Services Marketing: Integrating People, Technology, Strategy
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Lecture 30
Managing Relationships and Building Loyalty – Part I

Welcome to Services Marketing and now we will talk about the Module 30.

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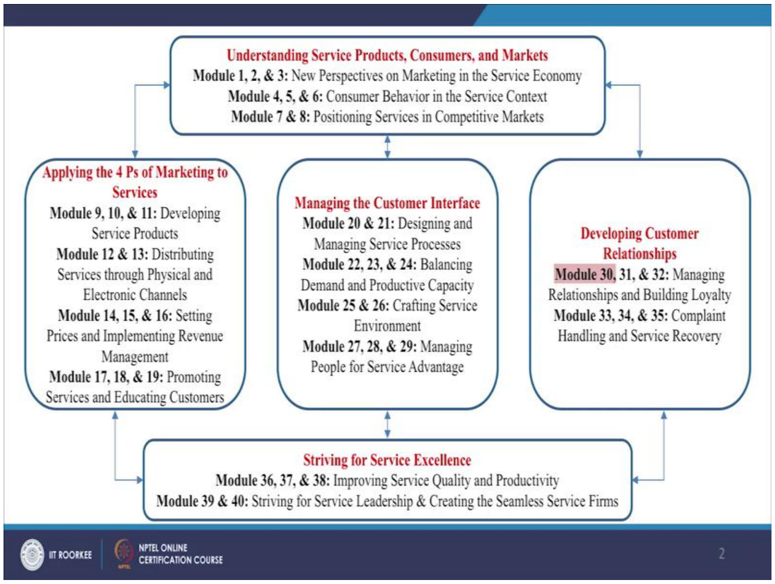

So we have covered the first three sections of this course on Service Marketing. The fourth section is on Developing Customer Relationships. And the three modules, that is module 30, 31 and 32 will cover Managing Relationships and Building Loyalty. So, let us look at what we will talk about in Managing Relationships and Building Loyalty that is module 30.

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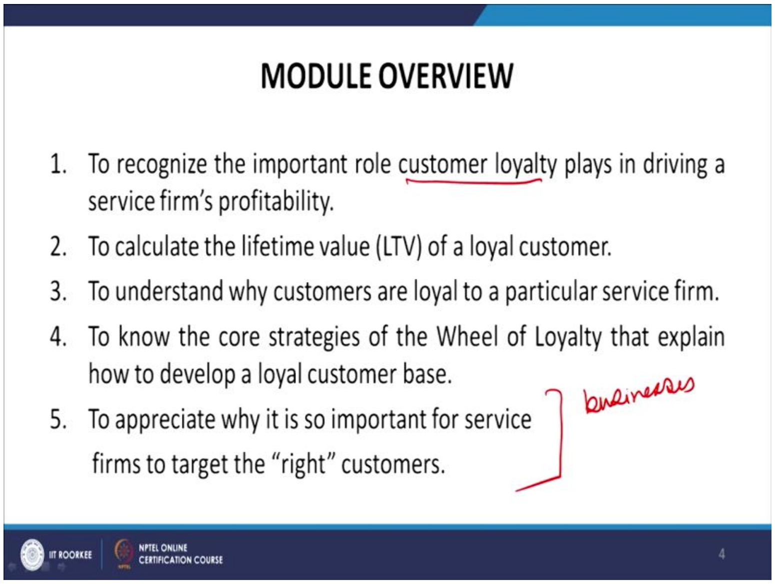

So, we will recognize the important role customer loyalty plays in driving a service firm's profitability. So, this customer loyalty is, is obviously the most important, most important thing that every business try to have because that affects the, the firm's profitability. The second is, we will try to calculate the lifetime value of a loyal customer and understand why customers are loyal to a particular service firms. To know the core strategies of the Wheel of Loyalty that explains how to develop a loyal customer base and to appreciate why it is so important for service firms to target the "right" customers. So, it, the targeting of "right" customers is important for all kind of businesses, but it is much more important for a service company, service business, to target the right kind of customers.

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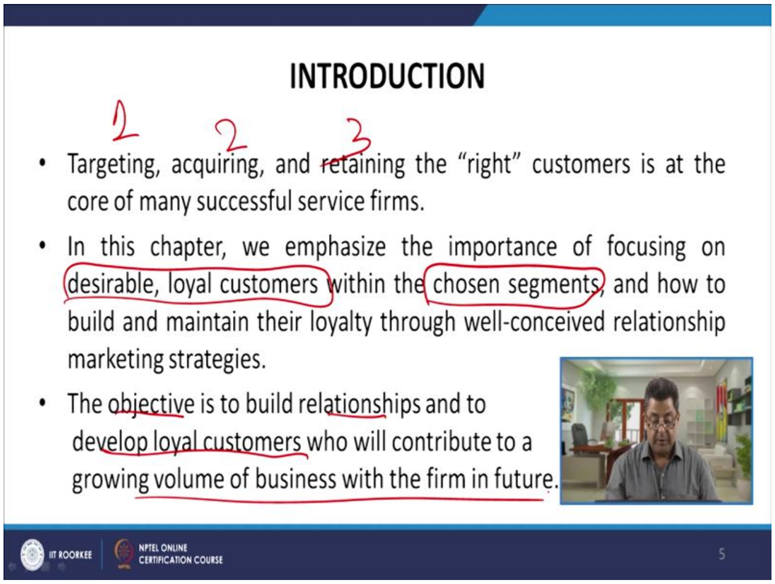

So, let us start. Targeting, acquiring and retaining the "right" customer is at the core of many successful service firms. Targeting, acquiring and retaining. So, first is that you are able to target, then acquire and also retain. So, in this Module, we emphasize the importance of focusing on desirable, loyal customers within the chosen segments, and how to build and maintain their loyalty through well-conceived relationship marketing strategies. So, we will focus on desirable and loyal customers. So every loyal customer may not be desirable. Every desirable customer may not be loyal.

So, so, we will have to look at those people from a chosen segment which are, who are desirable as well as loyal and how to build and maintain their loyalty. And for that, we have some well-conceived relationship marketing strategies. The objective is to build relationships and to develop loyal customers who will contribute to the growing volume of business with the firm in future. So, that is the objective, to build relationships, to develop loyal customers, so that they contribute to the growing volume of business within the firm.

