained via three important building blocks. One building block is competence. Companies and brands build *competence trust* when its managers have the skills required to do the job effectively, and when they meet or exceed expectations for those skills. Another building block is honesty. Firms build *honesty trust* by consistently telling the truth and keeping promises. A third building block is benevolence. Companies and brands build *benevolence trust* when they demonstrate genuine concern about the interests and goals of customers and employees.[62]

When customers are asked about how a particular company or brand performs with regard to the three building blocks, most companies learn that they are stronger with regard to some building blocks than with others. Facebook, for example, may be perceived as more competent than it is benevolent or honest. In contrast, a local bank may be perceived as more honest and benevolent than it is competent. It is therefore often overly simplistic to say that a company or brand is "trusted" or "distrusted," because companies are often trusted more with some things than with others. Companies and brands need to diagnose more specifically where their trust building blocks are strong or weak so they can more specifically develop strategies and tactics that will fortify trust where a building block may be weak.

Research by Kellogg School of Management expert on trust Kent Grayson suggests that a wide range of company activities can influence the extent to which customers trust a company or brand in terms of three building blocks: competency, honesty, and benevolence.[63]

- Consumers tend to judge **competence** by thinking about how what they experience with the company or brand is similar to or different from what they have experienced with relevant comparison cases. For example, customers who order room service at a three-star hotel are likely to assess their meal in relation to meals served at other three-star hotels and restaurants. If the customer asks for Dijon mustard and room service delivers regular mustard instead, the customer's trust in the hotel's competence will be more negatively affected if it is a five-star hotel than if it is a three-star hotel.
- Consumers tend to assess a brand's or company's **honesty** by comparing company statements with company actions. An airline that claims to have "no hidden fees" will become mistrusted by customers who find surprising fees on their airline ticket.
- Customers assess a brand's or company's **benevolence** based on whether they think they got a fair deal, and on whether those who work for the company have a clear understanding of customer needs and expectations. For example, many customers believe that charging customers different prices for the same product is not fair, so they mistrust companies that charge customers different prices depending on their ZIP code.

The activities that most strongly influence perceptions of the three building blocks of trust will differ, depending on factors such as the culture in which the company operates, the segment that the company is targeting, and customer perceptions of the company's brand. Companies that wish to effectively manage trust must therefore engage in customer research before deciding which activities require investment.

Research has shown that each of the three building blocks is differentially affected by positive and negative information. Competence is more strongly affected by positive information than by negative information. If a brand or company fails to deliver, and if the reason for the failure is related to competence, customers are often willing to forgive the behavior, especially if the brand has been competent in the past. In contrast, both honesty and benevolence are more strongly affected by negative information than by positive information. If a brand behaves in a way that demonstrates lack of honesty or benevolence, customers are less likely to forgive, even if the manager or brand has been honest and benevolent in the past.

Trust is more salient early in the development of a relationship and becomes less salient once a relationship has been established and is operating successfully. Once trust is established, companies and brands can benefit from the trust that employees and customers have. As long as a company or brand does not behave in a way that makes established customers question their trust, trust considerations move into the background of their consideration. This can sometimes encourage companies to exercise less care in their long-term relationships, or even to start cutting corners in ways that customers or employees will not notice. Although this can be an effective strategy in small measures, brands and companies cannot be too cavalier about trust with long-time employees and customers. The life-time value of long-term customers is often relatively high, and perceptions of trust violations in long-term relationships can sometimes have more significant negative effects than violations in shorter-term relationships.[64]

MEASURING CUSTOMER LIFETIME VALUE

Customer lifetime value is typically calculated as the net present value of the stream of future profits expected over the customer's lifetime purchases.[65] The company must subtract from its expected revenues the expected costs of attracting, selling, and servicing the account of that customer, applying the appropriate discount rate (say, between 10 and 20 percent, depending on cost of capital and risk attitudes). Lifetime value calculations for a product or service can add up to tens of thousands of dollars or even run to six figures.

