CHAPTER 4

Creating Customer Value, Satisfaction, and Loyalty

In this chapter, we will address the following questions:

1. How can companies deliver customer value, satisfaction, and loyalty?
2. What is the lifetime value of a customer, and why is it important to marketers?
3. How can companies cultivate strong customer relationships?
4. What is the role of database marketing in customer relationship management?

MARKETING MANAGEMENT AT Ritz-Carlton

The Ritz-Carlton hotel chain, owned by Marriott International, is known throughout the world for its singular focus on providing exceptional service and luxurious amenities. This customer-centered approach is expressed by the company’s motto: “We are ladies and gentlemen serving ladies and gentlemen.” Guests at any of the 62 Ritz-Carlton hotels in 21 countries notice the brand’s famed personal touch immediately upon checking in, when they are greeted by name.

Ritz-Carlton creates a daily “Service Quality Index” (SQI) at each of its locations, so employees can continually monitor key guest service processes and swiftly address any potential problems. At corporate headquarters in Maryland, management can check the SQIs of all Ritz-Carlton hotels and instantly analyze each location’s performance. Other customer service initiatives include the CLASS (Customer Loyalty Anticipation Satisfaction System) database that contains the preferences and requirements of repeat Ritz-Carlton guests, and the CARE (Clean and Repair Everything) room maintenance system that ensures all guestrooms are...
checked and free of defects every 90 days. Such initiatives helped Ritz-Carlton become the only service company to win the Malcolm Baldrige National Quality Award twice. And they've enabled Ritz-Carlton to forge long-lasting customer relationships, as evidenced by the hotel’s Top 20 ranking on the Brand Keys 2006 Customer Loyalty Index.¹

Today, companies face their toughest competition ever. Moving from a product and sales philosophy to a holistic marketing philosophy, however, gives them a better chance of outperforming the competition. And the cornerstone of a well-conceived marketing orientation is strong customer relationships. In this chapter, we discuss how companies can win customer loyalty and improve profits by doing a better job of meeting or exceeding customer expectations. We also discuss the use of database marketing for customer relationship management.

BUILDING CUSTOMER VALUE AND SATISFACTION

Consumers are more educated and informed than ever, and they have the tools to verify companies’ claims and seek out superior alternatives.² How then do they ultimately make choices? Customers tend to be value-maximizers, within the bounds of search costs and limited knowledge, mobility, and income. They estimate which offer will deliver the most perceived value and act on it. Whether the offer lives up to expectation affects customer satisfaction and the probability that the customer will purchase the product again.

Customer Perceived Value

Customer perceived value (CPV) is the difference between the prospective customer’s evaluation of all the benefits and all the costs of an offering and the perceived alternatives (see Figure 4.1). Total customer value is the perceived monetary value of the bundle of economic, functional, and psychological benefits customers expect from a given market offering because of the products, services, personnel, and image involved. Total customer cost is the perceived bundle of costs that customers expect to incur in evaluating, obtaining, using, and disposing of the given market offering, including monetary, time, energy, and psychic costs.

Suppose the buyer for a residential construction company wants to buy a tractor from either Caterpillar or Komatsu. After evaluating the two tractors, he decides that Caterpillar has greater product benefits, based on perceived reliability, durability, performance, and resale value. He also decides that Caterpillar’s personnel are more knowledgeable and perceives that the company will provide better services, such as maintenance. Finally, he places higher value on Caterpillar’s corporate image. He adds up all the benefits from these four sources—product, services, personnel, and image—and perceives Caterpillar as delivering greater customer benefits.

The buyer also examines his total cost of transacting with Caterpillar versus Komatsu, including money plus the time, energy, and psychic costs expended in product acquisition, usage, maintenance, ownership, and disposal. Then the buyer compares Caterpillar’s total customer cost to its total customer benefits and Komatsu’s total customer cost to its total customer benefits. In the end, the buyer will buy from the source he thinks delivers the highest perceived value.
Caterpillar can make this sale by improving its offer and delivering more customer-perceived value than Komatsu. First, it can increase total customer benefit by improving economic, functional, and psychological benefits of its product, services, personnel, and/or image. Second, it can reduce the buyer's nonmonetary costs by reducing the time, energy, and psychic costs. Third, it can reduce its product's monetary cost.