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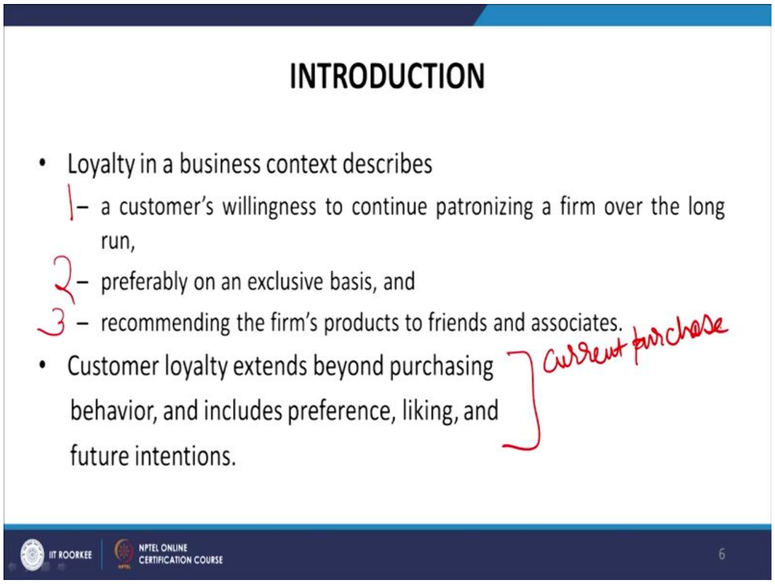

Loyalty in business context is a customer's willingness to continue patronizing a firm over the long run. So one, one thing that is there, that is required for loyalty, the first thing is that the customer should be willing to patronize, to keep on buying from the service firm. The second is, they should not buy from anybody else, but preferably as on an exclusive basis from this company only. So, first is that they should continue to buy from this firm, the second is, from exclusively this firm only and not somebody else and the third is they should also recommend the firm's product to their friends and associates.

So, these are the three important thing that the service companies, they want to achieve so far as customer loyalty is concerned. So, customer loyalty extends beyond purchasing behavior, and includes preference, liking and future intention. So, it is not only about the current purchase. So loyalty, customer loyalty, whether in case of services or in case of products, it is not about the current purchase, but it is also about their preference for a particular brand over other brands, liking for that, that brands and their future intentions to purchase the same brand.

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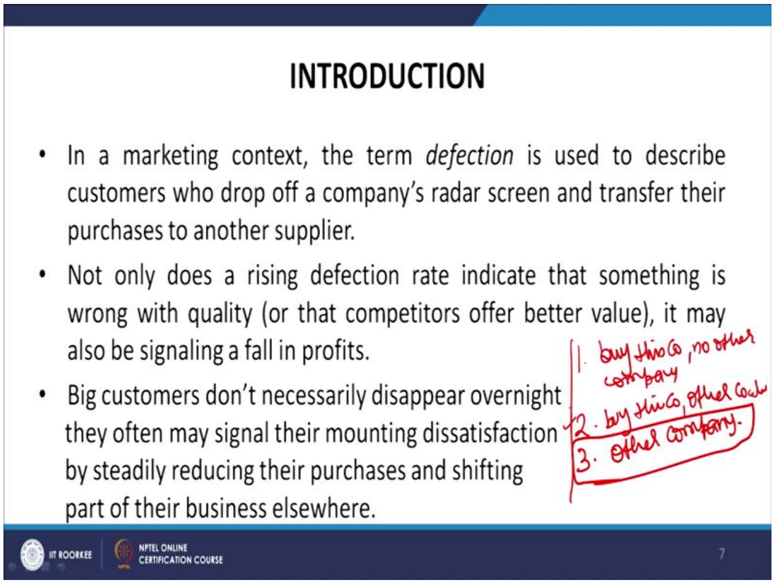

In a marketing context, the term defection is used to describe customers who drop off a company's radar screen and transfer their purchases to another supplier. So, this defection here is that, the customers, they leave this company and they start buying from another company. Now, you also keep in mind that there are three situation. One is that the customer buys from this company and no other company. Another time is, he buys from this company and other companies also.

And the third case is he buys from other companies only and not this company. So these are the three situations. And we call a defection as someone who has shifted and he is buying from some, somebody else and not us. Not only does a rising defection rate indicate that something is wrong with quality, or that competitors offer better value. It may also be signalling a fall in profits. So, when the customer defects, so that is one indicator that your profits will decrease in times to come.

Big customers don't necessarily disappear overnight. They often may signal their mounting dissatisfaction but steadily reducing their purchases and shifting part of their business elsewhere. So, these big customers who were maybe loyal sometimes, they were buying from this company only, now they have started doing the second option that is they are buying from this company. But then they have, they are, they have also started buying from somebody else. So, that fall in business is also important for companies to understand whether this big customer is buying everything from us or from our competitors also.

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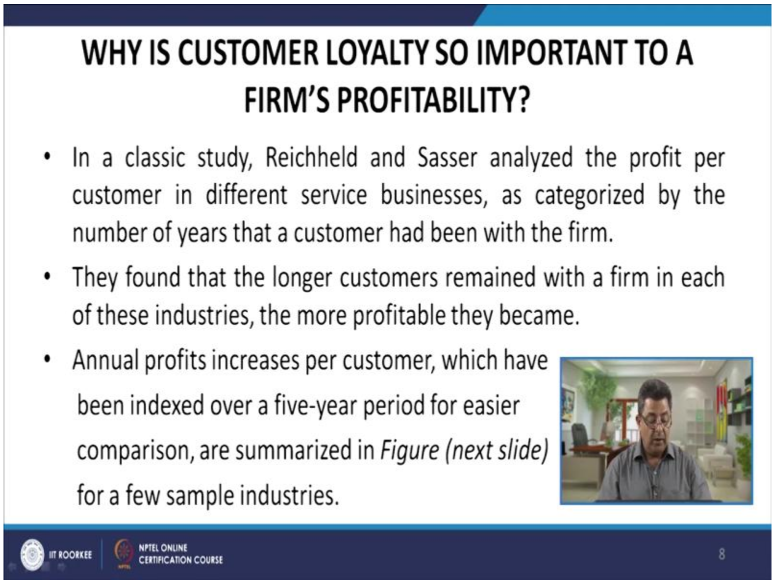

Why is customer loyalty so important to a firm's profitability? In a classic study, (Reich), Reichheld and Sasser analyzed the profits per customers in different service businesses, as categorized by the number of years that a customer had been with the firm. They found that the longer customers remained with a firm in each of these industries, the more profitable they become. So, the longer the customers are there, the more profitable they are. So, it means that profitability will increase over a period of time. Annual profit increase per customers, which has been indexed over a five, five-year period for easier comparison, are summarized in Figure that will come up in the next slide, for a few sample industries.

