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2008

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Publication Details

Balakrishnan, M. & Els, L. 2008, 'Customer Relationship Management: Are Companies Getting Divorced From Reality?', 2008 Oxford Business & Economics Conference; St Hugh's College, Oxford, OBEC, UK,

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 ISBN : 978-0-9742114-7-3

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Customer Relationship Management: Are Companies Getting Divorced From Reality?

ABSTRACT

Purpose: Service initiates aimed at customer relationship management often look at four areas – satisfaction, retention, loyalty and lifetime profitability. There is little research that explores the scope of each initiative and delineates each from the other. The purpose of this paper is to find the relationship between each factor and their influencers and area of influence.

Approach: Using a detailed literature review, the relationship between each type of service initiative is explored. This is used as a foundation to present a conceptual framework of the relationship between each initiative and to explain reasons why an investment in one need not accrue in the other.

Findings: Though they are related, and have a cascading effect, some factors act as hygiene factors. Hence investments in hygiene factors create satisfaction but will not accrue in other customer relationship management benefits. Organizations must find out whether their customer's value these services to the same extent that the organizations value these service schemes and whether the customers are willing to generate additional revenues because of these schemes vis-à-vis the organizational cost of these schemes.

Originality: This paper gives a practical checklist of a range of activities that organizations can pursue at different levels of customer relationship management.

Keywords: service management, customer satisfaction, customer retention, customer loyalty, customer lifetime value, customer relationship management, customer relationship orientation

Paper Type: Conceptual paper

1. INTRODUCTION

As the production and consumption of products become more globalised, we see services becoming the differentiating factor that could ensure survival in a competitive world market and bring profits to organizations. Worldwide, services themselves account for over 2/3rds of global GDP and employ as many as 40 % of the global workforce (ILO, 2007). The differentiating factor between developed countries and new developing countries is the focus on services (World Bank, 2007). Even if we look from the organizational perspective, services (or their lack) are often reasons for decreasing loyalty. With so much of choice, customer power is increasing. Keaveny (1995) found that 68% of the time, service related problems like inconvenience, core service failure, failed service encounters, and response to failed service were reasons why customers switched service providers while pricing was a factor only 17% of the time. Many of these reasons are highly subjective. Very often what organizations perceive is value for the customer, need not necessarily be what makes the customer satisfied (Anderson et al, 2006). Berry and Parasuraman (1991) found that customers have a band of tolerance and they evaluate service quality against this "mental" checklist of expectations. These expectations are of two types– hygiene quality factors (negative expectations) and positive expectations (Johns and Howard, 1998). This indicates that often the reason for dissatisfaction for the customer with the organization and its service initiatives may simply stem from the gap that arises between the perceptions of what works versus what does not. This research focuses on the gap between customer perception and company perception of customer expectation of various levels of service.

2. LITERATURE REVIEW

The objective is to gain an understanding of the various service initiatives that organizations can pursue in both their and the customer's interests. Once the relationship between various service initiatives is found, we will have a basis to bridge the gap between what organizations ***think*** works and what ***really works.*** This is what will be analyzed based on literature review as this gap has a tendency to grow into a gaping chasm! This will give organizations a basis to relook some of the more costly service programs they launch and checklist it against their own objectives and resources. To understand the factors that affect the gap we begin with the four service initiatives identified by Javalgi *et. al.,* (2006):

- Service Satisfaction Initiatives
- Customer Retention Programs
- Service Loyalty Programs
- Enhanced Customer Lifetime Profitability.

They are studied in that order to find the relationship between each and to see if which is a subset of which. Only these four programs are looked at though there may be other initiatives that overlap with the above.

