Chapter 9

Managing the customer lifecycle: customer retention and development

Chapter objectives

By the end of the chapter, you will understand:

1. **what is meant by the term 'customer retention'**
2. **the economics of customer retention**
3. **how to select customers to target for retention**
4. **the distinction between positive and negative customer retention**
5. **several strategies for customer retention, including meeting and exceeding customer expectations, finding new ways to add value, creating social and structural bonds, and building emotional commitment**
6. **the role of customer development**
7. **why and how customers are 'sacked'.**

Introduction

This is the second of the three chapters that look at the critical issues of process and structure for customer relationship management (CRM) implementation. The core CRM processes are customer acquisition, customer retention and customer development. Together, they make up the customer lifecycle. The processes of customer retention and development are the focus of this chapter. Customer acquisition is covered in Chapter 8, and structure is covered in Chapter 10.

In this chapter you will learn about the important issues of customer retention and development.

Managing the customer lifecycle is the last primary stage of the CRM value chain (Fig. 9.1).

We propose that the major strategic role of CRM is to manage a company's relationships with customers though three stages of the customer lifecycle: customer acquisition, customer retention and customer development.

Just as a customer acquisition strategy aims to increase the number of customers in the customer base, a customer retention strategy aims to keep a high proportion of current customers by reducing customer defections, and a customer development strategy aims to increase the value of those retained customers to the company. Just as acquisition is focused, so are retention and development. Not all customers are worth retaining and not all customers have potential for development.

We will deal with the issue of retention first, before turning to development.

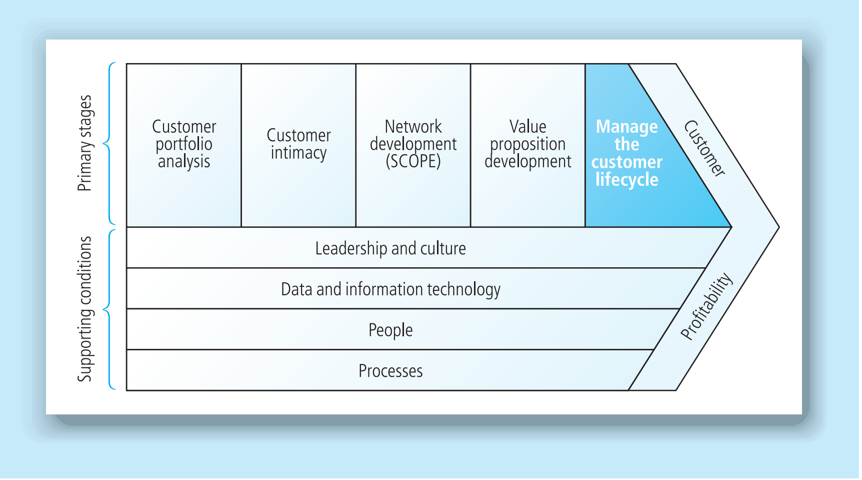

Figure 9.1
CRM value chain

Several important questions have to be answered when a company puts together a customer retention plan.

- Which customers will be targeted for retention?
- What customer retention objectives should be set?
- What customer retention strategies will be used?
- How will the performance of the retention plan be measured?

These issues need to be carefully considered and programmed into a properly resourced customer retention plan. Many companies, perhaps as many as nine out of 10, have no customer retention plan in place. As noted in Chapter 8, most marketing plans fail to distinguish between customer acquisition and customer retention. It is recommended that companies think about these as separate, but related issues, and develop appropriate strategies.

What is customer retention?

Customer retention is the strategic objective of striving to maintain long-term relationships with customers. Customer retention is the mirror image of customer defection. A high retention rate is equivalent to a low defection rate.[1]

Conventionally, customer retention is defined as:[2]

> the number of customers doing business with a firm at the end of a financial year expressed as percentage of those who were active customers at the beginning of the year.

However, the appropriate interval over which retention rate should be measured is not always 1 year. Rather, it depends on the repurchase cycle found in the industry. Consider customer retention in an auto dealership and an insurance broker. Insurance policies are renewed annually, unlike cars. If the normal car replacement cycle is 4 years, then retention rate is more meaningful if it is measured over 4 years instead of 12 months.

Sometimes companies are not clear about whether an individual customer has defected. The problems are created by the following factors.

- **Product-based views of customers**: consider insurance. Insurance companies often have product-based information systems. Effectively, they regard an insurance policy as a customer. If the policy is renewed, the customer remains active. However, take a customer who shops around for a better price and, after the policy has expired, returns to the original insurer. The insurer may take the new policy to mean a new customer has been gained. They would be wrong. Consider industrial chemicals. A customer bought 500 tonnes of hydrogen peroxide last year. This year, owing to a change in manufacturing processes and products, the customer buys a different product and volume, say 50 tonnes of magnesium peroxide. If the database is not smart enough to detect and note the changed order, the supplier's records may show this as a defected customer for hydrogen peroxide and a new customer for the magnesium product.
- **Channel-based views of customers**: telecoms companies acquire customers through many channels. Consider a customer who buys a 12 month mobile telecoms contract from a Vodafone-owned retail outlet. Part way through the year Vodafone launches a new pay-as-you-go product with no contractual obligation. The customer allows her current contract to expire, then buys the new pay-as-you-go product, not from a Vodafone outlet but from a supermarket. Vodafone regards her as a lost customer because the contract was not renewed. In the business-to-business (B2B) market, office equipment dealers have formed into buying groups to leverage better process and service. When a customer stops buying direct from Brother Electronics and joins a buying group, Brother's customer data may report a defection, but all that has happened is that the dealer has begun to buy through a different channel.[3]
- **Multiple product ownership**: a bank customer may have several accounts, such as current, savings and loan. Consider a customer who pays off his debt and closes the loan account. The bank may consider the customer to have defected because its customer data are held in product databases that are not integrated to give an overall view of product ownership by the customer. A customer view would reveal that the customer is still active with current and savings accounts.

Customer defection is the mirror image of customer retention. If retention is high, defection is low. The use of aggregates and averages in calculating customer retention rates can mask a true understanding of retention and defection. This is because customers differ in their sales, costs-to-serve and buying behaviours. It is not unusual for a small number of customers to account for a large proportion of company revenue. If you have 100 customers and lose 10 in the course of a year, your raw defection rate is 10 per cent. But what if these customers account for 25 per cent of your company's sales? Is the true defection rate 25 per cent? Consideration of profit makes the computation more complex. If the 10 per cent of customers that defected produce 50 per cent of your company's profits, is the true defection rate 50 per cent?

What happens if the 10 per cent lost customers are at the other end of the sales and profit spectrum? In other words, what if they buy very little and/or have a high cost-to-serve? It could be that they contribute less than 5 per cent of sales and actually generate a negative profit, i.e. they cost more to serve than they generate in margin. The loss of some customers might enhance the company's profit performance. It is not inconceivable that the company is retaining 90 per cent of its customers, 95 per cent of its sales and 105 per cent of its profit.

A solution to this problem is to consider three measures of customer retention:

- **raw customer retention rate**: the number of customers doing business with a firm at the end of a trading period expressed as percentage of those who were active customers at the beginning of the period
- **sales-adjusted retention rate**: the value of sales achieved from the retained customers expressed as a percentage of the sales achieved from all customers who were active at the beginning of the period.
- **profit-adjusted retention rate**: the profit earned from the retained customers expressed as a percentage of the profit earned from all customers who were active at the beginning of the period.