Some marketers might argue that this process is too rational. Suppose the customer chooses the Komatsu tractor. How can we explain this choice? Three possibilities are:

1. **The buyer might be under orders to buy at the lowest price.** To win this sale, Caterpillar must convince the buyer's manager that buying on price alone will result in lower long-term profits and customer value.

2. **The buyer will retire before the company realizes that the Komatsu tractor is more expensive to operate.** To win this sale, Caterpillar must convince other people in the buyer's company that it delivers greater long-term value.

3. **The buyer enjoys a long-term friendship with the Komatsu salesperson.** Here, Caterpillar must show the buyer that the Komatsu tractor will draw complaints from the tractor operators when they discover its high fuel cost and need for frequent repairs.

Customer perceived value is a useful framework that applies to many situations and yields rich insights. Here are its implications: First, the marketer must assess the total customer benefit and total customer cost associated with each competitor’s offer.
to know how his or her offer rates in the buyer's mind. Second, the marketer who is at a customer-perceived-value disadvantage can try to increase total customer benefit or decrease total customer cost.\(^4\)

Consumers have varying degrees of loyalty to specific brands, stores, and companies. Oliver defines **loyalty** as “A deeply held commitment to re-buy or re-patronize a preferred product or service in the future despite situational influences and marketing efforts having the potential to cause switching behavior.”\(^5\) The **value proposition** consists of the whole cluster of benefits the company promises to deliver. For example, Volvo’s core positioning has been safety, but it also promises other benefits, including a long-lasting car and good service. Volvo (and every brand) must represent a promise about the total experience customers can expect. Whether the promise is kept depends on how the firm uses core business processes to manage its **value-delivery system**, all the experiences the customer will have in obtaining and using the offering.\(^6\)

**Total Customer Satisfaction**

Whether the buyer is satisfied after a purchase depends on the offer’s performance in relationship to the buyer’s expectations and whether the buyer interprets any deviations between the two.\(^7\) In general, **satisfaction** is a person’s feelings of pleasure or disappointment that result from comparing a product’s perceived performance (or outcome) to expectations. If the performance falls short of expectations, the customer is dissatisfied. If performance matches expectations, the customer is satisfied; if it exceeds expectations, the customer is highly satisfied or delighted.\(^8\) Customer assessments of product performance depend on many factors, especially the type of loyalty relationship the customer has with the brand.\(^9\)

Buyers form their expectations from past buying experience; friends’ and associates’ advice; and marketers’ and competitors’ information and promises. If marketers raise expectations too high, the buyer is likely to be disappointed. However, if the company sets expectations too low, it won’t attract enough buyers (although it will satisfy those who do buy).\(^10\) Some of today’s most successful companies are raising expectations and delivering performance to match. Korean automaker Kia has been successful in the U.S. market by offering low-priced, high-quality cars reliable enough to be backed by 10-year warranties.

However, high customer satisfaction is not the ultimate goal. If the company increases customer satisfaction by lowering its price or increasing its services, the result may be lower profits. The company might be able to increase its profitability by means other than increased satisfaction (for example, by improving manufacturing processes). Also, the company has many stakeholders, including employees, dealers, suppliers, and stockholders. Spending more to increase customer satisfaction might divert funds from increasing the satisfaction of other “partners.” Ultimately, the company must try to deliver a high level of customer satisfaction subject to delivering acceptable levels of satisfaction to the other stakeholders, given its total resources.\(^11\)

**Monitoring Satisfaction**

Many companies are systematically monitoring how well they treat their customers, identifying the factors that shape customer satisfaction, and making changes in their operations and marketing as a result.\(^12\) A highly satisfied customer generally stays...
loyal longer, buys more as the firm introduces new products and upgrades existing products, talks favorably to others about the firm and its products, pays less attention to competing brands and is less sensitive to price, offers product or service ideas to the firm, and costs less to serve than new customers because transactions become routine.\textsuperscript{13} Greater customer satisfaction has also been linked to higher stock-market returns and lower market risk.\textsuperscript{14}