2.1 Service Satisfaction Initiatives

Satisfaction is a state of mind, according to dictionary.com (2007); it is a feeling of gratification, contentment and happiness. Satisfaction is also a method of compensation. Customer service satisfaction depends on the difference between what a customer expects and what is delivered (Javalgi *et. al.*, 2006). When people are not satisfied they are discontent. At the very least, these expectations need to be met. These expectations customers have are perceptions that are influenced by the company and the immediate environment around the customer. Customer perceived value is defined as the differences

between the benefits and the cost the customer incurs to get that product or service. Emotional value, social value and functional value affect customer satisfaction positively while perceived sacrifices affect it negatively (Wang *et. al.*, 2004). Customers' perceptions on quality and reliability are affected by messages promoted from the company, inferences drawn from pricing, tangibility of services and personalization and image (Ball *et. al.*, 2006; Parasuraman *et. al.*, 1988; Zeithaml, 1981). In fact Bebko (2001) found that the gap between customer expectations and perceptions increases as the level of intangibility of services increased.

Intangible factors are key value adders in the CPV equation (Low, 2000) and referrals play an important role. Satisfied customers can become service brand missionaries through word of mouth (Clemmer, 1993). Since tangible factors are few it is hard for a customer to compare quality and hence emotional responses like responsiveness, assurance and empathy, which can be used for evaluation (Zeithaml and Bitner, 2003; Parasuraman *et. al.*, 1988). This is not confined to the organization itself but also to its representatives. It has been found that the perception of product failure is linked to external factors like seller or service provider (Richins, 1983). Of course the ability of the service to deliver what was expected is an important part of satisfaction (Oliver, 1997). Convenience in location is an important part of satisfaction and affects repurchase intensions but repurchase does not mean satisfaction. Instead it acts as a barrier for switching. The less standardised the product and more personal, convenience of location plays a lower role (Jones *et. al.*, 2003). But convenience is not only location – it's in usage, getting customer support or in brief: reducing the time, effort and mental processing a customer has to go through when dealing with purchase or usage of the product.

It can be concluded that organizations must be careful about what they promise. Their communications must be clear on their product offerings or it could lead to an over-expectation from the customer point of view and this would lead to dissatisfaction with the service. Core service quality, relational service quality and perceived value are directly related to customer satisfaction (McDougall and Levesque, 2000). Post-purchase marketing activities that can decrease the level of dissonance on purchase or increase credence qualities can increase service satisfaction (Zeithaml, 1981).

Failure to satisfy, increases the chances of a customer switching products (McDougall and Levesque, 2000). But, not all satisfied customers remain – this is a fact seen in the consumer behaviour by customers who display variety seeking behaviour. They switch not because of dissatisfaction but boredom or the need for change. On the other hand; later customer relationship strategies stress segmenting and focussing on the 20% of giant revenue contributors as studies show the other 80% or those out of the system (long-tail customers) can collectively contribute much more. The key is to offer mass customization where the onus is on the customer (Ferguson and Hlavinka, 2006). Hence the next set of service initiatives must be focussed on retention and loyalty.

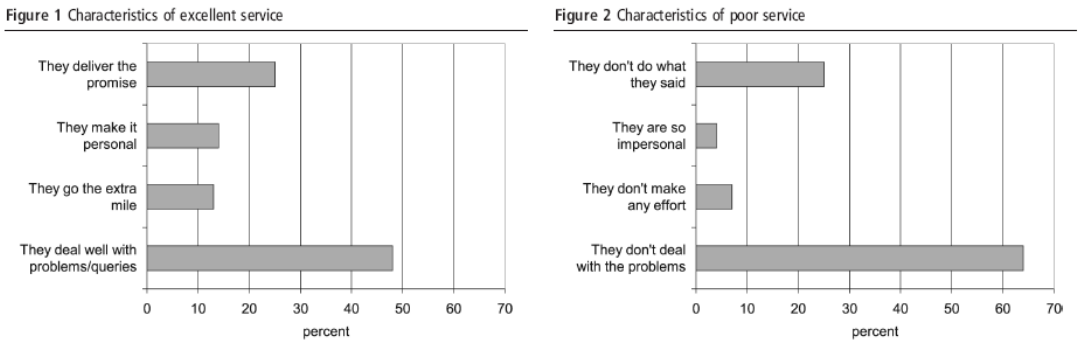
There is a relationship between satisfaction and loyalty. Satisfaction is affected by service quality, image, perceived quality and value of service, communication and store image (Ball *et. al.*, 2006; Sivadas and Baker-Prewitt, 2000; Bloemer and de Ruyter, 1998; Bitner, 1990). But store image has an indirect effect on store loyalty through store satisfaction (Bloemer and de Ruyter, 1998). Service quality influences satisfaction and the likelihood of recommending; a favourable attitude to repeat purchase which has a positive relationship to store loyalty (Sivadas and Baker-Prewitt, 2000). Caruana (2002) found that service quality via customer satisfaction (53% variance) acts on service loyalty. Ball *et. al.*,