A high raw customer retention rate does not always signal an excellent customer retention programme. This is because customer defection rates vary across cohorts of customers. Defection rates tend to be much higher for newer customers than for longer tenure customers. Over time, as seller and buyer demonstrate commitment, trust grows and it becomes progressively more difficult to break the relationship.[4] Successful customer acquisition programmes could produce the effect of a high customer defection rate, simply because new customers are more likely to defect.

A high sales-adjusted customer retention rate might also need some qualification. Consider a corporate customer purchasing office equipment. The customer's business is expanding rapidly. It bought 30 personal computers (PCs) last year, 20 of which were sourced from Apex Office Supplies. This year it bought 50 PCs, of which 30 were from Apex. From Apex's point of view it has grown customer value by 50 per cent (from 20 to 30 machines), which it might regard as an excellent achievement. However, in a relative sense, Apex's share of customer has fallen from 67 per cent (20/30) to 60 per cent (30/50). How should Apex regard this customer? The customer is clearly a retained customer in a 'raw' sense, and has grown in absolute value, but fallen in relative value. Consider also a retail bank customer who maintains a savings account, but during the course of a year transfers all but a few dollars of her savings to a different institution in pursuit of a better interest rate. This customer is technically still active, but significantly less valuable to the bank.

Customer retention is an important key performance indicator (KPI) for CRM implementations. Its definition and measurement need to be made with an understanding of the customer profitability issues raised above. It is important to remember that the fundamental purpose of focusing CRM efforts on customer retention is to ensure that the company maintains relationships with strategically significant customers. It may not be beneficial to maintain relationships with all customers. Some may be too costly to serve. Others may be strategic switchers constantly in search of a better deal. Others may perform no useful strategically significant role such as benchmark, door opener, inspiration or technology partner, as defined in Chapter 4.

Economics of customer retention

The economic argument in favour of customer retention goes as follows.[4,5]

- **Increasing purchases as tenure grows**: over time, customers come to know their suppliers. Providing the relationship is satisfactory, trust grows while risk and uncertainty are reduced. Therefore, they commit more of their spending to those suppliers with whom they have a proven and satisfactory relationship. Also, because suppliers develop deeper customer intimacy over time, they can enjoy better yields from their cross-selling efforts.
- **Lower customer management costs over time**: the relationship start-up costs that are incurred when a customer is acquired can be quite high. It may take several years for enough profit to be earned from the relationship to recover those acquisition costs. For example, it can take 6 years to recover the costs of winning a new retail bank customer.[6] In the B2B context in particular, the ongoing relationship maintenance costs such as selling and service costs can be low relative to the costs of winning the account. Therefore, there is a high probability that the account will become more profitable on a period-by-period basis as tenure lengthens. These relationship maintenance costs may eventually be significantly reduced or even eliminated as the parties become closer over time. In the B2B context, once automated processes are in place, transaction costs are effectively eliminated, while Extranets and portals largely transfer account service costs to the customer. In the business-to-consumer (B2C) context, especially in retailing, the claim that acquisition costs generally exceed retention costs is not well proven, in part because it is very difficult to isolate and measure customer acquisition costs.[7]
- **Customer referrals**: customers who willingly commit more of their purchases to a preferred supplier are generally more satisfied than

customers who do not. They are therefore more likely to utter word-of-mouth and influence the beliefs, feelings and behaviours of others. It is likely that newly acquired customers, freshly enthused by their experience, would be powerful word-of-mouth advocates, not longer term customers who are more habituated.[7] Reichheld shows that profit from customer referrals grows as tenure lengthens.[4] Research also shows that customers who are frequent buyers are heavier referrers. For example, online clothing customers who have bought once refer three people; after 10 purchases they will have referred seven. In consumer electronics, the one-time customer refers four; the 10 times customer refers 13. These referred customers spend about 50–75 per cent of the referrer's spending over the first 3 years of their relationship.[8]

- **Premium prices**: customers who are satisfied in their relationship may reward their suppliers by paying higher prices. This is because they get their sense of value from more than price alone. Customers in an established relationship are also likely to be less responsive to price appeals offered by competitors.

These conditions mean that retained customers are generally more profitable than newly acquired customers. Drawing from their consulting experience, Dawkins and Reichheld reported that a 5 per cent increase in customer retention rate led to an increase in the net present value of customers by between 25 and 95 per cent across a wide range of industries, including credit cards, insurance brokerage, auto services and office building management.[9] In short, customer retention drives customer lifetime value (LTV).

Which customers to retain?

Simply, the customers who have greatest strategic value to your company are prime candidates for your retention efforts. These are the customers we defined as having high LTV, or are otherwise significant as high-volume customers, benchmarks, inspirations, door openers or technology partners. You need to bear in mind that there may be a considerable cost of customer retention. Your most valued customers are also likely to be those that are very attractive to your competitors.

If the costs of retaining customers become too great then they might lose their status as strategically significant. For example, top-tier customers may demand customization, just-in-time delivery and price discounts. If this reduces their LTV significantly, and they do not fit into any other strategically significant category, they may be downgraded to tier two.

The level of commitment between a company and a customer will figure in the decision about which customers to retain. If the customer is highly committed, that is, impervious to the appeals of competitors, you do not need to invest so much in retention. However, if you have highly significant customers who are not committed, you may want to invest considerable sums in their retention.

Some companies prefer to focus their retention efforts on their recently acquired customers. They often have greater future LTV potential than longer tenure customers. There is some evidence that retention rates rise over time, so if defections can be prevented in the early stages of a relationship, there will be a pay-off in future revenue streams.[4] Another justification for focusing on recently acquired customers comes from research into service failures. When customers experience service failure, they may be more forgiving if they have a history of good service with the service provider. In other words, customers who have been recently acquired and let down are more likely to defect or reduce their spending than customers who have a satisfactory history with the supplier.[10]

Retention efforts where there is portfolio purchasing can be very difficult. Should effort be directed at retaining the high-share customer with whom you have a profitable relationship, the medium-share customer from whom you might lose additional share to competitors or the low-share customer from whom there is considerable LTV potential? The answer will depend on the current value of the customer, the potential for growing that value, and the cost of maintaining and developing the relationship.

Strategies for customer retention

Positive and negative retention strategies

An important distinction can be made between strategies that lock the customer in by penalizing their exit from a relationship, and strategies that reward a customer for remaining in a relationship. The former are generally considered negative, and the latter positive customer retention strategies. Negative customer retention strategies impose high switching costs on customers, discouraging their defection.

In a B2C context, mortgage companies have commonly recruited new customers with attractive discounted interest rates. When the honeymoon period is over, these customers may want to switch to another provider, only to discover that they will be hit with early redemption and exit penalties. Customers wishing to switch retail banks find that it is less simple than anticipated: direct debits and standing orders have to be reorganized. In a B2B context, a customer may have agreed a deal to purchase a given volume of raw material at a quoted price. Some way through the contract a lower cost supplier makes a better offer. The customer wants to switch but finds that there are penalty clauses in the contract. The new supplier is unwilling to buy the customer out of the contract by paying the penalties.

Some customers find that these switching costs are so high that they remain customers, although unwillingly. The danger for CRM practitioners is that negative customer retention strategies produce customers who feel trapped. They are likely to agitate to be freed from their obligations, taking up much management time. Also, they may utter negative word-of-mouth. They are unlikely to do further business with that supplier. Companies that pursue these strategies argue that customers need to be aware of what they are buying and the contracts they sign. The total cost of ownership (TCO) of a mortgage can include early redemption costs.

When presented with a dissatisfied customer who is complaining about high relationship exit (switching) costs, companies have a choice. They can either enforce the terms and conditions, or not. The latter path is more attractive when the customer is strategically significant, particularly if the company can make an offer that matches that of the prospective new supplier.