The link between satisfaction and loyalty, however, is not proportional. Suppose customer satisfaction is rated on a scale from one to five. At a very low level of customer satisfaction (level one), customers are likely to abandon the company and even bad-mouth it. At levels two to four, customers are fairly satisfied but still find it easy to switch when a better offer comes along. At level five, the customer is very likely to repurchase and even spread good word of mouth about the company. High satisfaction or delight creates an emotional bond with the brand or company, not just a rational preference. Xerox’s executives found out that their “completely satisfied” customers were six times more likely to repurchase Xerox products over the following 18 months than their “very satisfied” customers.\textsuperscript{15}

When customers rate their satisfaction with an element of the firm’s performance—say, delivery—they may vary in how they define good performance. 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.\textsuperscript{16} Marketers can monitor customer satisfaction in a number of ways.\textsuperscript{17} Bain’s Frederick Reichheld suggests that perhaps only one question really matters: “How likely is it that you would recommend this product or service to a friend or colleague?” According to Reichheld, a willingness to recommend is based on how well the customer is treated by front-line employees, which in turn is determined by all the functional areas that contribute to a customer’s experience.\textsuperscript{18}

For more on monitoring satisfaction, see “Marketing Skills: Gauging Customer Satisfaction.”

**MARKETING SKILLS: GAUGING CUSTOMER SATISFACTION**

The vital skill of gauging customer satisfaction requires a working knowledge of marketing research coupled with a sensitivity for customer concerns. Marketers start by defining their specific research goals as they relate to customer satisfaction. Next, they build on their knowledge of customer behavior and attitudes to design the study and encourage participation. After gathering and analyzing data, marketers should communicate the findings internally to highlight good news, act on bad news, and plan new ways of satisfying customers. Finally, continuously surveying customers or repeating research at regular intervals allows marketers to follow satisfaction trends and determine the effect of changes.

McAlister’s Deli, a 220-unit restaurant chain based in Mississippi, prints a satisfaction survey invitation on every receipt. Customers who call in and respond to a five-minute automated telephone survey receive a $3 discount on their next purchase. CEO Phil Friedman says that making changes based on this research has definitely made a difference in the chain’s financial results: “Satisfaction equals loyalty equals increased checks.”\textsuperscript{19}
Part II  Connecting with Customers

Product and Service Quality

Satisfaction will also depend on product and service quality. What exactly is quality? Various experts have defined it as “fitness for use,” “conformance to requirements,” and “freedom from variation.” We will use the American Society for Quality Control’s customer-centered definition: **Quality** (or grade) is the totality of features and characteristics of a product or service that bear on its ability to satisfy stated or implied needs. The seller has delivered quality whenever the product or service meets or exceeds the customers’ expectations. It is important to distinguish between conformance quality and performance quality. A Lexus provides higher performance quality than a Hyundai: The Lexus rides smoother, goes faster, and lasts longer. Yet both a Lexus and a Hyundai deliver the same conformance quality if all the units deliver their respective promised quality.

Studies have shown a high correlation between relative product quality and company profitability. Total quality is everyone’s job, just as marketing is everyone’s job. Marketers play six roles in helping their companies define and deliver high-quality goods and services to target customers. First, they bear the major responsibility for correctly identifying customers’ needs and requirements. Second, they must communicate customer expectations properly to product designers. Third, they must be sure that orders are filled correctly and on time. Fourth, they must provide customers with proper instructions, training, and technical assistance. Fifth, they must stay in touch with customers after the sale to ensure ongoing satisfaction. Sixth, they must gather customer ideas for product and service improvements and convey them to the appropriate departments. When marketers do all this, they’re making substantial contributions to product and service quality, customer satisfaction, customer profitability, and company profitability.

MAXIMIZING CUSTOMER LIFETIME VALUE

Ultimately, marketing is the art of attracting and keeping profitable customers. Yet every firm loses money on some of its customers. The well-known 20–80 rule says that the top 20% of the customers often generates 80% or more of the firm’s profits. In some cases the profit distribution may be more extreme—the most profitable 20% of customers (on a per capita basis) may contribute as much as 150% to 300% of profitability. The least profitable 10% to 20% of customers, on the other hand, can actually reduce profits of 50% to 200% per account, with the middle 60% to 70% breaking even. The implication is that a firm could improve its profits by “firing” its worst customers.