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So, this is why is customer loyalty so important to a firm's profitability. On X-axis, we have the time. And this is the profit index. This yellow is Industrial Laundry, this blue is Credit Card, pink is Auto Servicing and green is Industrial Distribution. Now, it shows how much profit a customer generates over time. So, now you see that the profits are steadily increasing across the years from 1 to year 5. But, where they are the highest?

So, you see that maybe in, in Credit Card, the profits are higher, as the customer is loyal for a longer period of time. So, in the first year, the profit maybe less. But now you see in the fifth year, the profit has increased so much and it is followed by Auto Servicing. So, in the first year obviously, the profits will be low. But then, as the customer become more comfortable with the company, they keep on visiting the company more often. So, the profits keeps on increasing.

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Why is customer so important, customer loyalty so important to a service profitability? So, factors that work to create incremental profits, so incremental profits. So, incremental profits increase profits every year over the period of time. So, profits derived from increased purchases. So, because the customers who are loyal, they will purchase more. So, the profits also will increase.

The second is profits from reduced customer service cost. Now, the company knows about this customer and therefore, it becomes easier and less costly for the company to service these customers. So, at the one, one hand the profits are increasing and on the other hand, the costs of servicing this customer are decreasing. Then, the profits from referral to other customers. Because he is a loyal customer, he has also referred your brand to somebody else. And that also has contributed to the increased profit.

Profits from lower price sensitivity that allows a price premium. And the, because the customer is loyal, therefore the price, price sensitivity is lower and that allows for higher price premiums. And this acquisition cost can be amortized over a longer period. So, if you keep on acquiring new customers all the time, then this cost of acquisition is amortized over shorter periods. But, when you have loyal customers, this cost of acquisition is amortized over longer periods of time.

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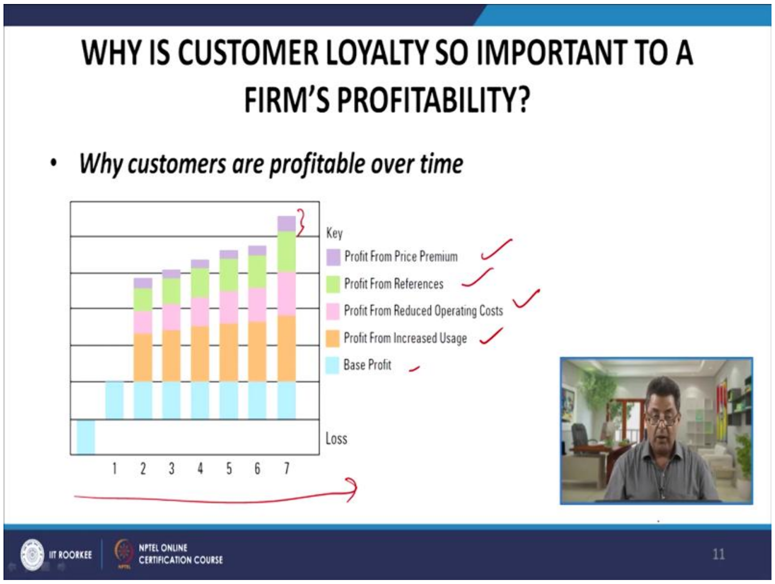

So, now why these customers are profitable over time? This orange is Profits From Price Premium, green is Profits From References, pink is Profits From Reduced Operating Cost and yellow is Profits From Increased Usage and this blue is the Base Profit. So, as we move from 1 year to 7th year, you see that the profits, they are increasing. So, initially the company was at a loss.

But then, slowly it, it goes up and now you see that, that profits for every component, they are increasing. So, the base profits may still remain the same but, profit from increased usage, then profits from reduced operating cost, the profits from references and you see, the profits from the price premium, they are all increasing. So that is the benefit, that is the advantage of having loyal customers.

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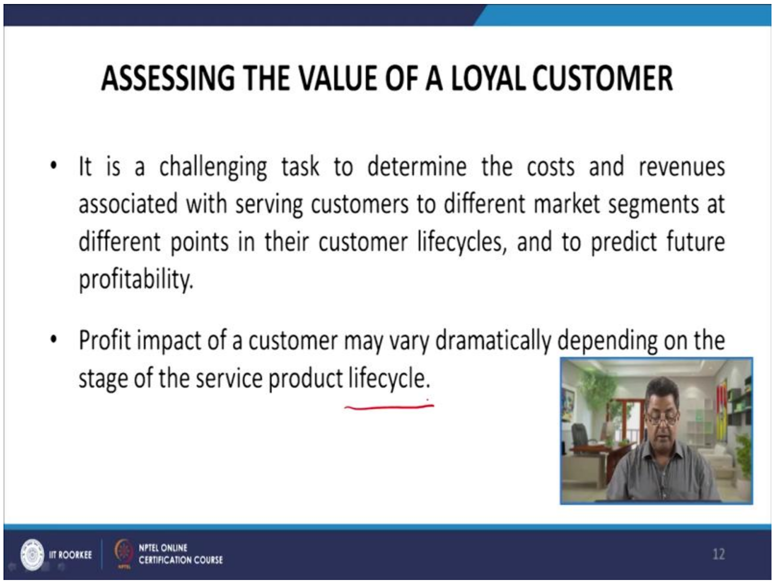

Now, how to go about assessing the value of a loyal customer? It is a challenging task to determine the cost and revenues associated with serving customers to different market segments at different points in their customer lifecycles, and to predict future profitability. Profit impact of a customer may vary dramatically depending on the stage of the service product lifecycle. So, the profits will increase or decrease depending upon this lifecycle.

