Summary of Issues Relating to Customer Retention and Value

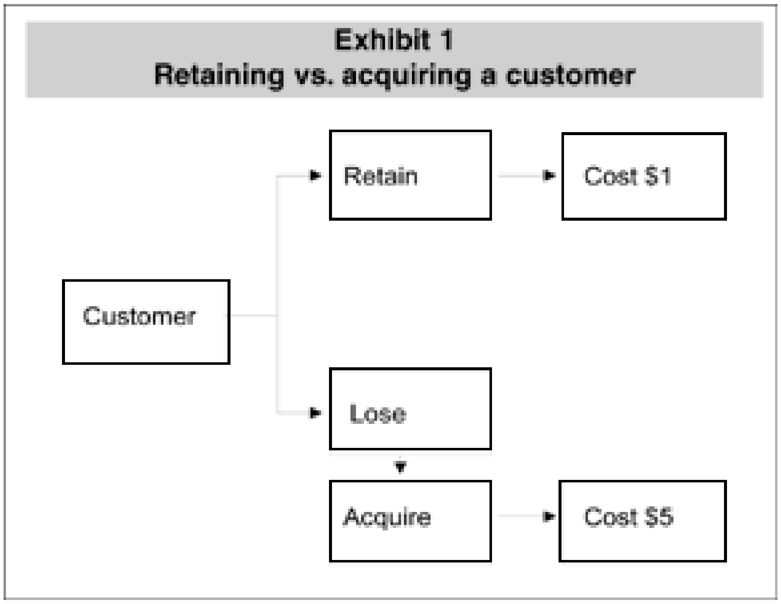
By Chuck Chakrapani

In this article I present a summary of the various issues that have an impact on customer retention and customer value.This article can be viewed as a consolidation of many of the issues that have been dealt with in detail in my earlier articles. To avoid repetition, I present these issues in summary form.

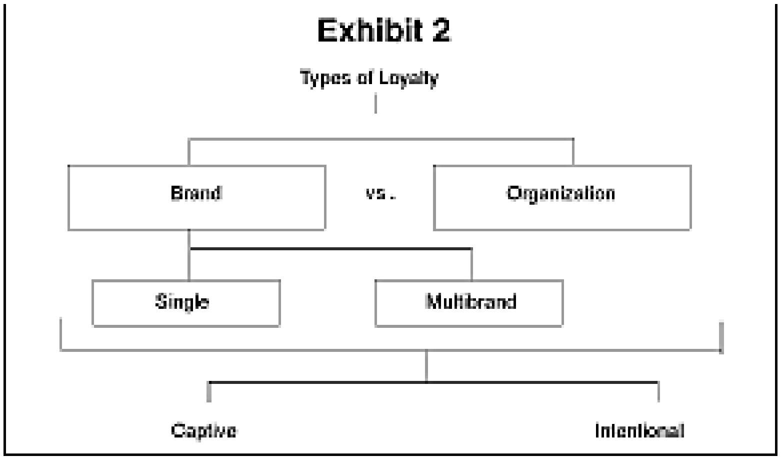
1. *Customer loyalty has direct implications to an organization's profitability* . This is so because the cost of acquiring a new customer is considerably higher than the cost of retaining an existing customer.

Current estimates by different experts indicate that the cost of acquiring a new customer is about 500% of the cost of retaining an existing one. *Directors & Boards* estimates that a 5% swing in customer retention rate drives profitability by 25% to 30%. Specific estimates indicate that a 1% loss in customers results in a loss of $2.6 million for the cellular phone industry, $6 million for on-line industries and $1.8 million for the banking industry.

Since this cost comes directly out of an organization's bottomline, loyalty contributes directly to an organization's profitability (See Exhibit 1).