The largest customers don’t always yield the most profit, because these customers can demand considerable service and receive the deepest discounts. The smallest customers pay full price and receive minimal service, but transaction costs reduce their profitability. The midsize customers who receive good service and pay nearly full price are often the most profitable.

Customer Profitability

What makes a customer profitable? A **profitable customer** is a person, household, or company that over time yields a revenue stream that exceeds by an acceptable amount the company’s cost stream for attracting, selling, and servicing that customer. Note that the emphasis is on the lifetime stream of revenue and cost, not on one transaction’s
profitability. Marketers can assess customer profitability individually, by market segment, or by channel.

Although many firms measure customer satisfaction, most fail to measure individual customer profitability. Banks say this is because a customer uses different banking services and the transactions are logged in different departments. However, banks that have succeeded in linking customer transactions are appalled by the number of unprofitable customers in their customer base. Some report losing money on over 45% of their customers. More marketers are recognizing the need to manage customer portfolios, made up of different groups of customers defined in terms of their loyalty, profitability, and other factors. One perspective is that a firm’s portfolio consists of a combination of “acquaintances,” “friends,” and “partners” that are constantly changing.

Figure 4.2 shows a useful type of profitability analysis. Customers are arrayed along the columns and products are arrayed along the rows. Each cell contains a symbol representing the profitability of selling that product to that customer. Customer 1 is very profitable, buying three profitable products. Customer 2 represents mixed profitability, buying one profitable and one unprofitable product. Customer 3 is a losing customer, buying one profitable and two unprofitable products. What can the company do about customers 2 and 3? It can either (1) raise the price of its less profitable products or eliminate them; or (2) try to sell customers 2 and 3 its profitable products. In fact, the firm should encourage unprofitable customers to switch to competitors.

Customer profitability analysis (CPA) is best conducted with an accounting technique called Activity-Based Costing (ABC). The company estimates all revenue coming from the customer, less all costs (including production, distribution, and all company resources that go into serving that customer). This helps classify customers into different profit tiers. Table 4.1 shows how a firm can classify its customers in terms of which are valuable and vulnerable; each of the four segments suggests different marketing and competitive activities.
TABLE 4.1  Customer Selection Grid

<table>
<thead>
<tr>
<th>Vulnerable</th>
<th>Not Vulnerable</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Valuable</strong></td>
<td>These customers are profitable but not completely happy with the company. Find out and address their sources of vulnerability to <strong>retain</strong> them.</td>
</tr>
<tr>
<td><strong>Not Valuable</strong></td>
<td>These customers are loyal and profitable. Don’t take them for granted, but <strong>maintain margins</strong> and reap the benefits of their satisfaction.</td>
</tr>
</tbody>
</table>

TABLE 4.2  A Hypothetical Example to Illustrate CLV Calculations

<table>
<thead>
<tr>
<th>Year 0</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
<th>Year 8</th>
<th>Year 9</th>
<th>Year 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Customers</td>
<td>100</td>
<td>90</td>
<td>80</td>
<td>72</td>
<td>60</td>
<td>48</td>
<td>34</td>
<td>23</td>
<td>12</td>
<td>6</td>
</tr>
<tr>
<td>Revenue per Customer</td>
<td>100</td>
<td>110</td>
<td>120</td>
<td>125</td>
<td>130</td>
<td>135</td>
<td>140</td>
<td>142</td>
<td>143</td>
<td>145</td>
</tr>
<tr>
<td>Variable Cost per Customer</td>
<td>70</td>
<td>72</td>
<td>75</td>
<td>76</td>
<td>78</td>
<td>79</td>
<td>80</td>
<td>81</td>
<td>82</td>
<td>83</td>
</tr>
<tr>
<td>Margin per Customer</td>
<td>30</td>
<td>38</td>
<td>45</td>
<td>49</td>
<td>52</td>
<td>56</td>
<td>60</td>
<td>61</td>
<td>61</td>
<td>62</td>
</tr>
<tr>
<td>Acquisition Cost per Customer</td>
<td>40</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Cost or Profit</td>
<td>−4000</td>
<td>2700</td>
<td>3040</td>
<td>3240</td>
<td>2940</td>
<td>2496</td>
<td>1904</td>
<td>1380</td>
<td>732</td>
<td>366</td>
</tr>
<tr>
<td>Present Value</td>
<td>−4000</td>
<td>2454.55</td>
<td>2512.40</td>
<td>2434.26</td>
<td>2008.06</td>
<td>1549.82</td>
<td>1074.76</td>
<td>708.16</td>
<td>341.48</td>
<td>155.22</td>
</tr>
</tbody>
</table>