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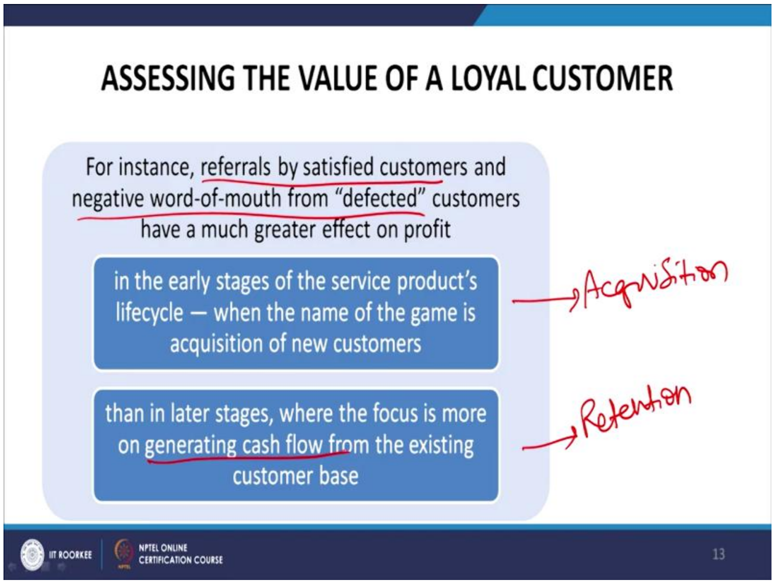

For instance, referrals by satisfied customers and negative word-of-mouth from “defected” customers have a much greater effect on profits. So, it is important, the referrals from satisfied customers and the negative word-of-mouth from “defected” customers. So, in early stages of service product’s lifecycle, when the name of the game is acquisition of new customers.

So, as any company introduces a, a new product or service, so the focus is always on acquisition of customers. Then, in later stages, where, where the focus is more on generating cash flows from existing customer base. So, then comes the retention, retention of existing customers and generating the cash flows.

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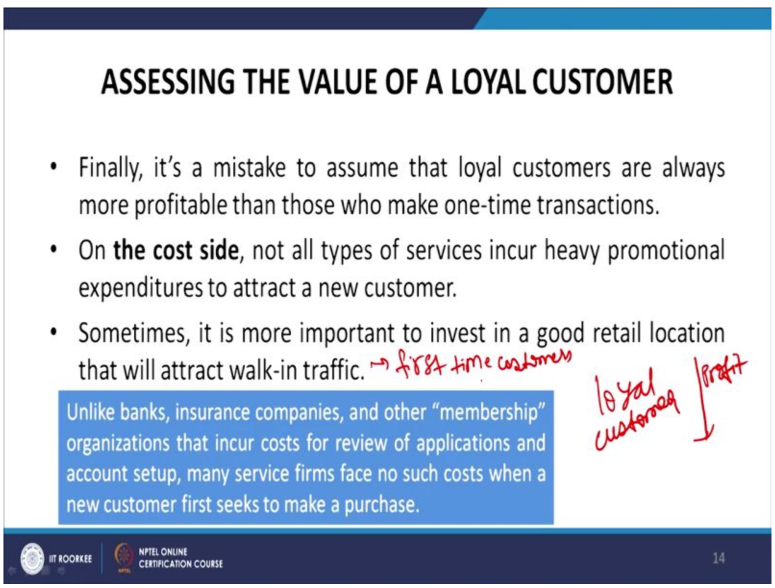

Finally, it is a mistake to assume that loyal customers are always more profitable than those who may come, may make one-time transaction. Finally, it is a mistake to assume that loyal customers are always more profitable than those who make one-time transaction. So, on the cost side, not all type of service incur heavy promotional expenditures to attract a new consumer. So, it may be that over a period of time, these loyal customers, the profitability of these loyal customers, it is decreasing.

And maybe, on the cost side, not all types of services incur heavy promotional expenditure to attract a new customer. So, sometimes, it is more important to invest in a good retail location that will attract walk-in traffic, that will attract the first-time customers. So, the customers will keep on coming in. Unlike banks, insurance companies, and other “membership” organization, that incur costs for review of applications and account setup, many service firms face no such cost when a new customer first seeks to make a purchase.

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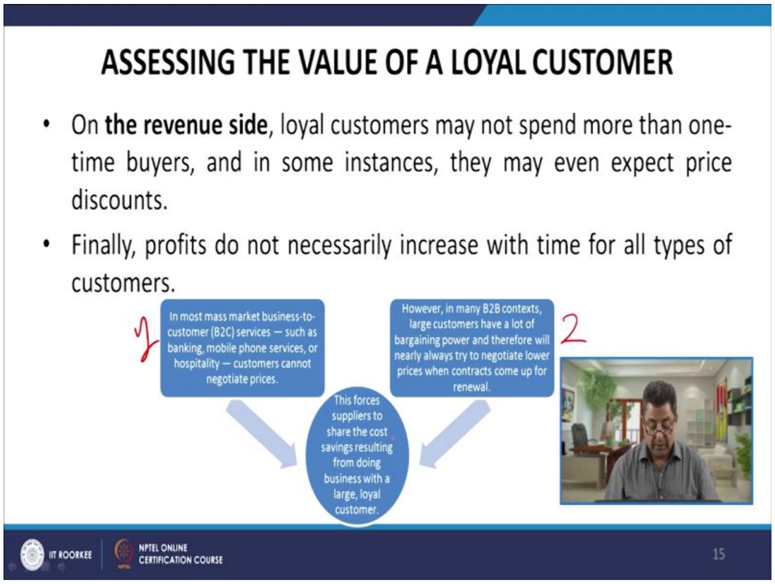

On the revenue side, loyal customers may not spend more than one-time buyers, and in some instances, they may even expect price discounts because they, they say that they are loyal. They have been coming to the, the same company every time, so (the), they want more discounts. Finally, profits do not necessarily increase by, with time for all types of customers. So, let us look at this one, in most mass market business-to-business, business-to-customer services, such as banking, mobile phone services or hospitality, customer cannot negotiate prices.