In the following sections we look at a number of positive customer retention strategies, including meeting and exceeding customer expectations, finding ways to add value, creating social and structural bonds, and building commitment.

Meet and exceed expectations

It is very difficult to build long-term relationships with customers if their needs and expectations are not understood and well met. It is a fundamental precept of modern customer management that companies should understand customers, then acquire and deploy resources to ensure their satisfaction and retention. This is why CRM is grounded on detailed customer knowledge (Chapter 5). Customers that you are not positioned to serve may be better served by your competitors.

Exceeding customer expectations means going beyond what would normally satisfy the customer. This does not necessarily mean being world-class or best-in-class. It does mean being aware of what it usually takes to satisfy the customer and what it might take to delight or pleasantly surprise the customer. You cannot really strategize to delight the customer if you do not understand the customer's fundamental expectations. You may stumble onto attributes of your performance that do delight the customer, but you cannot consistently expect to do so unless you have deep customer insight. Consistent efforts to delight customers show your commitment to the relationship. Commitment builds trust. Trust begets relationship longevity.

Customer delight occurs when the customer's perception of their experience of doing business with you exceeds their expectation. In formulaic terms:

$$\text{Customer delight} = P > E$$

where P = perception and E = expectation.

This formula implies that customer delight can be influenced in two ways: by managing expectations or by managing performance. In most commercial contexts customer expectations are ahead of perceptions. In other words, customers generally can find cause for dissatisfaction. You might think that this would encourage companies to attempt to manage customer expectations down to levels that can be delivered. However, competitors may well be improving their performance in an attempt to meet customer expectations. If your strategy is to manage expectations down, you may well lose customers to the better performing company. This is particularly so if you fail to meet customer expectations on important attributes.

Customers have expectations of many attributes, for example product quality, service responsiveness, price stability, and the physical appearance of your people and vehicles. These are unlikely to be equally important. It is important to meet customer expectations on attributes that are important to the customer. Online customers, for example, look for rapid and accurate order fulfilment, good price, high levels of customer service and website functionality. Dell Computers believes that customer retention is the outcome of their performance against three variables: order fulfilment [on time, in full, no error (OTIFNE)], product performance (frequency of problems encountered by customers) and aftersales service (percentage of problems fixed first time by technicians). The comments in parentheses are the metrics that Dell uses. Figure 9.2 identifies a number of priorities for improvement (PFIs) for a restaurant company. The PFIs are the attributes where customer satisfaction scores are low, but the attributes are important to customers. In the example, the PFIs are food quality and toilet cleanliness. There would be no advantage in investing in speedier service or more helpful staff.

Kano has developed a product quality model that distinguishes between three forms of quality. Basic qualities are those that the customer routinely expects in the product. These expectations are often unexpressed until the product fails. For example, a car's engine should start first time every time and the sunroof should not leak. The second form is linear quality. These are attributes of which the customer wants more or less; for example, more comfort, better fuel economy and reduced noise levels. Marketing research can usually identify these requirements. Better performance on these attributes generates better customer satisfaction. The third form is attractive quality. These are attributes that surprise, delight and excite customers. They are answers to latent, unarticulated

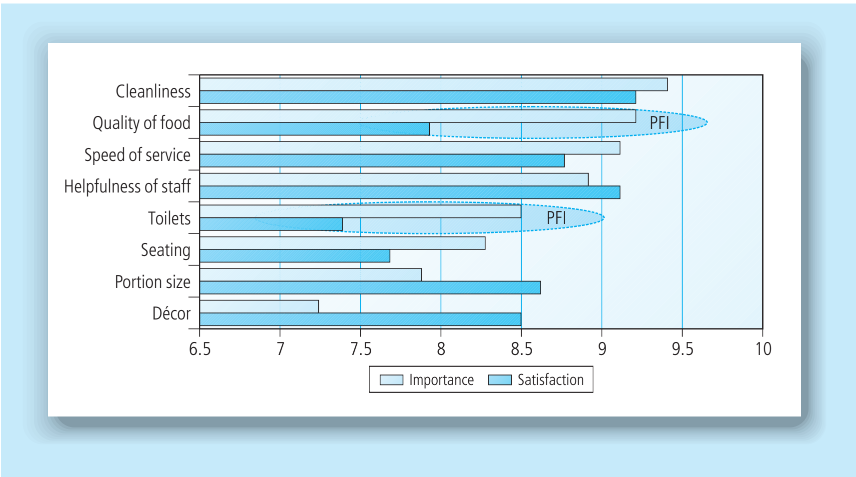

Figure 9.2 Using customer satisfaction and importance data to identify priorities for improvement

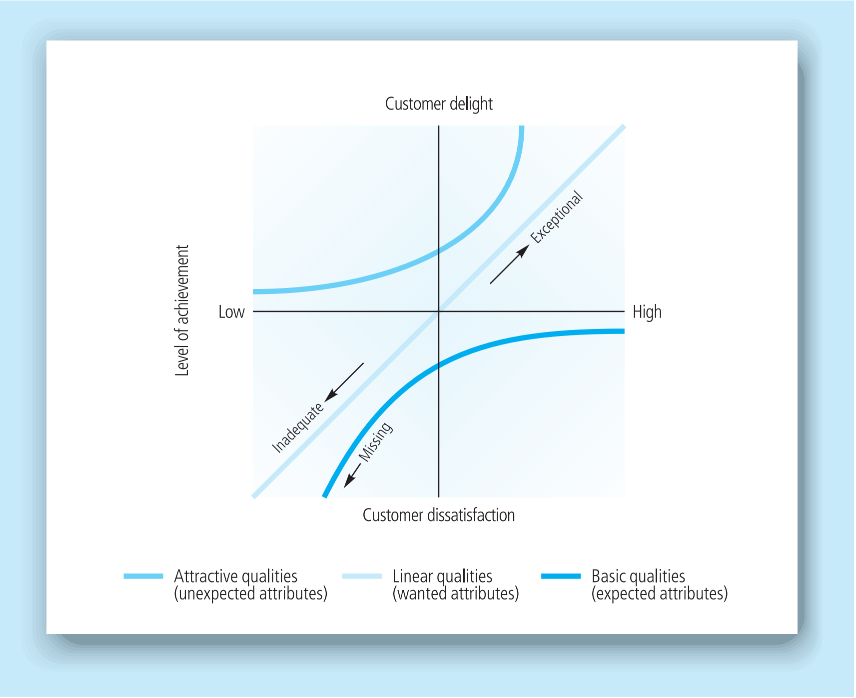

Figure 9.3 Customer delight through product quality (Source: Kano[11])

needs and are often difficult to identify in marketing research. As shown in Fig. 9.3, Kano's analysis suggests that customers can be delighted in two ways: by enhancing linear qualities beyond expectations and by creating innovative attractive qualities.[11]

A number of companies have adopted 'customer delight' as their mission, including Cisco, American Express and Kwik-Fit, the auto service chain. Others pay homage to the goal but do not organize to achieve it. In the service industries, customer delight requires front-line employees to be trained, empowered and rewarded for doing what it takes to delight customers. It is in the interaction with customers that contact employees have the opportunity to understand and exceed their expectations. The service quality attributes of empathy and responsiveness are on show when employees aim to delight customers.

Exceeding expectations need not be costly. For example, a sales representative could do a number of simple things such as:

- volunteer to collect and replace a faulty product from a customer rather than issuing a credit note and waiting for the normal call cycle to schedule a call on the customer
- offer better, lower cost solutions to the customer, even though that might reduce margin
- provide information about the customer's served market. A packaging company, for example, might alert a fast-moving consumer goods manufacturer customer to competitive initiatives in the market.