Measuring Customer Lifetime Value

The case for maximizing long-term customer profitability is captured in the concept of customer lifetime value. Customer lifetime value (CLV) describes the net present value of the stream of future profits expected over the customer's lifetime purchases. The company must subtract from its expected revenues the expected costs of attracting, selling, and servicing that customer’s account, applying the appropriate discount rate (say, between 10% and 20%, depending on cost of capital and risk attitudes). Lifetime value calculations for a particular offering can be tens of thousands of dollars or even more.

Many methods exist to measure customer lifetime value. Don Lehmann and Sunil Gupta illustrate their approach by calculating the CLV of 100 customers over a 10-year period (see Table 4.2). In this example, the firm acquires 100 customers with an acquisition cost per customer of $40. Therefore, in year 0, it spends $4,000. Some
of these customers defect each year. The present value of the profits from this cohort of customers over 10 years is $13,286.52. The net CLV (after deducting acquisition costs) is $9,286.52 or $92.87 per customer.

CULTIVATING CUSTOMER RELATIONSHIPS

Maximizing customer value means cultivating long-term customer relationships. Companies are now moving away from wasteful mass marketing to precision marketing designed to build strong customer relationships. Customer relationship management (CRM) is the process of carefully managing detailed information about individual customers and all customer “touch points” to maximize customer loyalty. A customer touch point is any occasion on which a customer encounters the brand and product—from actual experience to personal or mass communications to casual observation. The touch points for a hotel include reservations, check-in and check-out, frequent-stay programs, room service, business services, exercise facilities, and restaurants.

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, companies can customize market offerings, services, programs, messages, and media. CRM is important because a major driver of company profitability is the aggregate value of the company’s customer base. Peppers and Rogers outline a four-step framework for one-to-one marketing that can be adapted to CRM marketing as follows:

1. **Identify your prospects and customers.** Don’t go after everyone. Build, maintain, and mine a rich customer database with information derived from all the channels and customer touch points.

2. **Differentiate customers in terms of (1) their needs and (2) their value to your company.** Spend proportionately more effort on the most valuable customers. Calculate customer lifetime value and estimate net present value of all future profits coming from purchases, margin levels, and referrals, less customer-specific servicing costs.

3. **Interact with individual customers to improve your knowledge about their individual needs and to build stronger relationships.** Facilitate customer/company interaction through the company contact center and Web site.

4. **Customize products, services, and messages to each customer.** Formulate customized offerings that can be communicated in a personalized way.

A firm can improve the value of its customer base by reducing the rate of customer defection; increasing the longevity of the customer relationship; enhancing the growth potential of each customer through “share of wallet,” cross-selling, and up-selling; making low-profit customers more profitable or terminating them; and treating high-value customers in a special way.

Attracting and Retaining Customers

Companies seeking to expand their profits and sales have to spend considerable time and resources searching for new customers. To generate leads, they use advertising, direct mail, telemarketing, trade shows, and other methods to reach possible new prospects. Different types of acquisition methods can yield different types of
Part II  Connecting with Customers

customers with varying CLVs. One study showed that customers acquired through the offer of a 35% discount had about one-half the long-term value of customers acquired without any discount.\footnote{It is not enough, however, to attract new customers; the company must keep them and increase their business.\footnote{Too many companies suffer from high customer churn, or defection. Many cellular carriers and cable TV operators, for example, lose 25\% of their subscribers each year at an estimated cost of \$2 billion to \$4 billion. To reduce churn, the firm must first define and measure its retention rate; distinguish the causes of customer attrition and identify those that can be managed better; and compare the lost profit equal to the customer's lifetime value from a lost customer to the cost of lowering the defection rate. If the cost to discourage defection is lower than the lost profit, the firm should spend to retain the customer.}