In this, in many B2B context, large customers had a, have a lot of bargaining power and therefore will nearly always try to negotiate lower prices, when contracts come up for renewal. So, in this B2B context, when the customers are, are, are big, so they will keep on negotiating the prices. And this forces the suppliers to share savings, resulting from doing business with a large, loyal customer.

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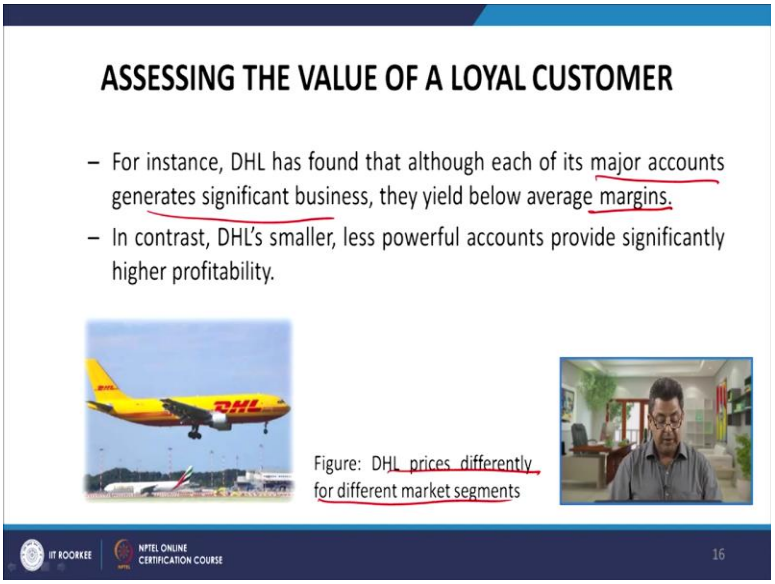

For instance, DHL had found that although each of its major accounts generates significant business, they yield below-average margins. So, now you see that these are the major accounts, they generate lots of businesses. But, the margins are not according to the average. In contrast, DHL's smaller, less powerful accounts provide significantly higher profitability. So, the big accounts, they, the big accounts, the major accounts, they contribute to the business, but not to the profits. Smaller accounts, they do, they may not contribute to the business, but they definitely continue, contribute to the profits. So, as DHL price differently for different market segments.

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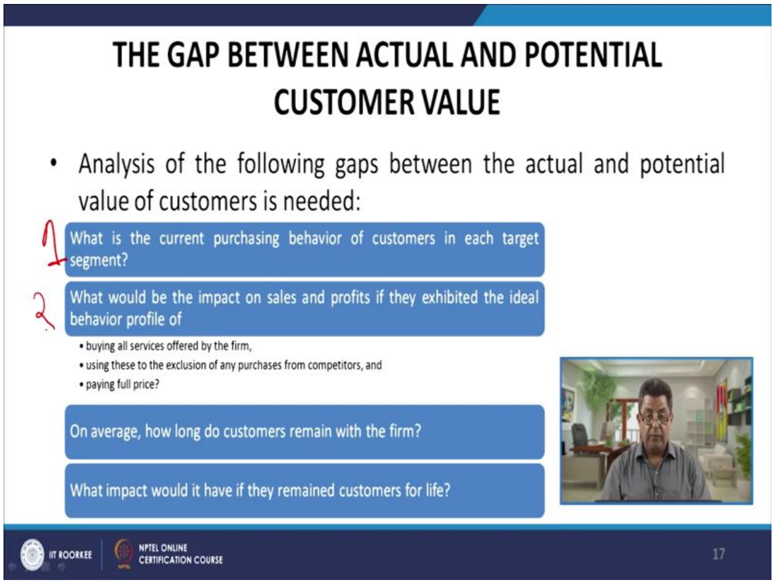

Let us look at the gap between the actual and potential customer value. Analysis of the following gaps between the actual and potential value of the customer is needed. The first is, what is the current purchasing behavior of customers in each of the target segment. So, the first thing that needs to be analyzed here, analysed is, what is the current purchasing behavior of the customers?

And second is, what would be the impact on sales and profit if they exhibited the ideal behavior profile of buying all services offered by the firm, using these to the exclusion of any purchases from the competitors and paying the full price. On average, how long do customers remain with the firm and what impact would it have if they remained customer for life?

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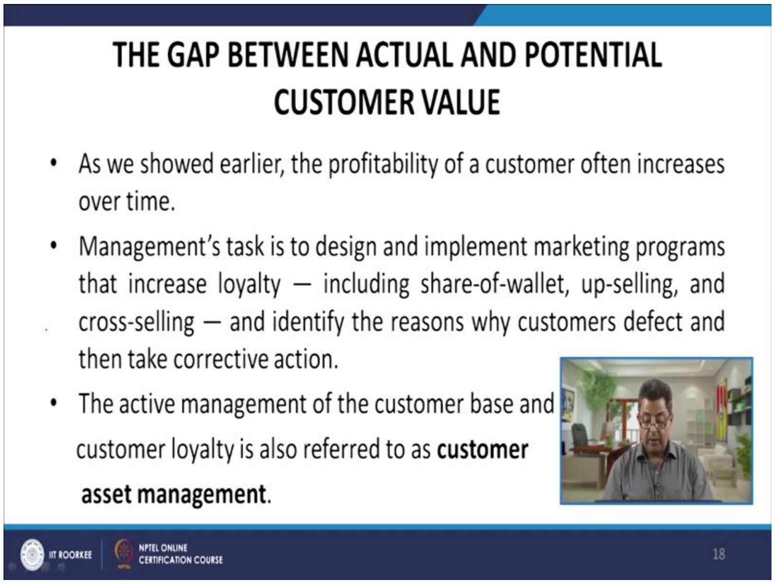

So, as we have talked about earlier, the profitability of a customer often increases over time. So, the longer he is, keeps on purchasing from this company, the more profits he generates. So, management's task is to design and implement marketing programs that increases loyalty, because if the customer is loyal, then obviously the profit that he generates will increase. So, that includes share-of-wallet, up-selling and cross-selling and identify the reasons why customer defect and then take corrective actions. The active management of the customer base and customer loyalty is also referred as customer asset management.