Customer lifetime value calculations provide a formal quantitative framework for planning customer investment, and they help marketers adopt a long-term perspective. Researchers and practitioners have used many different approaches for modeling and estimating customer lifetime value.[66] Common factors in such models include the revenues generated from a given customer, the cost of acquiring and servicing this customer, the probability of customer repeat buying in the future, the customer's likely tenure with the company, and the discount rate (cost of capital for the firm). Marketers who use customer lifetime value concepts must also take into account the short-term, brand-building marketing activities that help increase customer loyalty.

When measuring customer lifetime value, it is important to consider not only the monetary value each customer is likely to directly generate for the company but also the strategic value this customer will create by endorsing the company and its offering to others. Indeed, a customer's value to a company depends in part on the ability and likelihood that he or she will make referrals and engage in positive word of mouth. As useful as earning positive word of mouth from a consumer can be, though, getting consumers to directly engage with the company and provide it with feedback and suggestions can lead to even greater loyalty and sales.

marketing INSIGHT

Net Promoter Score and Customer Satisfaction

Many companies make measuring customer satisfaction a top priority, but how should they go about doing it? Bain's Frederick Reichheld suggests that only one customer question really matters: "How likely is it that you would recommend this product or service to a friend or colleague?"

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

In a typical Net Promoter survey that follows Reichheld's thinking, customers are given a 1-to-10 scale on which to rate the likelihood of their recommending the company. Marketers then subtract *Detractors* (those who gave a score of 0 to 6) from *Promoters* (those who gave a 9 or 10) to arrive at the Net Promoter Score (NPS). Customers who rate the brand with a 7 or 8 are deemed *Passively Satisfied* and are not included. A typical set of NPS scores falls in range of 10 percent to 30 percent, but world-class companies can score over 50 percent.

Reichheld has picked up many believers through the years. American Express, Dell, and Microsoft have adopted the NPS metric, and some companies have even tied their managers' bonuses to NPS scores. Philips has focused on engaging Promoters as well as addressing the concerns of Detractors, developing a Reference Promoter program to get customers who are willing to recommend the brand to actually do so through taped testimonials.

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

Despite the popularity of the Net Promoter Score, remember that it is only one of many dimensions on which customer satisfaction can be measured. Because of its simplicity, NPS cannot capture the different nuances of customer satisfaction and, hence, can produce inaccurate results. A common criticism is that many different patterns of responses may lead to exactly the same NPS. For example, NPS equals 20 percent when Promoters equal 20 percent, Passives equal 80 percent, and Detractors equal 0 percent, as well as when Promoters equal 60 percent, Passives equal 0 percent, and Detractors equal 40 percent, but the managerial implications of the two patterns of responses are very different. Another common criticism is that NPS is not a useful predictor of future sales or growth, because it ignores important cost and revenue considerations.

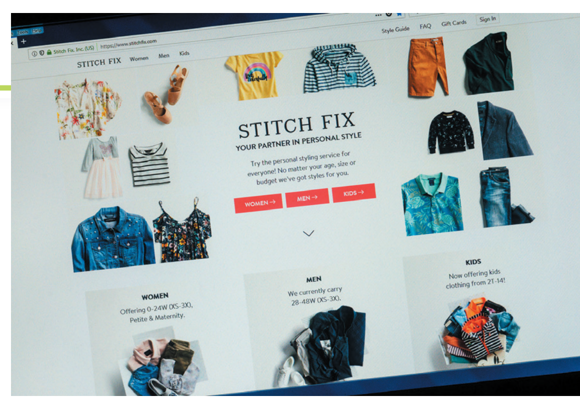
Others question the Net Promoter Score's actual research support. One comprehensive academic study of 21 firms and more than 15,000 consumers in Norway failed to find NPS superior to any other metrics, such as the ACSI (American Customer Satisfaction Index). Some have criticized both NPS and ACSI measures for not fully accounting for ex-customers or those who were never customers. Peoples' opinions about any of the single items or indices measuring customer satisfaction depend in part on how they value the trade-off between simplicity and complexity.[67]