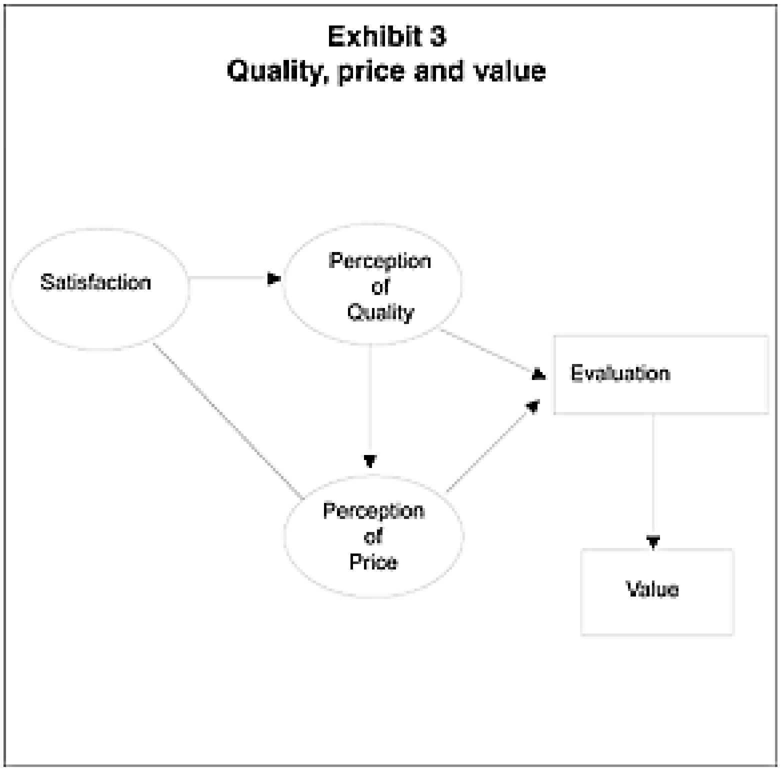


2. *Loyalty can be an elusive concept* . There is no agreed upon definition of customer loyalty. It can be measured in a number ways depending on your objectives. For instance, if we define loyalty as continued repeat buying, what happens when a customer continues to do business with us but does so with decreasing frequency? How do we cope with multibrand loyalty? Do we consider a customer 'loyal' if he or she does business with us due to lack of acceptable alternatives? Do we measure loyalty to the brand or to the organization (Exhibit 2)?



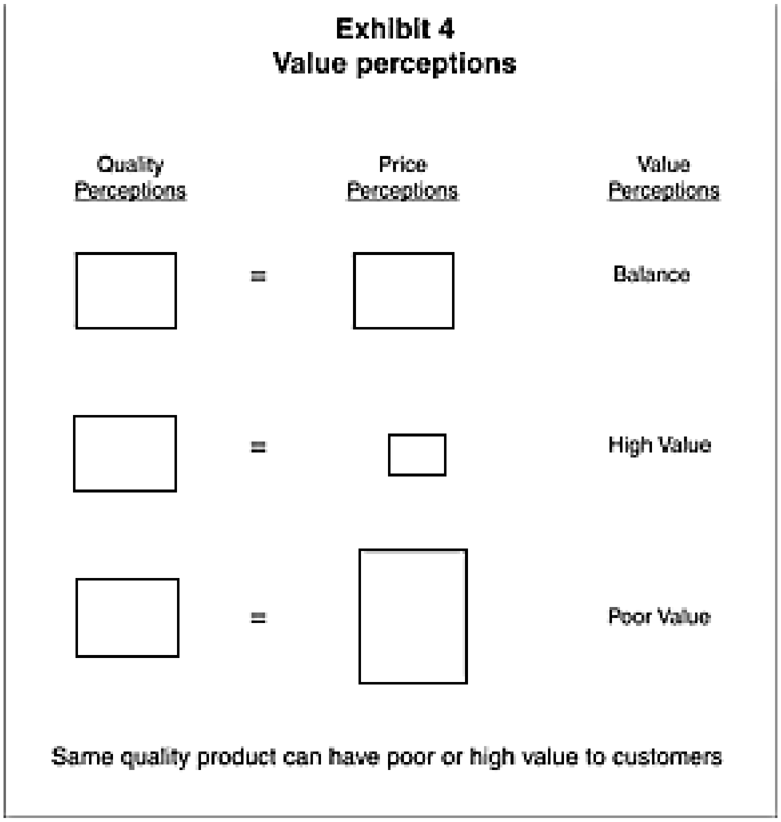
3. *Customer satisfaction does not directly lead to customer loyalty* . A clear majority of switchers state that they had been satisfied with the firm they switched from. It follows that customer satisfaction may not directly lead to loyalty (Exhibit 3).

