CUSTOMER EQUITY

WHO IS AFRAID OF CUSTOMERS?

by

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Abstract

The customer in a marketing point of view is the most risky asset of a company. Therefore, special weight has to be dedicated to the customer and its lifetime value provided to the company value. A shifting of companies from a product- to customer-centred approach is necessary. The 'profitable product death spiral' illustrates on the one hand the drawbacks of the product-centred business and on the other hand the importance of the customer as main value driver for the company valuation. But where does the customer equity origins from? The roots of customer equity come from different marketing approaches which still have their limitations of managing customers as assets.

The Profitable Product Death Spiral

New trends in the economy force managers to shift their focus from a product to a customer respectively from brand equity to customer equity focus, if they want to stay competitive. The practical example of Bell et al. (2002) emphasize this shift even more by the decision of Unilever, cutting the number of brands in its portfolio from 1800 to 400 and launching a new strategy to build more relationships with customers. However, Rust et al. (2000) justify this change, which currently shaping the business world, by the following four shifts: from goods to service, from transactions to relationships, from customer attraction to customer retention, and from product focus to customer focus. Moreover, Rust et al. (2000) give in their book of 'Driving Customer Equity' several relatively simple but descriptive examples of the so called 'profitable product death spiral', which illustrate the errors of the traditional approach of a product-centred corporation. The following case is demonstrated for better understanding of this issue:

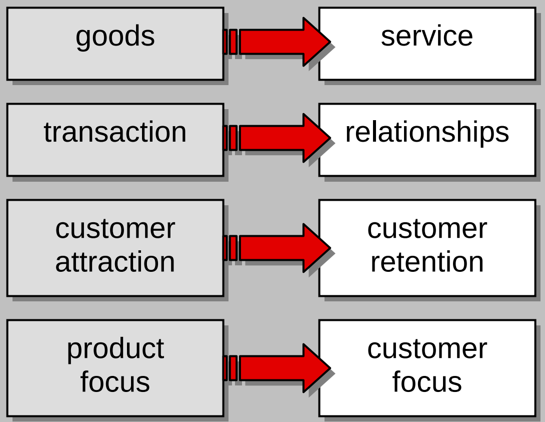

Figure 1: Shift from product to customer centering

The hotel "The Golden Aquarius" was booming with revenues of $231 million, and an 85% occupancy rate. The neighbouring theme park, belonging to the Golden Aquarius, however, was far less profitable. Therefore, the managers just shut down the theme park. But one year later the hotel's convention room nights were down 22% from the previous year. Obviously the hotel business had been badly hurt by the closing of the park. Finally, for individual customers, the theme park increased the value of the hotel.

The case of the Golden Aquarius shows that the managers were merely product-focused, and did not centre on the customer and therefore the whole business has fallen into the profitable product death spiral. The following steps of the profitable product death spiral entail the final drawback of losing customers and profits:

- Company improves profitability by eliminating unprofitable products/services
- Elimination of unprofitable product produces reduced service
- Reduced service drives customers away and lowers profits

Generally, this happens because corporations appraise product rather than customer profitability. Moreover they do not consider complementary customer choices, as products are seldom purchased in isolation. "The resulting loss of sales weakens demand for previously profitable products, subsequently causing them to be dropped." (Cannon et al., 2006, p. 270). This weakens the assortment even further, and continues in a downward death spiral.

The point is to avoid the drawbacks by putting more attention on the customer rather than the company's products. The customer-centred approach still provides customers with products they want, but it takes a portfolio of products into consideration that will both drive sales and maximize "share of wallet" (Cannon et al., 2006, p. 270). Apparently, this advantage refers not to the traditional product-centred approach.

Varies approaches in the areas of marketing streams are trying to provide ideas for avoiding the drawbacks of the product death spiral and supporting managers in decision making processes with attempts to a more customer-centred focus. Yet, these approaches enhance some improvements but still face some limitations concerning the customer-centred approach of customer equity. The following abstract illustrates the sources of concepts to customer equity and their limitations in the field of marketing.