summary

1. Customer loyalty reflects a deeply held commitment to patronize a particular product, service, or brand for future purchase and consumption occasions. Loyalty is a continuum, with different levels of loyalty varying in terms of their strength and ranging from satisfaction with the company's offering to advocacy and evangelism.
2. Customer satisfaction is the key to building customer loyalty. Satisfaction is a person's feelings of pleasure or disappointment that result from comparing the actual performance of a product or service to expectations. Recognizing that high satisfaction leads to high customer loyalty, companies must ensure that they meet or exceed customer expectations.
3. Customer satisfaction, product and service quality, and company profitability are intimately connected. Higher levels of quality result in higher levels of customer satisfaction, which support higher prices and (often) lower costs.
4. To ensure sustainable growth, a company must not only attract new customers; it must also keep them and increase their business. Losing profitable customers can dramatically affect a firm's profits. Three of the most effective strategies for building customer loyalty are interacting closely with customers, developing loyalty programs, and building brand communities.
5. Customer relationship management (CRM) is the process of carefully managing detailed information about individual customers and all customer touch points to maximize loyalty. The ultimate goal of CRM is to develop programs to attract and retain the right customers and to meet the individual needs of valued customers. Popular strategies for enhancing customer relationship management include customization, customer empowerment, customer word of mouth, and customer complaints.
6. Customer lifetime value (CLV) reflects the monetary equivalent of the value that customers will create for the company during their tenure with the company. CLV can refer to the value created by an individual customer, or it can refer to the cumulative value created by all of the company's customers—the sum of lifetime values of all customers. The aim of customer relationship management is to produce high customer lifetime value.
7. A company should aim to build customer value across all occasions on which a customer encounters its products, services, or brands—from actual experience to personal or mass communication to casual observation. Companies that fail to consistently deliver superior customer value are likely to see their customer base eroding over time.
8. Marketing managers must calculate the customer lifetime value of their customer base to understand the profit implications. Customer profitability analysis helps marketers identify their most valued customers and develop strategies to create value for these customers in a way that fosters long-term customer loyalty. When measuring customer lifetime value, it is important to take into account not only the monetary value each customer is likely to directly generate for the company but also the strategic value this customer will create by endorsing the company and its offerings to others.

marketing SPOTLIGHT

Stitch Fix



Source: sjscreens/Alamy Stock Photo

Stitch Fix is an online clothing subscription and personal styling service. The garments that customers receive are tailored by stylists based on surveys, social media habits, personal notes, and other consumer data. The concept was developed by Harvard MBA student Katrina Lake after findings of a study revealed that many consumers do not like going into stores to purchase clothes. She learned that a significant number of consumers found sorting through and trying on clothes a tedious process, even when shopping online. Lake viewed this as a significant opportunity for an accessible, personal-shopping service that would answer a great need in the clothing market.

Lake prototyped her concept in 2011 by asking friends around the Boston area to fill out style surveys. Initially, the preferences from the surveys were kept in basic spreadsheets. Then she went out to stores and picked clothes based on these preferences, dropping off boxes at her friends' homes. They would pay her for the clothes they wanted to keep, and she would return the rest. Venture capitalist Steve Anderson backed the concept, and a year later Stitch Fix leased a small office in San Francisco. Every week, employees went out and purchased clothes and shipped them from the office. The demand for these boxes, called "fixes," grew beyond what the office could handle. At one point, the company had a two-year wait list. This prompted Stitch Fix to expand, opening warehouses to manage inventory and hiring executives to streamline business operations.

As Stitch Fix grew, the company was presented with a major challenge: creating a personalized stylist for everyone. The highly idiosyncratic nature of fashion made it a tough task for the company to predict what kinds of clothing customers would want. The company was aware that fashion trends come and go in patterns that are difficult to forecast. In addition, aspects such as fit, style, and material are all qualities that customers consider when deciding whether they want to keep the clothes. If any one of these three aspects was not to the customer's liking, Stitch Fix found itself with returned inventory. In the summer of 2012, Stitch Fix made incorrect assumptions about the kinds of clothing its customers wanted that season and had to write off a large amount of inventory. Learning from this mistake, Stitch Fix began investing more heavily in their data-collection and styling algorithms.