Some efforts to delight customers can go wrong. For example, sooner is not necessarily better. For example, if a retail store customer has requested delivery between 1 and 3 pm, and the driver arrives an hour early, the truck may clog up goods inwards and interfere with a carefully scheduled unload plan. Many contact centres play music while callers are waiting online. This is to divert the caller's attention and create the illusion of faster passage of time. However, the cycle time of the selected music must not be too fast, otherwise callers will be exposed to the same songs repeatedly. Also, the music needs to be appropriate to the context. Customers may not appreciate '(I Can't Get No) Satisfaction' by the Rolling Stones if they are waiting online to complain.

Companies sometimes complain that investing in customer delight is unproductive. As noted earlier, expectations generally increase as competitors seek to offer better value to customers. Over time, as customers experience delight, their expectations change. What was exceptional becomes the norm. In Kano's terms, what used to be an attractive attribute becomes a linear or basic attribute. It no longer delights. Delight decays into normal expectation, and companies have to look for new ways to pleasantly surprise customers. In a competitive environment, it seems to make little sense to resist the quest for customer delight, because competitors will simply drive up expectations anyway.

Find ways to add value

Companies can explore ways to create additional value for customers. The ideal is to add value for customers without creating additional costs for the company. If costs are incurred then the value-adds may be expected to recover those costs. For example, a customer club may be expected to generate a revenue stream from its membership.

There are three common forms of value-adding programme: loyalty schemes, customer clubs and sales promotions.

Loyalty schemes

Loyalty schemes reward customers for their patronage. The more a customer spends, the higher the reward. Loyalty schemes have a long history. In 1844, in the UK, the Rochdale Pioneers developed a co-operative retailing operation that distributed surpluses back to members in the form of a dividend. The surpluses were proportionate to customer spend. S&H Pink Stamps and Green Shield stamps were collected in the 1950s and 1960s, and redeemed for gifts selected from catalogues. In the 1970s, Southwest Airlines ran a 'Sweetheart Stamps' programme that enabled travellers to collect proofs of purchase and surrender them for a free flight for their partner.[12]

Today's CRM-enabled loyalty schemes owe their structure to the frequent flier programmes (FFPs) that started with American Airlines' AAdvantage programme in 1981. The airline made a strategic decision to use its spare capacity as a resource to generate customer loyalty. Airlines are high fixed cost businesses. Costs do not change much, no matter whether the load factor is 25 or 95 per cent. American knew that filling the empty seats would have little impact on costs, but could impact significantly on future demand. The airline searched its reservation system, SABRE, for details of frequent fliers in order to offer them the reward of free flights.

This basic model has migrated from airlines into many other B2C sectors, such as hotels, restaurants, retail, car hire, petrol stations and bookstores. It has also transferred into B2B contexts, with many suppliers offering loyalty rewards to long-term customers.

The mechanics of these schemes have changed over time. Initially, stamps were collected. The first card-based schemes were anonymous, i.e. they carried no personal data, not even the name of the participant. Then magnetic stripe cards were introduced, followed by chip-embedded cards that carried a lot of personal and transactional data. Innovators developed their own individual schemes (see Cases 9.1 and 9.2). Eventually, these transformed into linked schemes, in which, for example, it was possible to collect air miles from various participating companies such as petrol stations, credit cards and food retailers. Current schemes are massively different from the early programmes. For example, Nectar is a consortium loyalty scheme operating in the UK, and managed not by the participants, but by an independent third party. Its core retail participants are all number one or two in their respective markets: Sainsbury's, Barclaycard, Debenhams and BP. Shoppers register in the scheme, then carry a single magnetic stripe card and collect points that are converted into vouchers redeemable in a wide range of retailers, including supermarkets, off-licences, catalogue retailers, restaurants, hotels, cinemas, travel agencies and tourist attractions. Each of the major retail participants had been a member of another loyalty programme, and customers were able to convert their existing credits to Nectar points.

Case 9.1

The Tesco Clubcard

The cornerstone of Tesco's CRM strategy has been its loyalty programmes. Tesco introduced its first loyalty programme in 1995. Called the 'Clubcard', this loyalty card programme enabled customers to accumulate points with each purchase that could be used to obtain discounts off future purchases.

The Clubcard proved to be very successful: first, in attracting more customers to Tesco stores; second, in capturing valuable information from customers with every swipe of the card, which led to the creation of a powerful database that was made possible through club membership information. For example, the card provided Tesco with vital information such as what products customers were and were not buying, where they were spending their time in the store, and where they were not, as measured by spending. As a result of this initial success, 108 customer segments were identified and specific offers were made to each, such as high-value customers receiving valet parking when they came to shop and other special privileges.

In 1996 Tesco introduced two further loyalty cards, a student card and a card for mothers, with offers specifically targeted to each group's needs.

Case 9.2

Loyalty programme at Boots the Chemist

Boots the Chemist is the UK's leading health and beauty retailer. Ninety per cent of the UK's 60 million population visits a Boots store at least once a year. The company has an annual turnover of around £3 billion from a network of some 1300 stores.

Boots launched their CRM strategy in 1999. It was built around the 'Advantage Card', a loyalty programme enabled by a chip-embedded smart card. The standard reward for purchases is four points for every £1 spent, equivalent to a 4 per cent discount or rebate. This is a very generous rate of reward compared with the other retail sectors, where the major supermarket loyalty schemes represent a 1 per cent saving for customers.

After an initial investment in excess of £30 million, the programme has become the third-largest retail loyalty scheme in the UK. Boots reported that it took 3 years to achieve the programme's revenue objectives and there have been many other benefits such as higher levels of customer retention, increased in-store spending and overall increased profitability.

Boots took its time to introduce the scheme, rather than rapidly following the trend to loyalty schemes in the early 1990s. It conducted extensive market research to determine what customer segments to target, how to differentiate their programme and how to ensure that it fitted the organization's image. The market research discovered that 83 per cent of Boots' customers were female, aged 20–45, who on 55 per cent of their visits to a store purchased a non-essential 'indulgent' item. Considering the results from the market research, the Advantage Card was targeted towards female customers, rewarding them with indulgent items, instead of reducing the cost of their normal shopping.

Since inception the card has become the largest smart card-based retail loyalty card scheme in the world. It currently has 12.3 million cardholders, and more than 40 per cent of transactions in-store are now linked to the card.

It has been suggested that successful schemes deliver five types of value to participants: [13]

- **cash value**: how much is the reward worth in cash compared with what is spent to obtain it?
- **redemption value**: how wide a range of rewards is offered?
- **aspirational value**: how much does the customer want the reward?
- **relevance value**: how achievable are the rewards?
- **convenience value**: how easy is it to collect the credits and redeem them for the reward?