Where does Customer Equity come from?

Customer equity has its roots in several relating streams, including direct marketing, service quality, relationship marketing, and brand equity (Hogan et al., 2002). Taking each stream alone, none of them, as usual provide a holistic solution to corporations. But seeing those altogether and combine synergies they contribute an effective approach to managing customers as assets. It has to be mentioned that because of practical issues, the well-elaborated theoretical streams are hardly realized entirely in the actual professional world. In fact that does not implicit that the single streams are failures, because well used the streams are effective. But by using the concepts in their 'narrow' boarders, limitations occur concerning the customer perspective, since they do not take an integrated view into consideration.

In the following each stream will be introduced briefly with a specific insight into relationship marketing, since it plays a more important role concerning customer relationships. The purpose of the illustration of the different streams is just to assess the limitations concerning the customer equity without deeper investigation into the professional application.

Direct marketing / database marketing

Direct marketing (also called database marketing) was the first to collect and file purchase data of individual customers. According to Hogan et al. (2002) direct marketers introduced statistical techniques for the forecast of customer response to marketing communication. Thus the segmentation became an increasingly common approach, especially the choice-based or behaviour based segmentation techniques (compare Hogan et al., 2002; Lilien & Rangsaway, 2003). Database marketing makes it possible with the use e.g. of mail, telephone, internet to "efficiently reach target customers and provide them with an incentive to take action" (Best, 2004, p. 258). For instance, customized direct-mail programs are one of the options to communicate with customers and prospects.

In a way direct marketing was also pioneering in the use of customer lifetime value assessments as a source for marketing strategy. By taking the customer behaviour into consideration to understand the value of a customer to the company, direct marketing has made some contributions to customer equity. Therefore, direct marketing literature counts as one of the roots to customer equity. But, however, this marketing stream has several limitations. On the one hand it focuses only on the operational narrow level and communications and response. Direct marketing has not taken changing customer preferences, pricing, product, quality, or customer service, etc. into account. On the other hand it tends to be relatively transaction-oriented rather than focusing on maximizing the value of relationship as a whole (compare Hogan et al., 2002; Rust et al., 2000).

Service Quality Literature

In principal service quality means, developing appropriate measures, and creating market-focused strategies to meet customer expectation. Although existing service quality literature is prodigious, researchers have paid little attention to usage frequency and its possible relationship with service quality perception, even though it is well known that service users may change their perceptions over time as they gain additional experience. Besides, most of the studies consider delivering quality services as an essential strategy for success and survival for any organisations (Dawkins & Reichheld, 1990; Parasuraman et al., 1985; Reichheld & Sasser, 1990; Zeithaml et al., 1990).

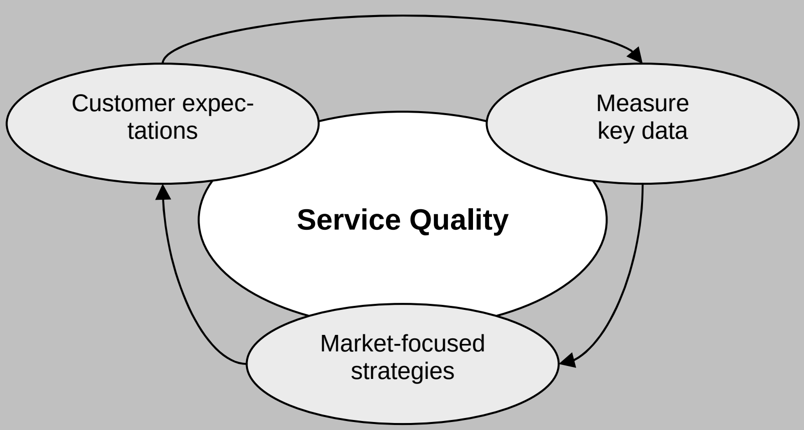

Figure 2: The core of Service Quality

Referring to King (2000) the relationships among customer satisfaction, customer retention and company profitability have not been completely explained in the customer satisfaction and service quality literature. But actually, the linkage of these three components seems to be obviously, as it is shown in the approach of Customer Lifetime Value. Furthermore, the narrow view on service quality has not taken the fully marketing mix, e.g. product, communications into consideration referring to customer equity management.