Stitch Fix turned to algorithm expert Eric Colson, who had previously served as VP for data science and engineering at Netflix. In his new role as chief algorithms officer, Colson led his team in collecting massive amounts of data on Stitch Fix customers. The wide breadth of data gathered included body dimensions, pattern preferences, and clothes previously kept. Stitch Fix's machine learning–backed algorithms were then combined with information that required a human stylist's judgment, such as fashion trends and personal requests made by the customer.

The algorithms developed by Stitch Fix improved the success of personalized styling dramatically, which helped to manage inventory and ensure customer satisfaction. As customers shared more information with the company, Stitch Fix clothing recommendations became more and more precise, and the company's many prediction techniques kept customers subscribed for long periods of time. Sales data showed that a quarter of Stitch Fix customers kept their subscription for at least nine months. Furthermore, Stitch Fix's analytics became so sophisticated that they could predict what stage of the buying cycle the customer was in. The data showed that most customers began their Stitch Fix subscription when their closets were in need of an overhaul, so they would order multiple boxes in a short period of time; as their closets filled, customers would become more and more specific in their preferences. The combination of these two factors helped Stitch Fix adjust different levels of inventory to different types of apparel needs, ensuring that less inventory would be returned to the warehouse.

Stitch Fix's algorithms were not limited to optimizing clothing personalization; rather, they were used to improve all aspects of company operations. The company's data science team was encouraged to explore the various problems that Stitch Fix management faced and write algorithms to improve logistics, inventory procurement, and demand estimates. These algorithms help to decrease capital costs, increase inventory turnover, and speed up product delivery. One algorithm was created by tracking the movement of company warehouse employees to help optimize their routes, saving time and energy.

The machine learning that Stitch Fix employs has also helped the company release its own apparel line, Hybrid Design. Data scientists saw that many product gaps in the clothing market could be filled by combining successful "traits." For example, Stitch Fix combined the neck, pattern, and sleeves from three different articles of clothing to create a new blouse. In its first year, Hybrid Design launched over 25 different items for women to meet unfulfilled style, size, and design needs.

Much of Stitch Fix's success can be attributed to its ingrained data-driven culture, which informs the majority of its operations. The data and algorithms have helped the company manage inventory, predict future product demands, design new products, and deliver products that customers didn't know they needed. Stitch Fix even showcases an "Algorithm Tour" on its website, displaying the ways in which the company utilizes collected data. By effectively employing data analytics in its operations, Stitch Fix was able to grow retail sales to over $1.6 billion by 2019.[68]

Questions

1. How does Stitch Fix benefit from using market data to gather customer insights?
2. What role does customization play in the Stitch Fix business model? Can this business model be easily replicated by competitors?
3. What are the pros and cons of Stitch Fix using artificial intelligence and machine learning in designing market offerings?

marketing
SPOTLIGHT

Emirates

Source: Iain Masterton/Alamy Stock Photo

On October 25, 1985, Emirates Airline flew its first flights from Dubai to Karachi and Mumbai, using aircraft that were wet-leased from Pakistan International Airlines. The airline was launched on the urgent directives of Sheikh Mohammed bin Rashid al Maktoum, the then Minister of Defense of the United Arab Emirates and a member of the royal family of Dubai, to create an airline that would "look good, be good, and make money." The airline that started with two aircraft—Boeing 737 and an Airbus 300 B4—is a global aviation leader today, with a fleet size of 270 airplanes. From its hub in Dubai, Emirates flies to nearly 160 destinations in 85 countries across six continents. The airline has a diverse workforce of more than 60,000 people from 160 different nationalities who help make it a truly global company. It has developed a loyal customer base around the world thanks to its modern aircraft, award-winning services, regional and international cuisine, and comfortable travel experience.