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Now, let us look at why the customers are loyal? So, for, we have till now discussed that why it is important for the, for the company to have customer, loyal customers. How they contribute to businesses or, and to the profits. But, now let us look at why are customers loyal. Customers are not automatically loyal to any one firm. Rather, we need to give our customers a reason to consolidate their buying with us and then stay with us.

So, customers will not automatically become loyal, but there should be a reason and this company should give the reason for them to, to become and remain loyal. We need to create value for them to become and remain loyal. Relationships can create value for individual customers through factors such as, first, they should be able to inspire greater confidence. Second is, by offering them social benefits and the third is by providing them with special treatment. So, these are the things that are required for creating relationships.

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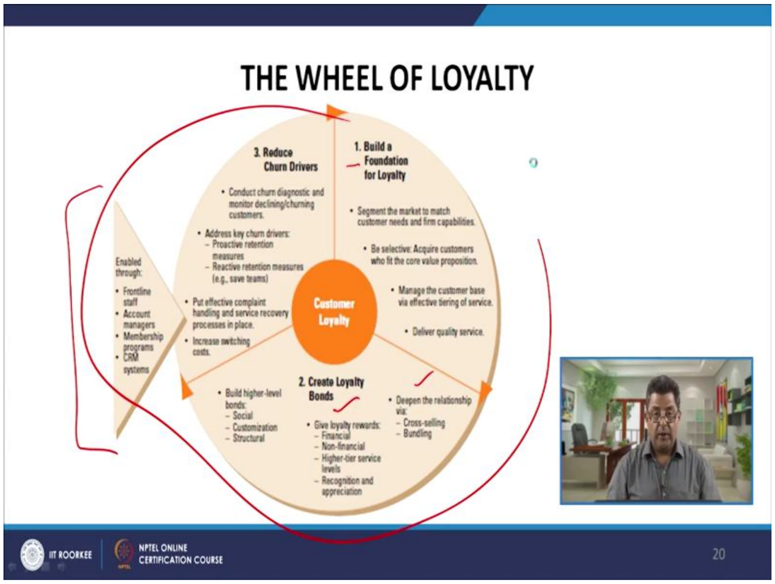

Now, this is the wheel of loyalty, of the customer's loyalty. As you can see, at the center is the customer loyalty. The first thing that needs to be done is to build a foundation for loyalty. The second is, then create loyalty bonds and then that will lead to the third thing, that is reduce the churn drivers.

So, now, let us start with this one, the first one, building a foundation for loyalty. Segment the market to match customer's needs and the firm capabilities. So, you segment the markets to match the customer needs and also according to whether the firm has the, that capability or not. Be selective. Acquire customers who fit the core value proposition. That is why this, this, targeting the right customers is more important in service companies. Manage the customer base via effective tiering of service and then, deliver quality service.

After building on this foundation for loyalty, then, then let us move on to the second thing that is create loyalty bonds. So, let us talk about the deepening the relationship via cross-selling and bundling. Then, giving them loyalty rewards. For example, financial rewards, non-financial rewards, higher-tier service levels, recognition and appreciation. And then, build higher-level bonds, that are the social bonds, customization bonds and structural bonds.

The third thing is then, this first and second will reduce the churn drivers. Conduct churn diagnostics and monitor declining and churning customers. Address key churn drivers, for example, proactive retention measures, reactive retention measures. Put effective complaint handling and service recovery processes in place and increase the switching cost for the customer. So, that is enabled through the frontline staff, accounts managers, membership programs and CRM system. And that, will that and this, then the wheel, this, this wheel will, will keep on moving.

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So, this wheel of loyalty is for building a foundation for loyalty. The first is to target the right customers. Loyalty management starts with segmenting the market to match customer needs and firm's capabilities. "Who should we be serving?" is a question that every service business need to arise periodically. "Who should we be serving?" So that is a very important question and that will keep on coming up periodically and it needs to be answered periodically. Not all customers offer a good fit with the organization capabilities, delivering technologies, and strategic directions.

So, the answer to this, "who should we be serving?" will keep on changing because these customers or the customers, today's customers, they may not, no longer be a good fit with the organization capabilities tomorrow. The company may have acquired new delivery technologies or strategic directions. So, the segments that they are targeting may change.

So, it is important to keep in mind that what are, whether the target segments, they are, they are a good fit with the organization capabilities, the delivery technologies that it has and its, its strategic direction.

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Companies need to be selective about segments they target if they want to build successful customer relationships. And managers must think carefully about, first, how customer needs relate to operational elements such as speed and quality, and the physical features and appearance of service facility. So, managers, they should think about this and then, they should also think about how well their service personal can meet the expectations of specific type of customers, in terms of both personal style and technical competence. Whether they have this kind of personal style or technical competence or not.

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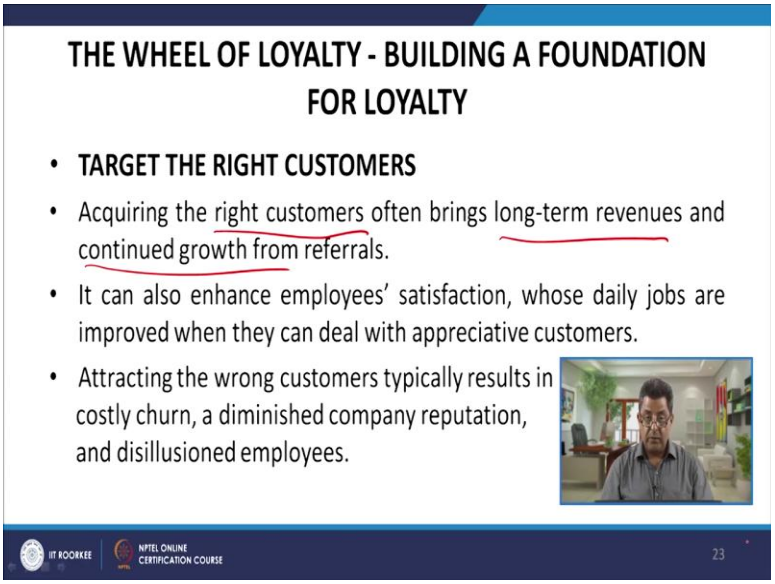