(2006) found that communication, image, perceived quality and personalization affected satisfaction and loyalty (Ball *et. al.*, 2006). Hence it can be concluded that satisfaction is an antecedent to loyalty (Bloemer and de Ruyter, 1998; Bitner, 1990).

2.2 Customer Retention Programs

Peter Drucker defined business as the business of getting and keeping customers (Anton and Petouhoff, 2002, pg 11). If customers do not leave because of dissatisfaction then how do you retain them? For example we know that people who seek variety are susceptible to promotional schemes (Trivedi and Morgan, 2003) and hence organizations must offer these customers choice within their range to retain them (Tang and Yam, 1996). What is the difference? Before they were satisfied now they are delighted. Retention focuses on delighting the customer. Ritz Carlton according to survey results delights its customers 92% of the time – the results speak for themselves (Ritz Carlton -Viewpoint, 2004). The results of a 5 year study into service excellence commissioned by the Institute of Customer Service showed that customers are easily delighted, though how organizations handled problems (from the customer point of view) was a key to retention. Some of those findings are placed below (Johnston, 2004).

Figure 1: Service Excellence (Johnston, 2004)



A Frankel brand marketing study found that one out of ten customers switch retailers after just one bad customer service experience (Sivadas and Baker-Prewitt, 2000). Are these customers lost forever? No. they can be recovered. A customer who has a problem which has been corrected promptly and satisfactorily ends up more loyal for the experience (Colgate and Norris, 2001). Service recovery is an important part of retention and leads to loyalty. However time is of essence which means empowering employees. Retaining current customers is less expensive than attempting to find new customers (Massey *et. al.*, 2001). When creating retention programs/loyalty programs you focus on one of three objectives: protecting existing customer database, enhancing repeat purchase value sales; or enhancing cross-selling/recommendations to existing products /alliances, products versus competitors (Dowling and Uncles, 1997; Jang and Mattila, 2005).

There are several challenges one faces with such programs. How do you identify your customers especially if you are not in direct contact with them? Capizzi and Ferguson (2005) recommend a mine sweeping approach that will help in segmenting customers to understand the financial implications of these segments (for some interesting company self introspection, see p. 77). At the end of the day – these programs are expensive in terms of money, effort and culture change and must help the organization meet its objectives. Organizations must also consider the aspect of timing – when and how does the customer get rewarded (Dowling and Uncles, 1997)? If it takes too long the customer may get frustrated and leave and if the rewards are too early you do not encourage customer relationship building (CRM). CRM has been strongly related to enterprise response (ERP) systems (Karimi *et. al.*, 2001), so larger customer bases means more investment in technology and related training.

Though financial incentives have been used to retain customers in the form of price discounts, rebates and sales promotion activities (Reichheld, 1993; Reichheld and Sasser, 1990) it has been found that this detracts from customer perceived value. Value is more than the calculation of price. It involves tangibles like the product differentiation and choice and intangibles like service quality and trust (Ennew and Binks, 1996); image and positive public relations and word of mouth (Reichheld and Sasser, 1990; Richin, 1983). The Halo effect and external validation of quality and image add value to the product (Javalgi and Moberg, 1997). Hence to retain customers and reward loyalty should an organization use monetary or non-monetary rewards?