Emirates has always maintained a strong focus on its customer by doing things differently. Its innovations have introduced many firsts for the aviation industry, and its practices, services, and offerings have become competitive benchmarks. In the late 1980s and the early 1990s, the airline essentially doubled its size every three years and continuously added new routes and destinations. In 1992, Emirates introduced a pioneering video system for inflight entertainment for seats across all cabin classes. Two years later, it became the first airline to offer telecommunications and fax services for all three classes too. To meet growing passenger and capacity demands, the facilities of the Dubai International Airport were continuously upgraded: in 1992, the airport was completely refurbished, and in 1998, it opened a new Terminal 2. In 2008, the Emirates-only Terminal 3 was opened to extend Emirates' signature travel experience beyond the aircraft and increase the value proposition to its customers. This state-of-the-art terminal provided some of the best lounges, restaurants, shopping options, and facilities available for Emirates passengers arriving in Dubai or taking connecting flights from there. To keep providing unique services and facilities, Emirates Terminal 3 built Concourse A, a dedicated facility for the Airbus A380 that offered exclusive lounges for its first- and business-class customers, including direct access to the A380 upper deck.

Emirates placed a strong focus on increasing customer satisfaction and customer-perceived value by developing services that would give its customers the best travel experiences both on the ground and in the air. Its services include lounge facilities around the world, inflight entertainment, onboard Wi-Fi, entertainment for kids, delicious meals and beverages, duty-free shopping options both on the ground and in the air, and chauffeur service for first- and business-class customers in 75 cities. ICE (Information, Communication, Entertainment), Emirates's inflight entertainment system, offers an extensive selection of entertainment that includes movies, TV shows, music and radio channels, podcasts, and video games—the ICE system has something for everyone, from kids to busy businesspeople who want to stay on top of the current market news. In 2017, Emirates set a new standard for luxury travel by introducing fully enclosed first-class private suites with new designs that offered unprecedented comfort.

Etihad Airways and Qatar Airways are two other carriers from the Gulf region that have introduced products and services to compete with Emirates, especially in the premium travel segment. Etihad's hub is in Abu Dhabi and Qatar Airways' is in Doha. Both have augmented their business- and first-class offerings to provide more value to their premium customers. Customer satisfaction in the luxury travel segment depends on how well an airline performs across several services and offerings, such as the chauffeur service, lounges, fleetwide design, cabin interiors (and design), cabin layout and seats, flatbeds, amenity kits, pajamas, duvets, food (including the number of meal services), inflight entertainment, and onboard bars. Emirates still has the edge across these dimensions, and customers continue to patronize the airline for its superior service.

The airline also places a lot of importance on its customer relationship management. Emirates has a highly successful loyalty program called Emirates Skywards, which has more than 23 million members. Frequent Emirates customers can spend the Skywards Miles they have earned by booking future flights, getting upgrades on their flights, booking hotel accommodation, and shopping for lifestyle brands. The Skywards program has four tiers with layered benefits: Blue, Silver, Gold, and Platinum. Premium customers get access to Emirate's first-class lounges at the

Dubai International Airport, which offer showers, business centers, fine dining options, spa services, exclusive duty-free areas, cigar lounges, and shoeshine services. The Skywards program recently reduced rates for buying, gifting, and transferring of Miles and introduced a feature called My Family, which enables the pooling of Miles among family members. In August 2018, Emirates extended its Skywards loyalty program to flydubai, a low-cost Dubai-based carrier established in 2008 by the city's government. Skywards replaced OPEN, flydubai's loyalty program, and absorbed its members, giving them the opportunity to redeem their points across a larger global network along with the privileges offered by both the airlines.

Emirates' innovations and customer-focused strategies have earned a number of awards and accolades. In 2014, at an estimated value of $3.7 billion, it was named the world's most valuable airline brand and the Middle East's most valuable brand by Brand Finance. In 2016, it was named the World's Best Airline and received the award for Best In-flight Entertainment at the Skytrax World Airline Awards for the twelfth successive year. In 2019, Emirates won four of the TripAdvisor Travelers' Choice® awards for airlines and in five categories at the Business Traveller Middle East Awards: Best Airline Worldwide, Airline with the Best First Class, Airline with the Best Economy Class, Airline with the Best Frequent Flyer Program, and Best Airport Lounge in the Middle East.[69]

Questions

1. With the global aviation sector facing increasing challenges, how can Emirates retain customers?
2. How can Emirates remain competitive and enhance customer satisfaction?
3. Why is customer loyalty important in the air travel industry? How can Emirates benefit from CRM in the digital age?