Figure 4.3 shows the main steps in attracting and retaining customers. The starting point is everyone who might conceivably buy the product or service (potentials). From these the company determines good prospects, people or organizations with the motivation, ability and opportunity to buy. The firm uses marketing to convert prospects into first-time customers, then into repeat customers, and then into clients, whom the company treats as special. The next challenge is to turn clients into members by starting a program that offers benefits to customers who join and then into advocates who recommend the company and its offerings to others. The ultimate challenge is to turn advocates into partners.

More companies are recognizing the benefits of satisfying and retaining current customers. Remember, acquiring new customers can cost five times more than the cost of satisfying and retaining current customers. On average, companies lose 10\% of their customers each year. Yet by reducing the customer defection rate by 5\%, companies can increase profits by 25\% to 85\%, depending on the industry. Also, the customer profit rate tends to increase over the life of the retained customer, due to increased purchases, referrals, price premiums, and reduced servicing costs.\footnote{Building Loyalty}

Companies that want to form strong customer bonds need to attend to a number of different considerations (see Figure 4.4). One set of researchers sees retention-building activities as adding financial benefits, social benefits, or structural ties.\footnote{Interacting with customers, developing loyalty programs, personalizing marketing, and creating institutional ties are four key marketing activities that companies are using to build customer loyalty.}

Interacting with Customers  
Listening to customers is crucial to customer relationship management. Some companies have created an ongoing mechanism that keeps senior managers permanently plugged in to front-line customer feedback. For example, Chicken of the Sea has 80,000 members in its Mermaid Club, a core-customer group treated to coupons and special offers. In return, club members provide valuable feedback on what the company is doing and is thinking of doing. When the company considered introducing canned whitefish, members emphatically rejected the idea and the company chose not to introduce it.\footnote{Listening is only part of the story. It's also important to be a customer advocate and, as much as possible, take the customers' side on issues, understanding their point of view. Customer evangelists are an especially valuable group because, say authors Ben}

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FIGURE 4.4  Forming Strong Customer Bonds

- Create superior products, services, and experiences for the target market.
- Get cross-departmental participation in planning and managing the customer satisfaction and retention process.
- Integrate the “voice of the customer” to capture stated and unstated needs or requirements in all business decisions.
- Organize and make accessible a database of information on individual customer needs, preferences, contacts, purchase frequency, and satisfaction.
- Make it easy for customers to reach appropriate company personnel and express their needs, perceptions, and complaints.
- Assess potential of frequency programs and club marketing programs.
- Run award programs recognizing outstanding employees.
McConnell and Jackie Huba, these customers not only buy a company’s offerings but also voluntarily spread the word, recruiting friends and colleagues on the company’s behalf. Developing Loyalty Programs Two customer loyalty programs that companies can offer are frequency programs and club membership programs. Frequency programs (FPs) are designed to provide rewards to customers who buy frequently and in substantial amounts. They can help build long-term loyalty with high CLV customers, creating cross-selling opportunities in the process. Originally pioneered by airlines, hotels, and credit card companies, FPs are now used in many other industries. Typically, the first firm to introduce an FP in an industry gains the most benefit. After competitors respond, FPs can become a financial burden to all the offering companies, although some marketers are more efficient and creative in managing FPs.

Many companies have created club membership programs, either open to everyone who purchases a product or service or limited to an affinity group (or to those willing to pay a small fee). Open clubs are good for building a database or snagging customers from competitors, yet limited membership clubs are more powerful long-term loyalty builders. Fees and membership conditions prevent those with only a fleeting interest in a company’s products from joining while attracting and retaining customers who are responsible for the largest portion of business.