Literature highlights the importance of developing Structural and Social Bonds (Massey *et. al.*, 2001; Turnbull and Wilson, 1989). Chandon *et. al.*, (2000) found that money is not the only driver for sales promotion activities – they look at quality, convenience, value expression and other benefits like entertainment. A study by Jang and Mattila (2005), found that in fast food and casual dining industry, over 80% of the customers preferred immediate rewards (not worth the effort of the "procedures" involved"), while over 85% preferred cash rewards (discounts/cash back rather than preferred seating, flower arrangements or free desserts) as it gave them more choices and flexibility; approximately 75% of the customers used the cut-off at $100 USD for a 10% loyalty program. It's interesting that customers have opinions like this which are rarely researched by industries concerned. The higher the effort, the more likely the customer would opt for luxury items (this is also validated by Kivetz and Simonson, 2002). Capizzi and Ferguson (2005) stress the importance of the WOW factor – bored customers make disloyal customers. They want less management from their side! Boredom can be alleviated using soft benefits, personalization and leveraging partners. Often "rewards" based on usage are offered to the

customer which are easy and inexpensive from the organizations point of view but are of no motivational value to the customer (Duffy, 2005).

A key component of retention in services depends on the Employee-Customer Interaction. This can be optimized through staff training, remuneration, empowerment and culture (Duffin, 1997). Jones *et. al.* (2003) found that rather than high investments in convenient locations, in the case of non-standardised and personal products, it is better for firms to invest in strategic service attributes like employee training and technology which would have a greater impact on retention. It was seen that the process of complaint handling is a method to retain dissatisfied customers. Firstly if customer complaints are handled promptly; then through complaint analysis, it is possible to get customer feedback on services to help gain a marketplace advantage (Fornell and Wernerfelt, 1987; DeSouza, 1992). Service recovery helps increasing loyalty (Colgate and Norris, 2001). There are challenges involved: up to two-thirds of dissatisfied customers do not report their dissatisfaction (Andreasen, 1984) – however if the company is perceived as proactive and approachable, it facilitates service recovery.

2.3 Service Loyalty Programs

In a competitive environment where the customer has myriad choices and few switching costs, loyalty could from the organization point of view decrease costs and increase revenues. Oliver (1999, p. 34) defined loyalty as: "*a deeply held commitment to rebuy or repatronize a preferred product/service consistently in the future, thereby causing repetitive same-brand or same brand-set purchases, despite situational influences and marketing efforts having the potential to cause switching behaviour*." We see that satisfaction and retention do lead to loyalty hence they are related. A brand is a promise and meeting that expectation creates satisfaction but does it create loyalty? Loyal customers are of five types