This does not mean that customer satisfaction is irrelevant to loyalty. Rather, customer satisfaction has to be related to price. What keeps customers is not satisfaction by itself or price by itself. The key question is customer satisfaction at what price?

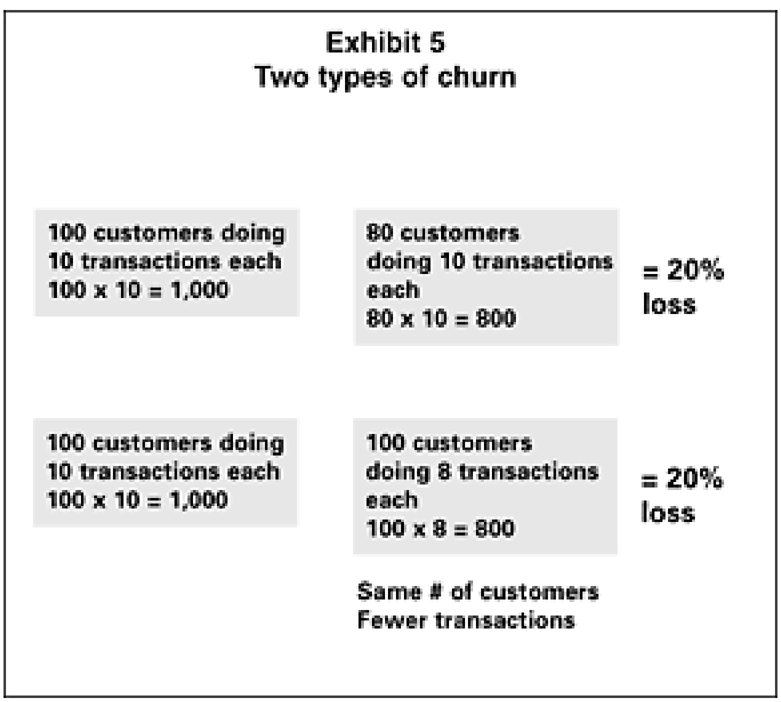


4. *Value is the currency that buys loyalty* . Customer satisfaction, to result in loyalty, has to be balanced by price. It is quite possible that customers are satisfied with our product or service, but they may not buy from us if we do not provide value. Satisfaction is only the first step leading to loyalty.

The question is, if customer satisfaction is the result of perceived quality, then how does perceived price compare to perceived quality? Does perceived quality match or exceed perceived price? If perceived price is lower than perceived quality, then the customers' probability of being loyal is increased (Exhibit 4).



5. *Providing customer value reduces churn* . Churn - the act of customers leaving us - can occur in two ways (Exhibit 5). Some customers may switch institutions or they may use competing institutions for part of their needs. The latter type of churn is much more difficult to detect since the customer continues to be a customer, even though we have lost business. The main causes of churn are price and quality issues (such as service failures, service encounter, and employee responses). Lack of value makes customers vulnerable to competitors' offers.