Personalizing Marketing Company personnel can create strong bonds with customers by individualizing and personalizing relationships. Not surprisingly, the right technology is an increasingly essential ingredient for this purpose. Companies are using e-mail, Web sites, call centers, databases, and database software to foster continuous contact with customers. E-commerce companies looking to attract and retain customers are discovering that personalization goes beyond creating customized information.

Even the BBC, British archetype of an old media company, is reaping the benefits of customizing its offerings, a practice that is taking it well beyond its commercial rivals in UK broadcasting. Its Web site, backstage.bbc.co.uk, provides data, resources, and support for Internet developers and designers—inside and outside the BBC—to share so they can build prototypes of new concepts using BBC material. One consumer-created prototype called Sport Map allows people to find the nearest soccer team and get that team’s latest news.

Creating Institutional Ties The company may supply special equipment or computer linkages to help customers manage their orders, payroll, inventory, and so on. Customers are less inclined to switch to another supplier when this would involve high capital costs, high search costs, or the loss of loyal-customer discounts. A good example is McKesson Corporation, a leading pharmaceutical wholesaler, which invested millions of dollars in electronic capabilities to help independent pharmacies manage inventory, order entry processes, and shelf space.

CUSTOMER DATABASES AND DATABASE MARKETING

Marketers must know their customers. And in order to know the customer, the firm must collect information and store it in a database for database marketing. A customer database is an organized collection of comprehensive information about individual customers or prospects that is current, accessible, and actionable for such marketing
purposes as lead generation, lead qualification, sale of a product or service, or maintenance of customer relationships. Database marketing is the process of building, maintaining, and using customer databases and other databases (products, suppliers, resellers) to make contact, facilitate transactions, and build customer relationships.

A customer database contains much more information than a customer mailing list, which is simply a set of names, addresses, and telephone numbers. Ideally, a customer database would contain the consumer’s past purchases, demographics (age, income, family members, birthdays), psychographics (activities, interests, and opinions), mediagraphics (preferred media), and other useful information. A business database should contain past purchases of business customers; past volumes, prices, and profits; buyer team member names (and their ages, birthdays, hobbies, and favorite foods); status of current contracts; an estimate of the supplier’s share of the customer’s business; competitive suppliers; assessment of competitive strengths and weaknesses in selling and servicing the account; and buying practices, patterns, and policies. “Breakthrough Marketing: Tesco” describes how the U.K. supermarket giant has used its database to attract and engage customers.

Data Warehouses and Datamining

Savvy companies capture data every time a customer comes into contact with any of their departments. Touch points include a customer purchase, a customer-requested service call, an online query, or a mail-in rebate card. The information is collected by the company’s contact center and organized into a data warehouse where marketers can capture, query, and analyze it to draw inferences about an individual customer’s needs and responses. This allows the company’s customer service reps or telemarketers to respond to customer inquiries based on a total picture of the customer relationship. Through datamining, marketing statisticians can extract useful information

**BREAKTHROUGH MARKETING: TESCO**

In the early 1980s, the U.K. supermarket chain Tesco had a reputation as a “pile it high and sell it cheap” mass-market retailer. By 1990, to gain share against Sainsbury’s, the more upscale market leader, Tesco was upgrading its stores, improving the shopping experience, and adding new products. A new image campaign highlighted these customer-friendly changes and Tesco’s commitment to “doing right by the customer.” The result: More than a million new customers and an increase in revenues that, by 1995, allowed Tesco to surpass Sainsbury’s as the market leader.

Tesco then introduced the initiative that made it a world-class example of how to build lasting relationships with customers: the Tesco Clubcard. A loyalty card with discounts and special offers tailored to individual shoppers, the Clubcard is also a powerful tool for building a comprehensive customer database. Based on their shopping habits, Tesco customers receive one of 4 million different variations of the quarterly Clubcard statement with targeted promotions. Analyzing Clubcard purchases helps Tesco do a better job of pricing products and scheduling promotions, at a $500 million savings. The Clubcard has helped Tesco expand in Europe, Asia, and beyond, including new stores in California, Arizona, and Nevada, bringing its total annual sales to $85 billion.45
about individuals, trends, and segments from the mass of data. Datamining uses sophisticated statistical and mathematical techniques such as cluster analysis, automatic interaction detection, predictive modeling, and neural networking.