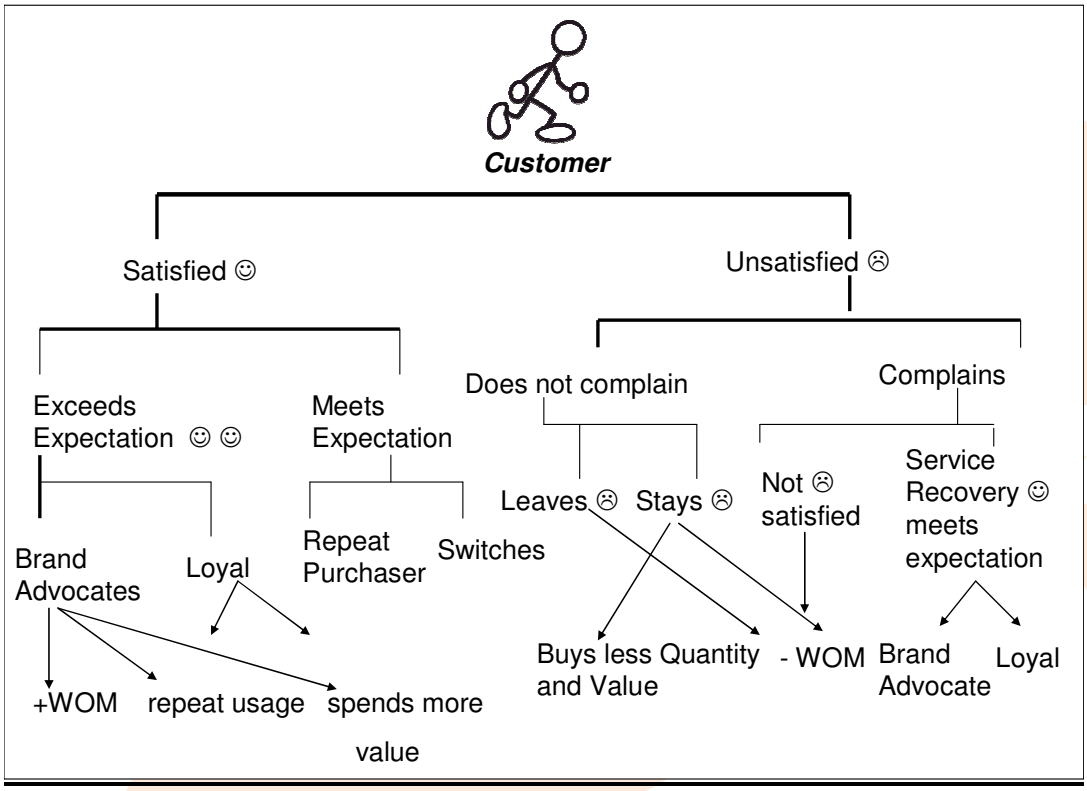
(Curasi and Kennedy, 2002) – the Prisoner (a captive customer – who has no choice), the Detached loyalist (who faces high switching costs), the Purchased loyalist (loyalty is bought using structural rewards), the Satisfied loyalists (satisfied so no reason to switch) and finally the Apostles (emotionally involved participants). An ideal customer is the Apostle who will act as brand ambassador on behalf of the service and go out of his way to convert other customers (see Figure 2 on customer satisfaction effects).

Loyalty is enhanced through increasing customer satisfaction (McDougall and Levesque, 2000) and by improving brand equity, trust and loyalty, which affects customer behaviour-based CRM performance (Taylor *et. al.*, 2004; Wang *et. al.*, 2004). Service personalization, customization of delivery or the functional quality of the product increases loyalty (Ball *et. al.*, 2006; Grönoos, 1984). Hence we see that to increase loyalty we need more than mere satisfaction and retention – we need relationships! Relationships with influencers (halo effect), and networks that facilitate intra-customer networking and even association with complementary products can aid loyalty generation (Ferguson and Hlavinka, 2006). Most organizations focus on rewarding loyalty through frequent usage programs. They should instead focus on customer expression and experience rather than on purchases (Pearson, 2006). Loyalty should not depend on financial or structural bonds but also social/personal bonds (Sharma, 2006). Greater perceived approachability, and responsiveness to customer voice leads to greater loyalty and greater purchase behaviour (Divett *et. al.*, 2003). Conversely, a study by Stauss *et. al.* (2005) found that customer frustrations in loyalty programs are due to inaccessibility, worthlessness, qualification barrier, and redemption costs, which affect future relationships with the firm. Hence greater retention leads to greater loyalty, ***though*** greater satisfaction does not necessarily lead to greater loyalty (Skogland and Siguaw, 2004). The difference is whether the customer who is satisfied is delighted or not (Kumar et al

 ISBN : 978-0-9742114-7-3

2001). A delighted customer is more loyal and hence will buy more, is willing to spend up to 7% higher, and is a source of positive word of mouth (WOM) (Torres and Kline, 2006).