Even if they possess these characteristics, loyalty schemes are not without critics. They can be very expensive to establish and manage. In respect of operating costs, retail schemes typically reward customers with a cash rebate or vouchers equivalent to 1 per cent of purchases. This comes straight out of the bottom line, so a retailer that is making 5 per cent margin loses one-fifth or 20 per cent of its profit to fund the scheme. There may also be a significant investment in technology to support the scheme, and marketing to launch and sustain the scheme. Supermarket operator Safeway dropped its UK loyalty programme, which had been costing about £30 million annually. Shell is reported to have spent up to £40 million to develop its smart card scheme.[14] Unredeemed credits represent liabilities for scheme operators. For example, it has been suggested that if all the unused air miles were redeemed on the same day it would take 600 000 Boeing 747s to meet the demand.[12]

Schemes have become less distinctive and value-adding as many competitors now operate me-too programmes. Fundamentally, these schemes may not be creating loyalty at all. For example, many UK supermarket shoppers carry loyalty cards from more than one supermarket.[15] The customer's choice set when grocery shopping includes all suppliers with whom they have a card-based relationship. It is also claimed that customers become loyal to the scheme rather than to the company or brand behind the scheme.[16]

Whether they develop loyalty or not, these schemes certainly reward buying behaviour. Accumulated credits represent investments that the customer has made in the scheme or the brands behind the scheme. When customers get no return from this investment, they can be deeply distressed. Members of at least five airlines, Braniff, Midway, MGM Grand, Legend and Ansett, lost their air miles when their airlines folded. Members of Pan Am's FFP were fortunate to have their credits transferred into Delta Airlines when Pan Am stopped flying. Frequent fliers of Australia-based Ansett forfeited their miles after the airline stopped flying in 2001. Passengers organized themselves into a group to lobby,

Figure 9.4
ipoints website

ultimately unsuccessfully, for their loyalty to be recognized and rewarded by the company administrators, or prospective purchasers of the airline.

In addition, loyalty schemes are successful enablers of customer insight. Personalized cards are obtained only after registering personal data. Then it becomes possible to monitor transactional behaviour. Chip-embedded smart cards carry the information on the card itself. A huge amount of data is generated that can be warehoused and subjected to data mining for insights into purchasing behaviour. These insights can be used to guide marketing campaigns and offer development. Boots, for example, ran a series of controlled experiments mailing health and beauty offers to select groups of carefully profiled customers. It achieved 40 per cent response rates in comparison to 5 per cent from the control group. For more information on the history and development of loyalty schemes, see Worthington.[17]

The loyalty scheme concept has migrated into the online retail environment. One of the innovators, beenz, which was established in 1998, has not survived. Other scheme brands include ipoints (Fig. 9.4) and mypoints.

Customer clubs

Customer clubs are organizations established by companies to deliver a range of benefits to members. The initial costs of establishing a club can be quite high, but thereafter most clubs are expected to cover their operating expenses and, preferably, return a profit. Research suggests that customer clubs are successful at promoting customer retention.[18]

To become a member and obtain benefits, clubs require customers to register. With these personal details, the company is able to begin interaction with customers, learn more about them, and develop offers and services for them. Clubs can only succeed if members experience benefits that they value. Club managers can assemble and offer a range of value-adding services and products that, given the availability of customer data, can be personalized to segment or individual level. Among the more common benefits of club membership are access to member-only products and services, alerts about upcoming new and improved products, discounts, magazines and special offers.

There is a huge number of customer clubs. One report estimates that there are 'several hundred' in Germany alone.[18] B2C clubs include:

- Swatch the Club (see www.swatch.com)
- The Rolling Stones Fan Club (see Case 9.3)
- The Pampers Parenting Institute (see http://www.pampers.com/en_US/learning/ppi/jhtml)
- Casa Buitoni (see http://www.buitoni.com/index/index.asp)
- The Harley Owners' Group (HOG) (see http://www.hog.com/home.asp)
- Sainsbury's **Little**ones Club (see http://www.sainsburys.co.uk/littleones/default.asp?page = main.asp)
- The Volkswagen Club (see http://www.vw-club.de/).

Case 9.3

The Rolling Stones fan club

- Offers three classes of membership: Premium, Got a Ticket and Basic. Membership at Premium status costs US$95 a year. At the beginning of 2003 benefits included:
  – Access to all the features of the Rolling Stones Official Fan Club website
  – The chance to purchase up to four tickets to one show (two to theatres and clubs) before they go on sale to the general public.
  – A complimentary copy of the new Stones CD, *Forty Licks*
  – A complimentary Official Fan Club hat
  – A code good for 5 per cent off all purchases in the soon-to-be launched Official Fan Club store

There are 650 000 paid-up members of the Harley Owners' Group. They choose from two levels of membership, full and associate, and a variable membership length, from 1 year to lifetime. Among the many benefits are an affinity group Visa card, a membership manual, a touring handbook, a dedicated website, magazines, a mileage programme, membership in over 600 chapters, invitations to events and rallies, and a lot more.

Sales promotions

Whereas loyalty schemes and clubs tend to have a long life, sales promotions offer only temporary enhancements to customer value. Sales promotions can also be used for customer acquisition (see Chapter 8). Retention-oriented sales promotions encourage the customer to repeat purchase, so the form they take differs.

- **In-pack or on-pack voucher**: customers buy the product and receive a voucher entitling them to a discount off one or more additional purchases.
- **Rebate or cashback**: rebates are refunds that the customer receives after purchase. The value of the rebate can be adjusted in line with the quantity purchased, to reward customers who meet high volume requirements.
- **Free premium for continuous purchase**: the customer collects proofs of purchase and mails them in, or surrenders them at retail to obtain a free gift. Sometimes the gift might be part of a collectible series. Customers buying preserves and jams collected proofs of purchase and mailed them in to receive an enamel badge. There were 20 different badges in the series. So popular was this promotion that a secondary market was established so that collectors could trade and swap badges to obtain the full set.
- **Self-liquidating premium**: a self-liquidating promotion is one that recovers its own direct costs. Typically, consumers are invited to collect proofs of purchase, such as store receipts or barcodes from packaging, and mail them in with a personal cheque. This entitles the customer to a discounted premium such as a camera or gardening equipment. The

promoter will have reached a deal with the suppliers of the premiums to buy at a highly discounted rate, perhaps on a sale-or-return basis. Margins earned from the sale of product, plus the value of the cheque, cover the costs of running the promotion.

- **Collection schemes**: these are long-running schemes in which the customer collects items with every purchase. Kellogg's ran a promotion in which they inserted picture cards of carefully chosen sports stars into packets of cereals. Customers did not know what card they had until they bought and opened the pack. These became collectable items.

Bonding

The next customer retention strategy is bonding. B2B researchers have identified many different forms of bond between customers and suppliers. These include interpersonal bonds, technology bonds [as in electronic data interchange (EDI)], legal bonds and process bonds. These different forms can be split into two major categories: social and structural.[19]

Social bonds

Social bonds are found in positive interpersonal relationships between people on both sides of the customer–supplier dyad. Positive interpersonal relationship are characterized by high levels of trust and commitment. Successful interpersonal relationships may take time to evolve as uncertainty and distance are reduced. As the number of episodes linking customer and supplier grow, there is greater opportunity for social bonds to develop. Suppliers should understand that if they act opportunistically or fail to align themselves to customer preferences, trust and confidence will be eroded.

Strong social bonds can emerge between employees in companies having similar sizes, cultures and locations. For example, small and medium-sized businesses generally prefer to do business with similar-sized companies, and Japanese companies prefer to do business with other Japanese companies. Geographical bonds emerge when companies in a trading area co-operate to support each other.

Social relationships between buyer and seller can be single-level or multi-level. A single-level relationship might exist between the supplier's account manager and the customer's procurement officer. The more layers there are between the dyad, the more resistant the relationship is to breakdown. For example, technical, quality and operations people talk to their equivalents on the other side.

Social bonds characterized by trust generally precede the development of structural bonds. Mutual investments in a joint venture are structural bonds. Companies are unlikely to commit resources if there is a low level of trust in the partner's integrity and competence.

Structural bonds

Structural bonds are established when companies and customers commit resources to the relationship. In general, these resources yield mutual benefits for the participants. For example, a joint customer–supplier quality team can work on improving quality compliance, benefiting both companies. Resources committed to a relationship may or may not be recoverable if the relationship breaks down. For example, investments made in training a customer's operatives are non-returnable. In contrast, a chilled products manufacturer that has installed refrigerated space at a distributor's warehouse may be able to dismantle and retrieve it on relationship dissolution.