In general, companies can use their databases to (1) identify the best prospects by sorting through responses to marketing efforts; (2) match a specific offer with a specific customer as a way to sell, cross-sell, and up-sell; (3) deepen customer loyalty by remembering customer preferences and offering relevant incentives and information; (4) reactivate customer purchasing through reminders or timely promotions; and (5) avoid serious mistakes such as sending a customer two offers for the same product but at different prices.

The Downside of Database Marketing and CRM

Four problems can prevent a firm from effectively using database marketing for CRM. The first is the large investment in computer hardware, database software, analytical programs, communication links, and skilled personnel as well as the difficulty in collecting the right data during all company interactions with customers. Thus, building a customer database would not be worthwhile when the product is a once-in-a-lifetime purchase (e.g., a grand piano); when customers show little brand loyalty; when the unit sale is very small (e.g., a candy bar); and when the cost of gathering data is too high.

The second problem is the difficulty of getting everyone in the company to be customer oriented and use the available information for CRM rather than carrying on traditional transaction marketing. The third problem is that not all customers want an ongoing relationship with a company and may resent having their personal data collected and stored. Marketers must be concerned about customer attitudes toward privacy and security; online businesses in particular would be smart to explain their privacy policies and allow consumers to avoid having their information stored in a database.

A fourth problem is that the assumptions behind CRM may not always hold true. For example, it may not cost less to serve more loyal customers. High-volume customers often know their value and can extract premium service and/or price discounts; loyal customers may expect and demand more from the firm and resent the company charging full or higher prices. One consulting firm reported that 70% of companies found little or no improvement from implementing a CRM system. The reasons are many: the system was poorly designed, it became too expensive, employees didn’t make much use of it or report much benefit, and collaborators ignored the system. Each company must therefore determine how much and where to invest in building and using database marketing to manage its customer relationships.

EXECUTIVE SUMMARY

Customers are value maximizers. They form an expectation of value and act on it. Buyers will buy from the firm that they perceive to offer the highest customer-delivered value, defined as the difference between total customer benefits and total customer cost. A buyer’s satisfaction is a function of the product’s perceived performance and the buyer’s expectations. Recognizing that high satisfaction leads to high customer loyalty, many companies today are aiming for total customer satisfaction. For such companies, customer satisfaction is both a goal and a marketing tool. Satisfaction also depends on quality, the totality of features and characteristics of a product or service that bear on its ability to satisfy stated or implied needs.
Companies need to understand which customers are profitable and calculate each customer’s lifetime value. They must also determine how to increase the value of the customer base. Losing profitable customers can dramatically affect a firm’s profits. The key to retention is customer relationship marketing (CRM), the process of managing detailed information about individual customers and managing all customer touch points to maximize loyalty. Customer relationship management often requires building a customer database and using datamining to detect trends, segments, and individual needs.

NOTES

3. Irwin P. Levin and Richard D. Johnson, “Estimating Price–Quality Tradeoffs Using Comparative Judgments,” Journal of Consumer Research (June 11, 1984): 593–600. Customer perceived value can be measured as a difference or as a ratio. If total customer value is $20,000 and total customer cost is $16,000, then the customer perceived value is $4,000 (measured as a difference) or 1.25 (measured as a ratio). Ratios that are used to compare offers are often called value-price ratios.
16. Note that managers and salespeople can manipulate customer satisfaction ratings: They can be especially nice to customers just before the survey; they can also try to exclude unhappy customers. Another danger is that if customers know the company will go out of its way to please them, some may express high dissatisfaction in order to receive more concessions.


29. V. Kumar, “Profitable Relationships,” Marketing Research, 18 (Fall 2006): 41–46.


32. Lanning, Delivering Profitable Value.

33. Don Peppers and Martha Rogers, The One-to-One Future: Building Relationships One Customer at a Time (New York: Doubleday, 1993); Don Peppers and Martha Rogers, Enterprise One to One: Tools for Competing in the Interactive Age (New York: Currency, 1997); Don Peppers and Martha Rogers, The One-to-One Manager: Real-World Lessons in Customer Relationship Management (New York:


