## Customer loyalty and customer value - 1
# From customer satisfaction to customer value and loyalty

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### Towards customer loyalty and value
We are now increasingly aware that customer satisfaction does not necessarily lead to customer loyalty. Some people even wonder whether customer satisfaction measurements are of any use at all.

Pioneering researchers in this field believe that customer satisfaction measurement is indeed useful. However, in and of itself, it does not provide customer value or create customer loyalty.

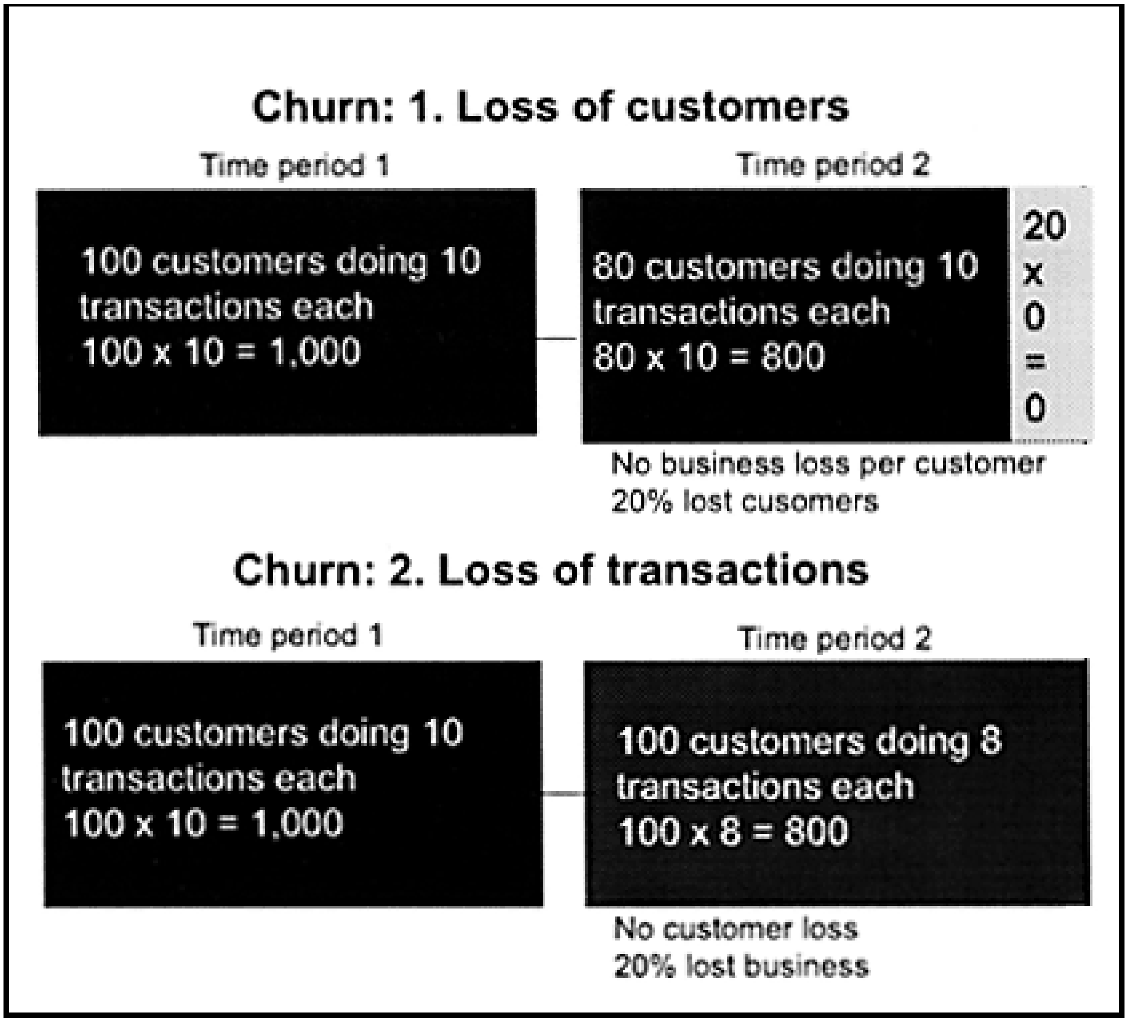
For instance, Bradley Gale (*Managing Customer Value* ) views providing customer value as a four-step process in which customer satisfaction is only the second step (see Exhibit below). Frederick Reichheld (*The Loyalty Effect* ) also views customer satisfaction as an important criterion. What is an issue is whether customer satisfaction, as measured by CSM studies, really provides an indication of real customer satisfaction. Many researchers feel that standard customer satisfaction studies do not really measure customer satisfaction. Reichheld states that: "The early successes with satisfaction programs are often a matter of picking low-hanging fruit." Once obvious problems are fixed, CSM studies may not be able to take us to the next level. The main point made by those who use measures such as value and loyalty is not that customer satisfaction is unimportant but that it is measured much better by behaviour measures (such as repurchase) than by verbal statements (such as "I am satisfied").

**Four stages of customer value management**

| Stages | Focus | Typical objective |
|---|---|---|
| 1. Conformance to quality | Internal operations | Get close to requirements |
| 2. Customer satisfaction | Customers | Get closet to customers |
| 3. Market-perceived quality and value | Targeted market and performanced jvs. competitors | Get close to the markets |
| 4. Customer value management | Quality and value ini overall framework | Get your organization close tot he targeted market |

The central argument for measuring customer retention as opposed to customer satisfaction is that it correlates with hard measures such as productivity and pre-tax profit margins. *Directors & Boards* (September 1990) reported " a 5% swing in customer retention rate drives profits by 25%-85% for a wide range of industries." As Gale notes, we need to move customer satisfaction "from a slogan to a science."

### Managing churn
Even when customers are satisfied, it does not automatically follow that they will be loyal to us. They can be lured away by the competition who can provide comparable satisfaction but can also give them a better deal. Even worse, customers can stay with us but may not do as much business with us. In other words, we can lose business without losing customers.




Churn is the term that is being used to denote loss of business. As noted, churn can happen in two ways: first, customers leave us to become customers of our competition; second, customers stay with us, but do an increasing amount of business with our competition (see Chart above).

We lose business in either type of churn although the churn is more difficult to detect when customers stay with us while doing part of their business elsewhere.

Susan Devlin and Terry Gleason of the New Jersey-based Artemis Group provide some estimates of the financial impact of churn. In the cellular phone industry the typical churn rate ranges between 18 and 35%; in the on-line industry the churn is 36% and in the banking industry it is over 1%. What is the annual loss when churn goes by 1%? It is $2.6 million for the cellular industry, $6 million for the on-line services industry and $1.8 million for the banking industry.

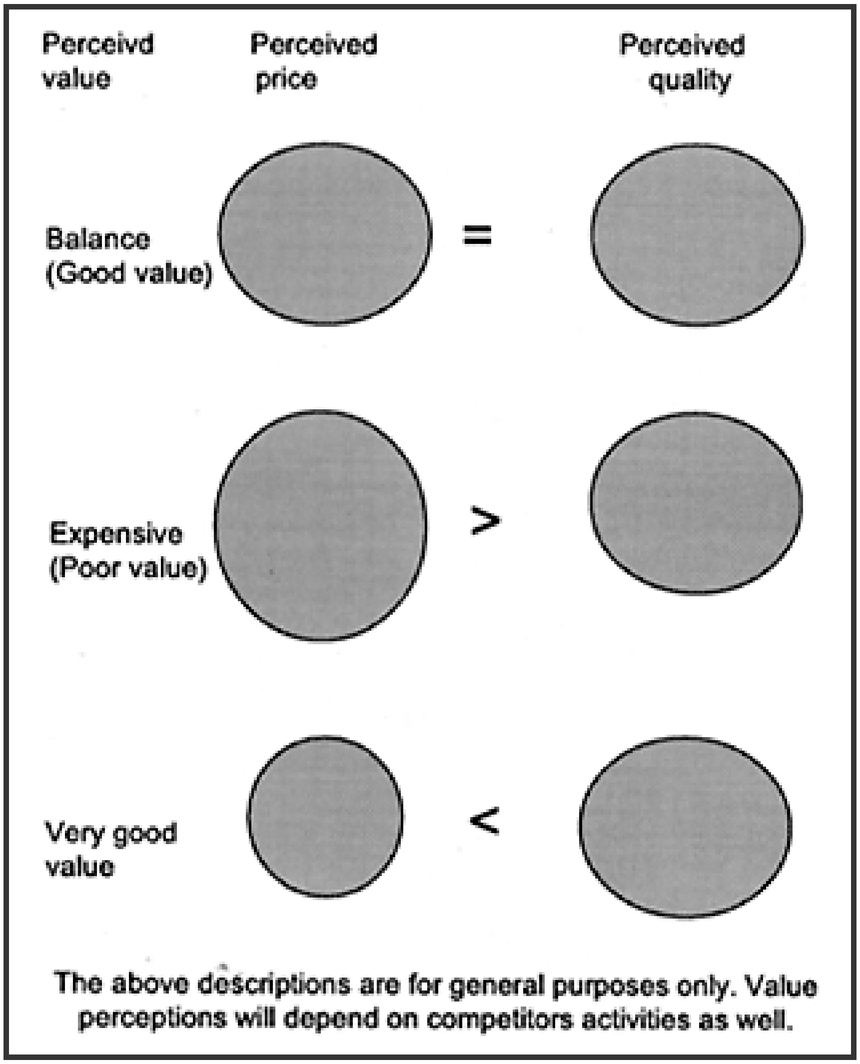
The above costs do not even include the lifetime value of a customer, the cost of replacing a lost customer and the processing cost that is involved when a customer leaves us.

It is obvious we need to attract and keep customers. In this context, churn management converges with loyalty management. We provide value to customers and they reward us with their loyalty. This is the basis and the rationale for customer value, customer loyalty and churn management.

In this series of articles we will discuss the basic concepts that are critical to the understanding of customer loyalty and value and discuss appropriate ways of measuring them.

**Perceived Price vs. Perceived Quality**

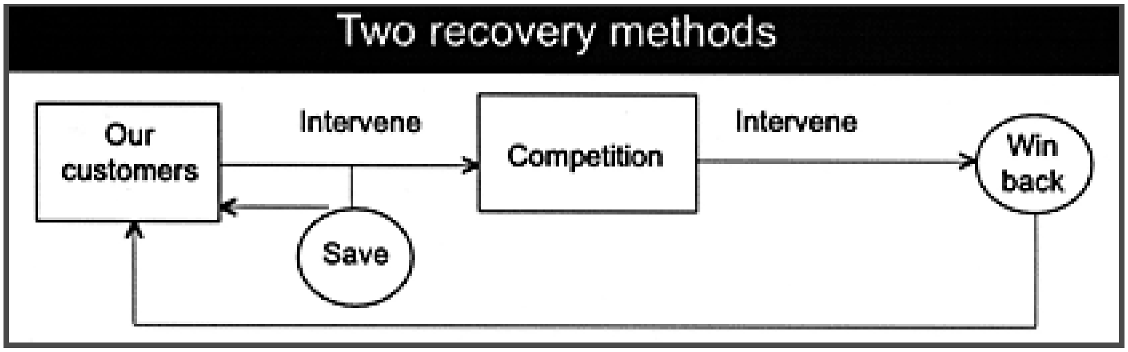
In the examples below, perceived quality is identical for three different products. Yet, the value of the products is not uniform. Many customer satisfaction studies may correctly conclude that these three products are of equal quality. However, the second product is much more vulnreable to competitors' marketing efforts compared to the third product. Hence the need to go beyond customer satisfaction and measure customer value.




**Where is the gap?**

If the four stages of customer value management are a natural pro?gression, where do we fall short? Gale feels that a gap arises when we limit our measurements to customer satisfaction and do not extend measurement to market perceived value. For instance, when we ask customers how they perceive and rate our product, we are in fact talking about *customer* perceived quality. But what is critical is market perceived quality. So it is not enough for the manufacturer of a computer to know how a customer rates its product. The customer is buying a computer, so it is critical for us to know what they expect in a computer and how a given brand fits in the whole spectrum of computers. Our research should therefore extend to our non-customers. We should pay attention to the target market as a whole rather than concentrating on finding out whether customers are satisfied with our product or not.

Traditional customer satisfaction studies fail on two counts. First they don't make a serious attempt to understand non-customers in order to assess why they do not buy from us. Second, they don't study the market as a whole. We not only need to retain our customers, we also need to attract customers from our target market.




**Customer value**
What is customer value? Operationally, customer value is defined as quality with respect to price. Therefore value is defined in terms of price. What is of value at one price may not be of value at another price. Customers buy based on value. Do they perceive that the quality delivered is commensurate with the price? To the extent that there is an imbalance between price and quality with price exceeding perceived quality, there is a risk of customer churn. This is one of the major problems with traditional customer satisfaction studies. Our product or service may be satisfactory but satisfaction may not turn into loyalty if the product or service does not offer value.

What does quality include? Quality in this context refers to all positive attributes of the product or service, excluding price.

What follows from this is that quality, price and value are not independent of each other. These concepts are interdependent and related to each other. Thus *value* is defined by *quality* and price and quality is defined by the product and the customer service that goes with it.

If we are to measure customer value, it follows that we need to measure the two basic components: a profile of quality as perceived by the market and a profile of price, again as perceived by the market.

**Two recovery methods**
Customers leave us when they are dissatisfied with us or, even when they are satisfied, when they don't perceive that we provide value.

As a result, defection is usually the result of two factors: customer dissatisfaction and competitor activities that provide greater value. How do we stop customer defection? Traditionally, there are two methods: The first method is called "save". This process involves contacting the dissatisfied customer and removing the cause of the dissatisfaction. For instance, if a customer complains to a telephone company about its rates, the company can offer a better package to the customer. This is the "save" method of customer retention. Or, it may contact customers who have already defected and provide incentives for them to come back. This is the "win back" method.

Both these methods involve costs that are likely to be higher than a pro-active program that is designed to provide value. The win back method, for instance, often involves offering better value than the competition. It cannot be offered only to defectors, because doing so would antagonize current customers. In other words, we will be playing by the rules set by the competition rather than creating value for our customers in a way that is consistent with our goals and customer needs.

While these strategies are better for recovery than having no strategies at all we should remember that recovery strategies, even when they work, are expensive. They often attract "spinners" or customers who switch from company to company, mostly to take advantage of the best available deals.

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