A key attribute of structural bonding is investment in adaptations to suit the other party. Suppliers can adapt any element of the offer – product, process, price and inventory levels, for example – to suit the customer. Customers also make adaptations. They can adapt their manufacturing processes to accommodate a supplier's product or technology. Power imbalances in relationships can produce asymmetric adaptations. A major multiple retailer might force adaptations from small suppliers while making no concessions itself. For example, it could insist on a reduction in product costs, or co-branding of point-of-sale material, or even attempt to coerce the supplier not to supply competitors.

Different types of structural bond can be identified. All are characterized by an investment of one, or both parties, in the other:

- **financial bonds**: where the seller offers a financial inducement to retain the customer. Insurance companies form financial bonds with customers by offering no-claims discounts, tenure-related discounts and multi-policy discounts
- **legal bonds**: when there is a contract or common ownership linking the relational partners (see Case 9.4)
- **equity bonds**: where both parties invest in order to develop a competitive offer for customers, e.g. the owners of airports invest in the shells of the duty-free retail outlets. The retailer invests in the internal fixtures and fittings
- **knowledge-based bonds**: when each party grows to know and understand the other's processes and structures, strengths and weaknesses
- **technological bonds**: when the technologies of the relational partners are aligned, e.g. with EDI or partner relationship management software
- **process bonds**: when processes of the two organizations are aligned, e.g. the quality assurance programme on the supplier side and the quality inspection programme on the customer side. Some suppliers offer to manage the inventory of their customers and ensure that inventory levels are optimized. This is known as vendor managed inventory (VMI), e.g. chemicals company Solvay Interox enables VMI by using telemetry systems
- **project bonds**: when the partners are engaged in some special activity outside their normal commercial arrangements, e.g. a new product development venture. There may be an exchange of resources to enable the desirable mutual outcome to be achieved, for example an exchange of engineers and technologists between the companies

Case 9.4

Customer retention at Korea Telecom

Korea Telecom places a high level of importance upon creating valuable relationships with customers, both business and consumer, in the telecommunications markets of South Korea and south-east Asia.

The organization places significant emphasis on maintaining high retention rates in markets that are becoming increasingly competitive. To this end, Korea Telecom estimates that it costs around US$185 to gain a consumer for a broadband Internet service. However, for an average customer it takes almost 2 years for the organization to break even with such a service. Consequently, the organization undertakes a number of activities as part of its CRM strategy to retain customers, including offering the bundling of a number of services such as Internet, mobile and home phone at a discount to customers who enter into service contracts for at least 2 years.

- **multi-product bonds**: when a customer buys several products from a supplier, the bond is more difficult to break. There are economies for customers in dealing with fewer suppliers. When a relationship with a supplier of several products is dissolved, the customer may incur significant money, search and psychic costs in searching for one or more replacements. Further, the level of perceived risk attached to a new relationship may become uncomfortable.

Social bonds are generally easier to break than structural bonds. Structural bonds link organizations. Social bonds link people. If the account manager and procurement officer do not grow to trust each other, they may fall out, but this is unlikely to bring down a joint venture.

Build commitment

The final strategy for building customer retention is to create customer commitment. Various studies have indicated that customer satisfaction is not enough to ensure customer longevity. For example, Reichheld reports that 65–85 per cent of recently defected customers claimed to be satisfied with their previous suppliers.[20] Another study reports that 1 in 10 customers who said they were completely satisfied, scoring 10 out of 10 on a customer satisfaction scale, defected to a rival brand the following year.[21]

Several authorities have urged companies to work on developing customer commitment.[22,23] These customers are more than satisfied. They have an emotional attachment to your proposition or company. Committed customers have the following characteristics.

- They are very satisfied customers.
- They believe that your brand, offer or company is superior to other competitors.

- They are involved in your brand, offer or company.
- They have a strong intention to buy that overrides promotional offers from competitors.

Three different form of commitment have been identified: instrumental, relational and values-based.[24]

Instrumental commitment

This occurs when customers are convinced that no other offer or company could do a better job of meeting their needs. They are not just very satisfied, but unbeatably satisfied. All expressed and latent needs have been met. When a customer feels that her bank has the best products, the best access, the best processes, the lowest interest rates on loans and the best reputation, she is committed.

Relational commitment

Customers can become highly attached to a company's people. The emotional tie may be with an individual person, a work group or the generalized company as a whole. Customers who talk about 'my banker' or 'my mechanic' or 'my builder' are expressing this attachment. They feel a sense of personal identification with that individual. Often, these are employees who 'break the rules' or 'go the extra mile' to satisfy customers completely. They are reliable, competent, empathic and responsive. When these employees recover an at-risk customer, they create a friend. Customer-focused organizations make heroes out of these individuals. They are feted and celebrated. For example, American Express tells the story of a customer service agent who responded to a call from a customer who had been robbed, by arranging to have replacement traveller's cheques delivered personally to the customer. He also confirmed the customer's hotel reservation, arranged for a car to collect the customer from the phone booth and notified the police: all above and beyond the call of duty. Customers can also become attached to a work group. In banking, for example, some customers are highly committed to a specific branch and prefer not to transact elsewhere. Finally, customers can become attached to an organization as a whole, believing its people to be better than competitors on dimensions that are important to the customer. They may provide 'the best service' or be 'the friendliest people'.

Values-based commitment

Customers become committed when their values are aligned with those of the company. Values can be defined as:

> core beliefs that transcend context and serve to organize and direct attitudes and behaviours.

Customers have many and varied core beliefs such as environmental awareness, honesty, child protection, independence, family-centredness and so on. Many of these reflect cultural norms. Where these values coincide with those of an organization, the customer may become a committed, highly involved customer. Companies that are accused of using child labour, damaging the environment or otherwise acting unethically place themselves at risk. Nestlé had been accused of marketing infant formula in African countries where the infrastructure made its use dangerous. Many babies died as mothers used unclean water and unsterilized equipment. This is estimated to have cost the company $40 million.[25] Sales of Shell fuel were estimated to have fallen between 20 and 50 per cent during the Brent Spar boycott.[26] The company had planned to decommission the 4000 tonne Brent Spar oil platform by dumping it into the North Sea. Just as customers can take action against companies that they feel are in beach of their values, so can they commit to companies that mirror with their values. Research supports the claim that there is a hierarchical relationship from values to attitudes to purchase intention and ultimately to purchase.[27]

Various companies benefit from values-based commitment, for example Body Shop, John Lewis, Harley Davidson, Co-operative Bank and Virgin.

Body Shop International, the health and beauty retailer, was founded by Anita and Gordon Roddick. The company's values include a refusal to source products tested on animals, and support for community trade, human rights and the environment. A successful and influential business was developed on the back of these values. Body Shop influenced other retailers to become more sensitive to these issues.

The John Lewis Partnership is a UK-based department store with a 140 year history. It is a mutual organization, owned by its staff and incorporated as a trust. Profits are not distributed to external shareholders. Rather, they are shared with employees, who are regarded as partners. The company is reputed to look after these partners very well, including, for example, having a final salary pension scheme.

Harley Davidson, the US motorcycle manufacturer, has a phenomenally committed customer base. When Harley riders replace their bikes, 95 per cent buy another Harley. The bike is a central part of a lifestyle that is grounded on fraternity, independence and rebellion. Image is critical to the Harley rider. In the USA, the average age of a Harley rider is 46 (up from 38 a decade ago), the average salary is $78 000 and the typical cruiser bike costs $17 000. The challenge for Harley is to develop value propositions that appeal to a younger customer.[28]

The Co-operative Bank is positioned in the UK retail banking market as the ethical bank. The mutually owned bank believes that its ethical stance contributed about £20 million to pre-tax profits of £107.5 million reported in 2001. In its annual partnership report, which measures ethical performance, the bank said it had turned down 52 finance opportunities on ethical grounds in 2001. About 41 per cent were rejected because they could damage the environment, including finance for an engineering group to build a pipeline in Sudan. Another 15 per cent were rejected because the companies did not have a satisfactory animal-testing policy or were involved in intensive farming. One-third of the bank's customers moved to the bank because of its ethical and eco-friendly policies.[29]

The Virgin Group is a family of many hundreds of privately owned strategic business units ranging from airline to rail, cosmetics, cola, telecoms, music and financial services. In year 2000 group sales reached US$5.8 billion. The values of the Virgin brand are integrity, value for money, quality and fun. Virgin Group is chaired by its founder, the renegade but highly visible Sir Richard Branson. Customers are attracted to the brand because of its reputation for fairness, simplicity and transparency. Customers trust the brand and rely on it in markets that are new to them. For example, Virgin was a late mover into the index-linked mutual fund marketplace. It still managed to become market leader in 12 months, despite having no history as a financial institution.

Context makes a difference

Context makes a difference to customer retention in two ways. First, there are some circumstances when customer acquisition makes more, indeed the only, sense as a strategic goal. Secondly, customer retention strategies will vary according to the environment in which the company competes.

When launching a new product or opening up a new market, a company's focus has to be on customer acquisition. In contexts where there are one-off purchases such as funerals, infrequent purchases such as heart surgery, or unique conditions such as gave rise to the demand for Y2K compliance software, customer retention is subordinate to acquisition.

The impact of contextual conditions on the choice and timing of customer retention practices has not been thoroughly researched. However, several contextual considerations impact on customer retention practices.

Number of competitors

In some industries, there is a notable lack of competitors, meaning that companies do not suffer badly from customer churn. This typically applies in state-provided services such as education and utilities such as gas, electricity, rail and telecoms, whether deregulated or not. When customers are dissatisfied they have no competitor to turn to. They may also believe that the competitors in the market are not truly differentiated by their service standards. In other words, each supplier is as bad as the others. The result is inertia.

Corporate culture

In corporate banking, the short-term profit requirement of both management and shareholders has resulted in the lack of real commitment to relationship banking. Banks have been very opportunistic in their preference for transactional credit-based relationships with customers.[30]

Channel configuration

Sellers may not have the opportunity to maintain direct relationships with the ultimate buyers and users of their products. Instead, they may rely on their intermediaries. Caterpillar, for example, does not have a relationship with the contractors who use their equipment. Instead, it works in partnership with about 200 independent dealers around the world to provide customer service, training, field support and inventories of spare parts.

Purchasing practices

The purchasing procedures adopted by buyers can also make the practice of customer retention futile. Customers do not always want relationships with their suppliers. For example, government departments in the UK have adopted compulsory competitive tendering (CCT) as their mechanism for making purchasing decisions. The process is designed to prevent corrupt relationships developing and to ensure that tax-payers get good value for money; that is, pay a low price for the services rendered. Every year or so, current suppliers and other vendors are invited to pitch for the business. Price is often the primary consideration for the choice of supplier.

Ownership expectations

The demands of business owners can subordinate customer retention to other goals. For example, Korean office-equipment manufacturers are very focused on sales volumes. They require their wholly owned distributors to buy quotas of product from Korea, and sell them in the served market regardless of whether the products are well-matched to local market conditions and customer requirements. The distributors are put in a position of having to create demand against competitors that do a better job of understanding and meeting customer requirements.[3]

Ethical concerns

Public sector medical service providers cannot simply focus on their most profitable customers or products. This would result in the neglect of some patients and a failure to address other areas of disease management. Private sector providers do not necessarily face this problem. The Shouldice Hospital in Ontario specializes in hernia repairs. Their website, www.shouldice.com, reports that they have repaired 270 000 hernias over a 55 year period with a 99 per cent success rate. They even organize annual reunions. Recently, these events have been attended by 1000 satisfied patients.

Key performance indicators of customer retention programmes

Practitioners of CRM are concerned with a number of KPIs for these customer retention activities, among them the following:

- What is the raw customer retention rate?
- What is the raw customer retention rate in each customer segment?
- What is the sales-adjusted retention rate?
- What is the profit-adjusted retention rate?
- What are the sales and profit-adjusted retention rates in each customer segment?
- What is the cost of customer retention?
- What is the share of wallet of the retained customers?
- What is the customer churn rate per channel?
- What is the cost-effectiveness of customer retention tactics?

The choice of KPI will vary according to context. Some companies do not have enough data to compute raw retention rate per segment. Others may not know their share of wallet (share of customer spending on the category).

The role of research

Companies can reduce levels of customer churn by researching a number of questions:

- Why are customer defecting?
- Are there any lead indicators of impending defection?
- What can be done to address the root causes?

The first question can be answered by contacting and investigating former customers to find out why they took their business elsewhere.

Customers defect for all sort of reasons, not all of which can be foreseen, prevented or managed by a company. For example, Keaveney identified eight causes of switching behaviours in service industries: price, inconvenience, core service failures, failed employee responses to service failure, ethical problems, involuntary factors, competitive issues and service encounter failures. Six of the eight causes of switching behaviours are controllable by the service provider.[31]

Other research has identified six types of defectors: [32]

- **price**: for a lower price
- **product**: for a superior product
- **service**: for a better service
- **market**: for a different market, for example, a transport company that has moved out of road haulage and therefore no longer buys trailers
- **technological**: a customer that has converted from using one technology to another, for example from dedicated word processors to multipurpose PCs
- **organizational**: switches due to political pressure.

The second question attempts to find out whether customers give any early warning signals of impending defection. If these were identified the company could take pre-emptive action. Signals might include the following:

- reduced RFM scores (recency–frequency–monetary value)
- non-response to a carefully targeted offer
- reduced levels of customer satisfaction
- dissatisfaction with complaint handling
- reduced share of customer (e.g. customer only flies one leg of an international flight on your airline)
- inbound calls for technical information
- late payment
- querying an invoice
- customer touch points are changed (e.g. store closes, change of website address)
- preferred customer contact person moves on
- customer change of address.

Customer researchers are also advised to analyse the reasons for customer defection, and to identify the root causes.[33] Sometimes these can be remedied by management. For example, if you lose customers because of the time taken to deal with a complaint, management can audit and overhaul the complaints management process. This might involve identifying the channels and touchpoints through which complaints enter the business, updating complaints database management, or training and empowering frontline staff. Root causes can be analysed by customer segment, channel and product. The 80:20 rule may be applicable. In other words, it may be possible to eliminate 80 per cent of the causes of customer defections with relative ease.

Strategies for customer development

Customer development is the process of growing the value of retained customers. Companies generally attempt to cross-sell and up-sell products into the customer base while still having regard for the satisfaction of the customer. Cross-selling means selling additional products and services. Up-selling means selling higher value (and margin) products and services. Customers generally do not respond positively to persistent and repeated efforts to sell additional products and services that are not related to their requirements. There is an argument that companies should seek to down-sell where appropriate. This means identifying and providing lower cost solutions to the customers' problems, even if it means making a lower margin. Customers may regard up-selling as opportunistic and exploitative, thereby reducing the level of trust they have in the supplier, and putting the relationship at risk. Successful CRM-based customer development activities have a number of characteristics.