Acquiring the right customer often brings long-term revenues and continued growth from referral. So, that is why these right customers are even more important because they bring long term revenues from themselves and the continued growth from referral. It also enhances employee satisfaction, whose daily jobs are improved when they can deal with appreciative customers. And then, because they are dealing with the same customers on a regular basis, it is easier for them to identify those, their customer's needs and deliver on those needs effectively. Attracting the wrong customer typically results in costly churn, a diminished company reputation, and disillusioned employee. So, every time the employees will have to service new customers.

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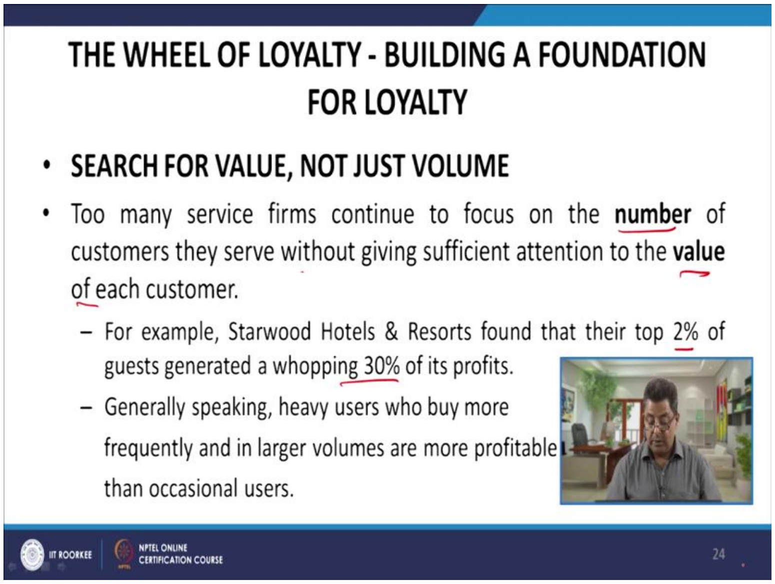

So, you, there is next thing that is important to be done is to search for value, not just volume. Many service firms continue to focus on the number of customers they serve, without giving sufficient attention to the value of each customer. So, that is what is important, that is what, that is why we keep on talking about customer lifetime value. It is not the, about the number of the customers but the value of each customer.

For example, Starwood Hotels & Resorts found that their top 2 percent of guests generated a whopping 30 percent of its profits. Top 2 percent contributing 30 percent of the profits. Generally speaking, heavy users who buy more frequently and in large volumes are more, more profitable than occasional users.

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Ironically, it is often the firm that are highly focused and selective in their customers' acquisition rather, rather than those that focus on unbridled acquisition, that are growing fast over long period. So, you see that highly focused and selective organizations, they are growing more over longer periods. Service customers who buy strictly based on lowest price, who are in a minority in most markets, are not good target customers for relationship marketing in the first place.

So, those people although they are in a minority but those who are looking at the lowest price, they may not be the right kind of customers for building relationships. They are deal-prone, continuously seeking the lowest price on offer, and switch brands easily. So, as soon as another brand, it comes up with a deal, these customers, they will shift to the, to the, to another brand. So there is no point in, in, in keeping those, those customers and, and building relationship with these kinds of customers.

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Different segments offer different value for a service firm. Like investments, some types of customers may be more profitable than others in the short term, but others may be, may have greater potential for the long term. So, now you see that there are different segments and each segment will be of different kind of value to the firm. Some segments are profitable in the short-term and some segments are profitable in the long term. Similarly, the spending patterns of some customers may be stable over time, while others may be more cyclical.

For example, spending heavily in boom times but cutting back sharply in recessions. So, some people, some segments, they, they may, they may make purchases which are stable over time, while there are some customers who are more cyclical in nature. So, these segments, there are some segments which are more profitable and some segments which are less profitable. There are some customers who buy on a regular basis, some customers who have a cyclical purchase patterns. So, that is why different segments offer different value for the service firm.

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A wise marketer seeks a mix of segment in order to reduce the risk associated with volatility in demand. So, the company wants all types of customers, those who buy continuously or whose buying patterns are stable over a period of time and those customers who buy more during, during expansion and less during recession. So, marketing is about getting better business, not just more business. For instance, the calibre of a professional firm is measured by the type of client it serves and the nature of the task on which it works. Volume alone is no measure of excellence, sustainability, or profitability.

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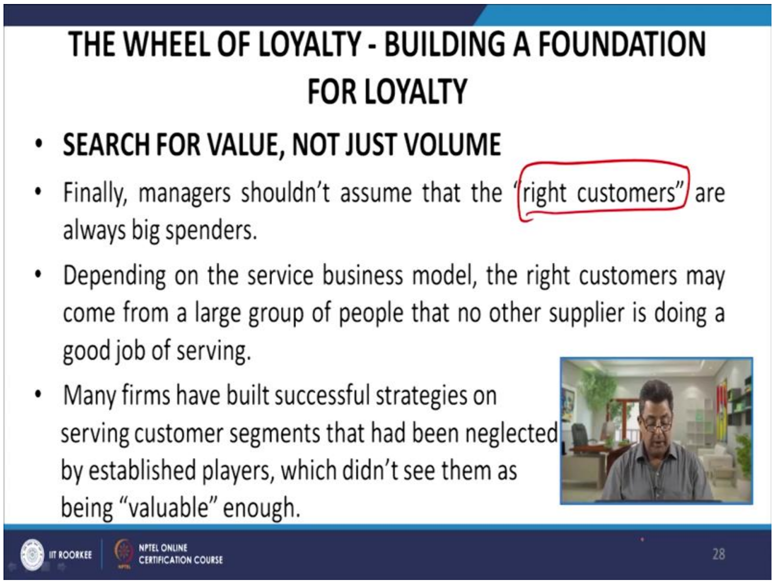

Finally, managers should not assume that the "right customers" are always big spenders. So that is important. Only big spenders are not the right customers. Depending on the service business model, the right customer may come from a large group of people that no other supplier is doing a good job of servicing. Many firms have built successful strategies on serving customer segments that had been neglected by established players, which did not see them as being "valuable" enough.