Figure 2: Customer Satisfaction Effects



Customer relationship management is being linked to technology enabled Data Management (Ferguson and Hlavinka, 2006; Capizzi and Ferguson, 2005). The purpose of CRM is not just data management which focuses on customer identification, tracking, customer personalization, and repeat usage rewards. CRM must be used to satisfy and build relationships. CRM can take advantage of coalitions to increase value; changing technologies like, RFID, smart card, cellular phone payments, biocards etc., and forge

alliances to minimize the effects of industry convergence (Ferguson and Hlavinka, 2006; Capizzi and Ferguson, 2005). If you collect data from customers, organizations must know how to use it. By collecting data, you create an expectation with the customer … and any expectation must be proactively met. Organizations often mistake customer database marketing for relationship marketing. Relationship marketing is personal and emotional; database marketing is impersonal. It is not enough to know the customer name – you must ***know*** the customer – what service he prefers, how he likes it delivered and why it is important for him!

Loyalty must be organization based and not just employees based. Very often organizations leave it to individual employees to mange the customers. In SMEs this often backfires with the employee walking away with the account. What the Chinese call guanxi (personal relationship) and xinyong (personal trust). Guanxi affects Xinyong more than satisfaction (Leung *et, al.*, 2005). Managing this means creating a customer centric knowledge culture (Stefanou and Sarmaniotis, 2003) – it is not about the technology but the ***information gathered by the organization and how the people use it***. That means customer information is the organizational responsibility and not the sole responsibility of the employee who is responsible for the interface. This means that the customer meets other employees (especially from other levels – not only at times of trouble but even when things are going well) so the emotional bonds are to the organization and not just to the individuals who represent the organization.

2.4 Enhanced Customer Lifetime Profitability

Customer lifetime value is the net of the revenues obtained by the customer over the lifetime of transactions (past and especially the probability of future transactions) with that particular customer minus the cost of attracting, selling, and servicing that customer taking into account the time, value and

money (Jain and Singh, 2002). Loyalty and profitability are related (Reinartz and Kumar, 2002; Anderson and Mittal, 2000). A 5% increase in retention can increase net present value of customers from 25-85% (Reichheld and Sasser, 1990). It costs less ($1/5^{th}$ – $1/10^{th}$) to keep an existing customer than to get a new one (Rosenberg and Czepiel, 1984). However customer lifetime profitability is not only dependent on retention but also on customer satisfaction. Loyalty depends on the current level of satisfaction with the relationship rather than on what the future may bring (Leverin and Liljander, 2006).

A big part of customer relationship strategies hinges on the fact that you must be able to segment your customers as not every customer is a profitable one. Most companies can retain up to 75% of key accounts, but this may not necessarily increase revenues (Howell and Soucy, 1990; Ryals and Knox, 2005; Leverin and Liljander, 2005). To manage services, one needs to mange the costs associated with it and the customers (Van Trieste, 2005). Value is calculated by considering the revenues from the aggregate sales to the customer; the additional revenues from upgrades, cross selling; and marginal revenues from referrals (Bauer and Hammerschmidt, 2005). Costs involve acquisition costs, marketing retention , recovery costs and sales costs (Reinartz and Kumar *et. al*., 2001). Hence firms need to segment customers based on current and future profitability and this is where measuring CLV helps though there are many methods to do so (Raaij, 2005). CLV can be enhanced by increasing customer perceived value and productivity or reducing cost (Gummesson, 2004). Value strategies fall in three areas – brand equity, value equity and relationship equity (Rust *et. al.*, 2004).

If we want a lifetime commitment from the customer we need a relationship and the more emotionally the customer is involved with the organization of its service, the harder is it for the customer to switch. Customer-employee interactions play an important role in delivering delightful and satisfying

experiences (Torres and Kline, 2006). By focussing on brand experience –differentiating based on family values, social structural bonds, community relationships and experiential shopping you can create a greater CLV (Mascarenhas *et. al.*, 2006). Organizations find creating customer communities increases CLV, and it encourages word of mouth (WOM). In a previous study, it was found that the average loyal bank and dental customer recommended his service provider to approximately 5.5 to 7 other people (this number marginally increased with no of years of service interaction, services used and money invested by the customer) which itself creates a WOM ripple effect (Gremler and Brown, 1999). Relationships must focus on interactions versus transactions and psychic needs versus functionality (Khalifa, 2004)

3.0 Bridging the Gap

Keeping in mind all of the above, how do we go about bridging the gap? From the above study we see a linkage between all four service initiates. There is a considerable degree of overlap but the distinguishing factor is the relationship focus. As you move towards developing CLV you focus on customer interactions and emotional bonding. The focus must be to create an emotional dependency on the organization. It's not the value of the scheme or the functionality of the project of the so called CRM initiates that reward loyalty. It is about whether the customer feels an emotional bond with the service and the organization that delivers it. This can be called the *Funnel-Trickle Effect* (see Figure 3). Though the same schemes can be used for satisfaction, retention and long term loyalty, the differentiating factor is the emphasis on emotional bonding and making the customer experience personal and a delightful one.

Figure 3: Funnel -Trickle Effect of Various Service Programs

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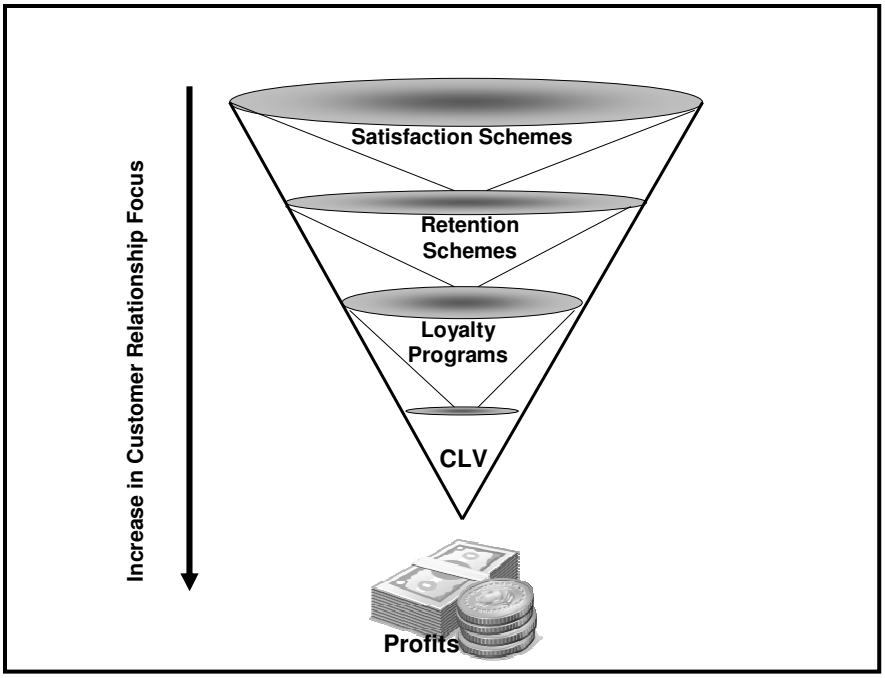

The final objective of any organization when implementing customer satisfaction schemes is to increase profitability and achieve organizational objectives. If the cost of these schemes is more than the revenue that can be brought in, then organizations need to have a good long look at why. There can be three reasons: one to remain competitive with the industry (everyone else is doing it), to invest in a long-term relationship taking the initiative (knowing in future you will become the gold standard for all competition) and finally to be different. To stand out by having some similarities but yet introducing schemes that make the customer stand up and take notice, at the same time contributing to the organizational objectives. There are three ways this customer perceived value can be increased as given in Figure 4. Organizations can increase productivity, decrease perceived costs or increase perceived value. This will help in delivering lower costs, improving quality, increasing efficiency and interaction time and quality, reinforcing the image through word of mouth and improving emotional bonding.

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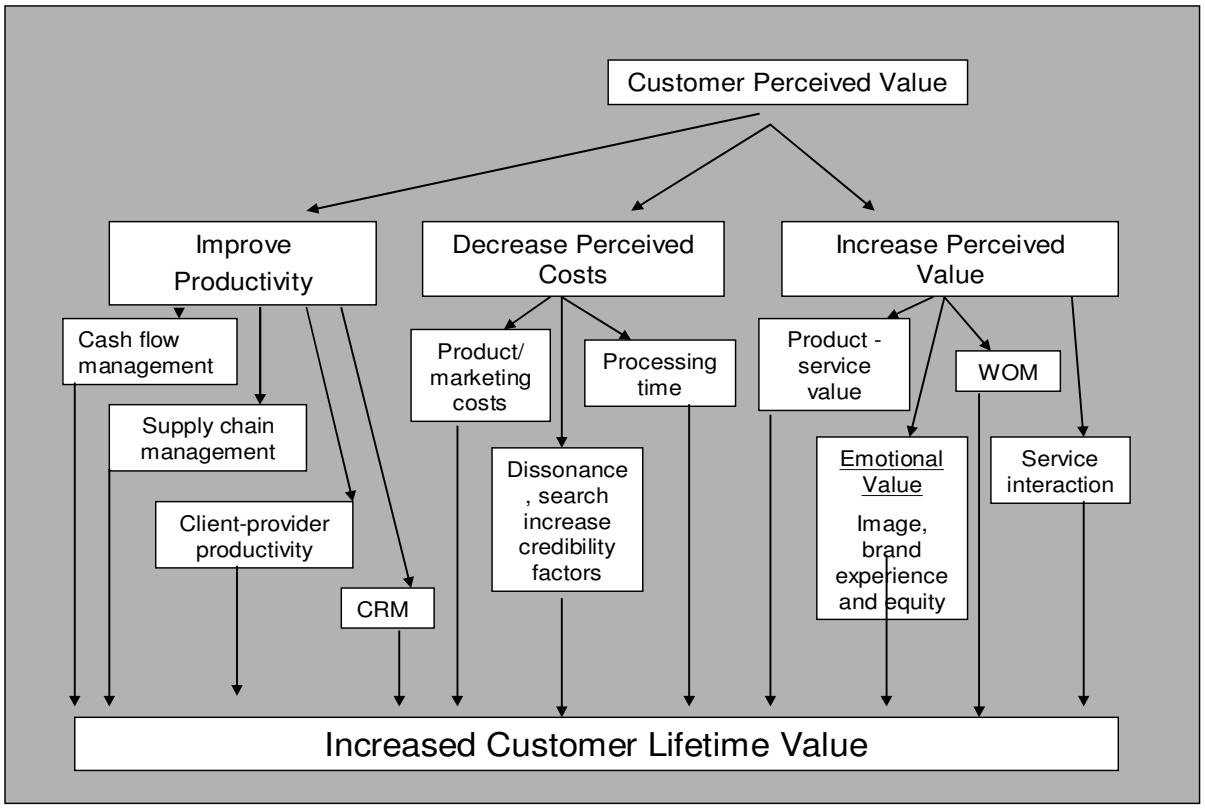
Figure 4: Methods to Improve Effectiveness of Service Schemes through Differentiation



4.0 Future Direction

There is a growing industry concern that organizations are attempting customer relationship management programs without a clear focus of direction and this leads to poor consequences. This paper explores various common customer initiatives based on the consequences like satisfaction, loyalty, retention and customer life time value (CLV). It explores the relationships between each consequence and finds that they have a trickle effect where satisfaction, retention and loyalty are necessary conditions for CLV in that order. A fundamental criterion for the success of customer initiative schemes is making

sure that customer perceived value is met or better still, whether it is exceeded. This paper suggests methods based on an extensive literature review of how to do so. Hence the framework provided helps organizations evaluate future service schemes with respect to cost and results. Loyalty schemes maybe misnomers and may actually be satisfaction schemes. Organizations must be clear why they invest in programs and must have some idea on how much of each program trickles to the next level as a metric for the success in investing in such schemes. Future research can test the frameworks presented in this paper and evaluate the gap in the perceptions between what organizations perceive as customer initiatives and what customers perceive.

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