- **Data mining**: offers are based on intelligent data mining. Mining tells you what customers have already bought. It can also tell you the probability of a customer buying any other products (propensity to buy), based on their transactional history or demographic/psychographic profile. First Direct, the Internet and telephone bank, uses propensity-to-buy scores to run targeted, event-driven cross-sell campaigns through direct mail and call centres. They aim at high conversion rates through follow-up calls.
- **Customization**: offers are customized at segment or unique customer level. Also personalized is the communication to the customer and the channel of communication – e-mail, surface mail or phone call, for example.
- **Channel integration**: customer development activities are integrated across channels. It is regarded as bad practice to have different channels making different offers to the customer. In retail, this would mean that channels such as stores, web and direct-to-consumer channels act in an integrated, customer-centric manner. Clearly, customer information and customer development plans need to be shared across channels.
- **Integrated customer communication**: the messages communicated to customers are consistent across all channels.
- **Campaign management**: campaign management software is used to develop customer development campaigns and track their effectiveness, particularly in terms of sales and incremental margin.

In mature markets, where customer acquisition is difficult or expensive, the development of retained customers is an important source of additional revenues. For example, in the mature mobile telecoms market, the penetration of handsets is at a very high level. Winning new-to-market customers is regarded as too difficult, since these are the laggards, and expensive to convert. Network operators have begun to focus on selling additional services to their existing customer bases, including data applications, as shown in Case 9.6.

Case 9.5

Tesco's strategy for customer development

The cornerstone of Tesco's customer development programme has been its loyalty card. The retailer uses it to retain, develop and add value to relationships with customers.

Tesco's Clubcard is a loyalty programme that employs magnetic stripe technology. The Clubcard has been extremely popular, with over 12 million members. It continues to grow, with a large number of prominent retailers in the UK becoming affiliated with the programme.

Tesco attributes an average 34 per cent increase in customer spend since 1995 to the programme, which enables the company to target communications and offers much more effectively.

Case 9.6

Customer development at Vodafone

⟨ Extract from the Vodafone Annual Review 2001 ⟩

- 'We expect to see customer growth moderate as most of our markets have now reached a high level of penetration. This means that the rate of future growth will slow, although the potential for more rapid growth still exists in the US, Japan and China, where penetration rates are still at relatively low levels.
- 'Emphasis will move from market growth to the retention of our customers, particularly those of highest value. In addition, we will aim to stimulate more usage of voice traffic and introduce a new range of data applications, to increase the value of our service to our customer base. We must be able to respond to the changing needs of our customers and the new and different services they require, as we move from the relatively straightforward world of nationally operated voice services to the complex world of globally provided voice and data.'

Strategies for sacking customers

Just as employees can be sacked, so it is possible to sack customers (see Case 9.7). Candidates for dismissal include customers who will never be profitable and who serve no other useful strategic purpose. More specifically, these include fraudsters, persistent late payers, serial complainants, those who are capricious and change their minds with cost consequences for the supplier, and switchers who are in constant search

Case 9.7

Sacking unprofitable customers at the CBA

The Commonwealth Bank of Australia (CBA), like many other banks, has been criticized in the media for adopting a strategy of sacking unprofitable customers.

In recent years the bank has closed branches in many areas that were considered unprofitable, particularly in less populated areas of rural and regional Australia. The bank believes that customers are unprofitable if their balance is less than $500. For these customers the bank has introduced higher bank fees. The bank has also trialled the transaction fees of up to $3 when customers withdraw their money over the counter in a branch.

The media has widely speculated that actions such as these by many banks will continue to occur as banks and other financial institutions attempt to shift customers to electronic banking channels, where the cost to the bank of performing a simple deposit or withdrawal transaction can be just a few cents as opposed to a few dollars for similar over-the-counter service in a branch.

for a better deal. McKinsey reports that 30–40 per cent of a typical company's revenues are generated by customers who, on a fully costed, stand-alone basis would be unprofitable.[34] These customers would be potential candidates for dismissal. Nypro, a large plastic injection moulder, had 800 customers and sales of $50 million in 1987 when it decided to move out of low value-add manufacturing. Many of these customers served no useful strategic purpose and by 1997, the company had only 65 customers, all of whom were large, and required value-added solutions rather than cheap moulded products. However, sales revenues were $450 million.

Sacking customers needs to be conducted with sensitivity. Customers may be well connected and spread negative word-of-mouth about their treatment. In the year 2000, UK banks began a programme of branch closures in geographical areas that were unprofitable. Effectively, they were sacking low-value customers in working-class and rural areas. There was considerable bad publicity, the government intervened and the closure strategy was reviewed.

There are a number of strategies for sacking customers:

- **Raise prices**: customers can choose to pay the higher price. If not, they effectively remove themselves from the customer base. Where price is customized this is a feasible option. Banks introduced transaction fees for unprofitable customers.
- **Unbundle the offer**: you could take the bundled value proposition that is sold to the customer, unbundle it, reprice the components and reoffer it to the customer. This makes transparent the value in the offer, and enables customers to make informed choices about whether they want to pay the unbundled price.
- **Respecify the product**: this involves redesigning the product so that it no longer appeals to the customer(s) you want to sack. For example, BA made a strategic decision to target frequent-flying business travellers who they regarded as high value. They redesigned the cabins in their fleet, reducing the number of seats allocated to economy travellers.
- **Reorganize sales, marketing and service departments** so that they no longer focus on the sackable segments or customers. You would stop running marketing campaigns targeted at these customers, stop salespeople calling on them and stop servicing their queries.
- **Introduce ABC class service**: migrate customers down the service ladder from high-quality face-to-face service from account teams, to sales representatives, or even further to contact centre or web-based self-service. This eliminates cost from the relationship and may convert an unprofitable customer into profit. In a B2C context, this equates to shifting customers from a high-cost service channel into a low-cost service channel. Frontier Bank, for example, introduced a no-frills telephone account for business customers who needed no cash-processing facilities. A minimum balance was needed for the bank to cover its operating costs. Customers who did not maintain the targeted credit balance in their account were invited to switch to other products in other channels. If they refused, the bank asked them to close their account.[35]

Summary

This chapter has looked at the important issues of how companies can retain, develop and, if necessary, sack customers. The economic argument for focusing on customer retention is based on four claims about what happens as customer tenure lengthens: the volume and value of purchasing increases, customer management costs fall, referrals increase and customers become less price sensitive. Measures of customer retention vary across industry because of the length of the customer repurchase cycle. There are three possible measures of customer retention. Raw customer retention is the number of customers doing business with a firm at the end of a trading period, expressed as percentage of those who were active customers at the beginning of the same period. This raw figure can be adjusted for sales and profit. Customer retention efforts are generally directed at customers who are strategically significant. These same customers may be very attractive to competitors and may be costly to retain, thus undermining their value and significance.

A number of alternative strategies can be used to retain customers. A distinction can be made between positive and negative retention strategies. Negative retention strategies impose switching costs on customers if they defect. Positive retention strategies reward customers for staying. There are four main forms of positive retention strategy. These are meeting and exceeding customer expectations, finding ways to add value, building bonds and establishing emotional commitment. Companies have a number of methods for adding value, including loyalty schemes, customer clubs and sales promotions. Customer bonds can be categorized as either social or structural. Three different forms of commitment have been identified: instrumental, relational and values-based. What is an appropriate customer retention strategy will be contextually defined. Not all strategies work in all circumstances. In addition to customer retention, two other CRM activities were discussed in this chapter. These are developing and sacking customers. Customer development aims to increase the value of the customer by selling additional or replacement offers to the customer. Sacking aims to improve the profitability of the customer base by getting rid of customers who show no signs of ever becoming profitable or strategically significant.

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