So, now every service company should be clear about what kind of customers they are targeting. And one, one customer, one type of customer may be right kind of customer for one service company but not the other. So, there are several kinds of customers who are, who are, who may be available and who are not being currently served by any company.

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So, the examples for that includes Enterprise Rent-A-Car, which targets customers who need a temporary replacement car. It avoided the more traditional segment of business travellers targeted by their principal competitors. So, the principal competitors, they were, they were targeting the business travellers and this Enterprise Rent-A-Car, they started targeting customers who need a temporary replacement car.

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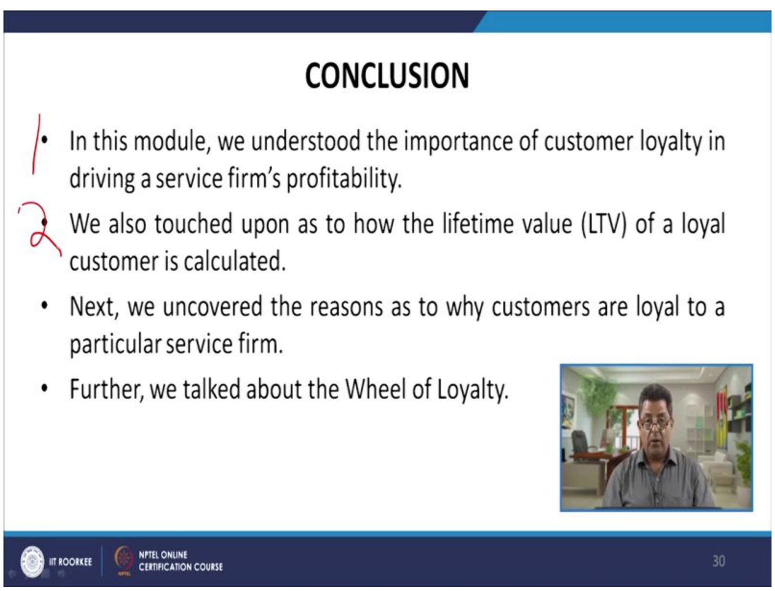

So, to conclude, in this Module, we understood the importance of customer loyalty in driving a service firm’s profitability. That is the first thing. The second, we also have in touched upon how the lifetime value of a loyal customer is calculated. Next, we uncovered the reasons as to why customers are loyal to a particular service firms. And then, we have talked about the Wheel of Loyalty.

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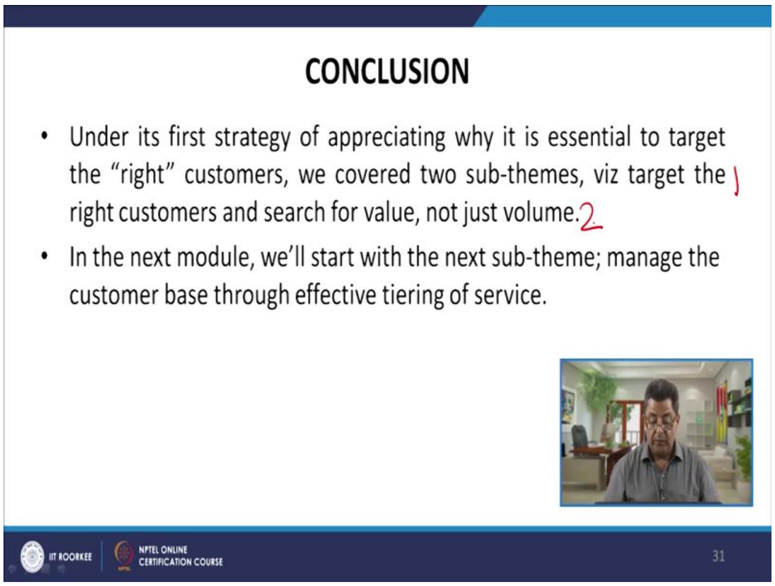

Under its first strategy of appreciating why it is essential to target the “right” customers, we covered two sub-themes. For example, target the right customers and search for value, not the volume. So, these are the two important things. So, in the next module, we will start with the next sub-theme; that is, manage the customer base through effective tiering of service.

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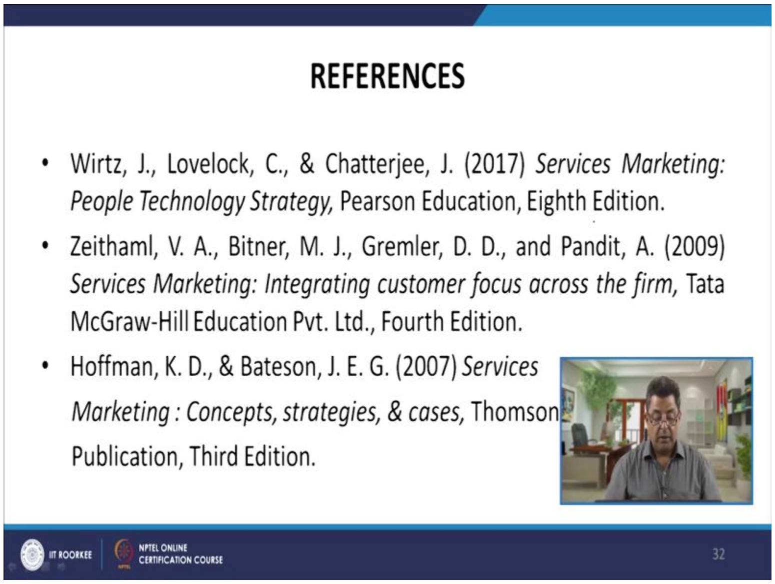

These are the three books from which the material for this module was taken. Thank you.