6. *Customer value management is a four-stage process* . As Bradley Gale points out, customer value management is a four-step process (Exhibit 6):

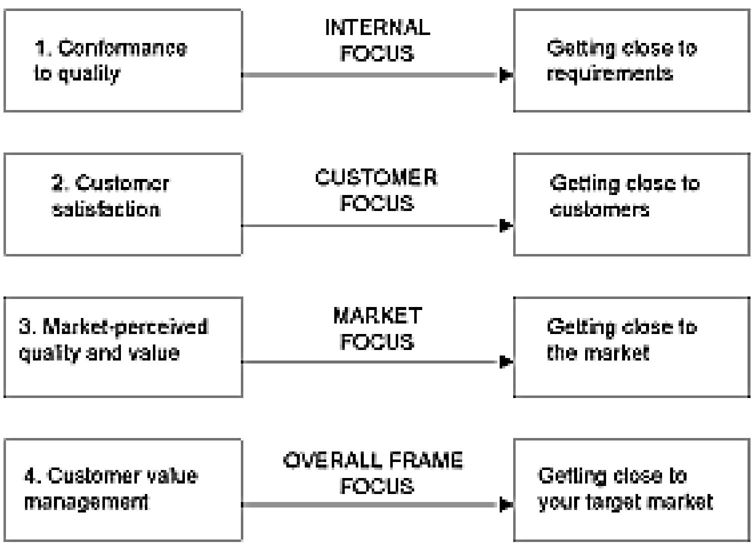
Step 1. *Conformance to quality* to get close to requirements

Step 2. *Customer satisfaction* to get close to customers

Step 3. *Market-perceived quality and value* to get close to markets

Step 4. *Customer value management* to get your organization close to the targeted market.

Exhibit 6
Stages of customer value management

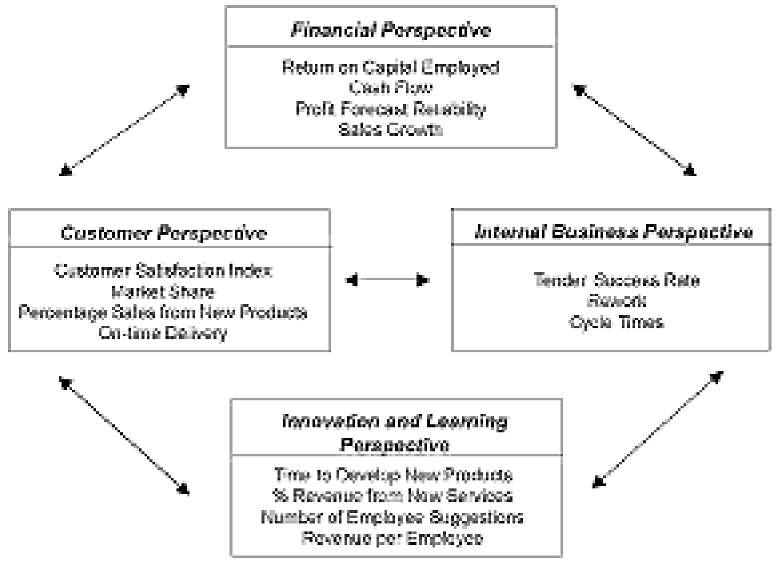


7. *Customer value and loyalty programs should be a part of the system as a whole, not isolated entities.* Deming used to insist that one of the bases of a "system of profound knowledge" is the understanding that an organization operates as an interdependent system. We cannot effect any enduring changes unless we understand how a component of a system (such as a customer satisfaction program) affects other parts of the system (such as employee satisfaction).

Unfortunately, programs such as customer satisfaction and loyalty are often handled by different designated individuals or departments. Such programs can - and often are - carried out without any regard to how they might affect other aspects of an organization. Deming points out that optimizing at the local level (eg. best performance by each division of the organization) does not necessarily result in optimization at the organizational level. In fact, optimizing at the local level often results in suboptimal results for the organization.

There are many approaches to optimizing the system and achieving a balance. One of the most popular of these approaches is the balanced score card (Exhibit 7) which takes into account the factors that affect an organization as a whole. (This approach has been discussed in some detail in an earlier article.)

Exhibit 7
An example of a balanced scorecard



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