Nevertheless, the service quality literature has made a substantial progress toward understanding the connection between customer satisfaction and components of customer profitability, e.g. retention. But a broader view of the connection between the total marketing mix and customer profitability is still needed.

Relationship Marketing

According to Berry (1983), relationship marketing bases on building, maintaining and enhancing long-term customer relationships in multi-service organisations. Herewith, the central point of the marketing effort, in contrast to direct marketing, is not the short-term single transaction oriented on success, but the long-term profitable customer relationship. The relationship marketing literature was also the first, which realized the key elements, to focus on customer relationships as a strategic assets and therefore to build up a long-term relationship (Hogan et al., 2002). Kotler (2003) also defines the aim of relationship marketing as "building long-term, mutually satisfying relations" (Kotler, 2003, p. 29). This definition makes it clear that this stream focuses a lot on the combination of trust, commitment and shared values to gain profitability and shareholder value.

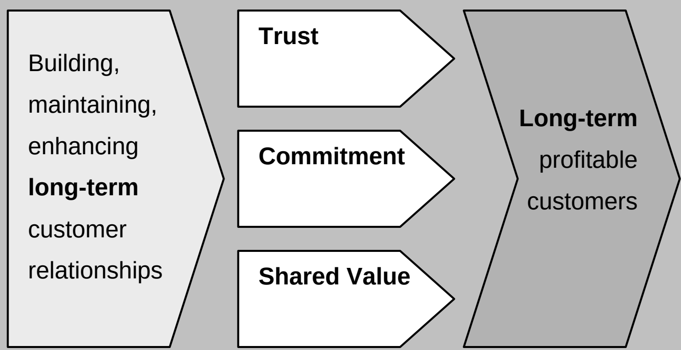

Figure 3: Main parts of Customer Relationships

Although, the practice of relationship marketing hasbeen facilitated by several generations of customer relationship management (CRM) software, it does not necessarily mean that it makes a company more customer-oriented. Mainly, CRM systems were just designed to help service and sales representatives improving interactions with customers, using recent and past customer interaction and transaction data (Hansotia, 2004).

However, many companies have made major investments in CRM but they still not recognise the true value of customers (Shaw, 2001). In general CRM fails to focus on improving customer equity, and therefore no significant improvement in customer performance or ROI can be recognized (Hansotia, 2004).

Relationship marketing, as already mentioned, focuses on relations with all key parties and all relationships should lead to long-term commitment. But it does not recognize that, actually not all relationships are profitable and then should not be continued. Furthermore, not all customers want a committed relationship. Therefore, Hogan et al. (2002) suggests that a model is necessary which balances the customer's desired level of relationship against the profitability of doing so to finally improve strategies. Also Gordon (1999) criticises the use of traditional marketing tools in relationship marketing. For instance, he mentions that the marketing mix approach is too limited to provide a usable framework for assessing and developing customer relationships in many industries and should be replaced by an alternative model where the focus is on customers and relationships rather than markets and products.

Brand Equity

Sattler (2001) reveals that the origin of the idea of brand equity was at the beginning of the 80s in the USA. For him, brand equity stands simply for a new interpretation of marketing expenditures, which are no more viewed as short-term but as long-term investments. Hence, marketing expenditures and short-dated advertisement investments increased and brand equity justifies the high investments and budgeting part. According to Keller (1998), the brand equity literature puts a significant contribution to the customer equity approach.

Kotler (2003) describes brand equity as an important company asset. This makes brand equity as a measurable asset. However, the real calculation of brand equity is quite difficult and there is no common sense about it so far. Best (2004) just describes the calculation of brand equity like the owner's equity: total brand-asset score (performance that adds value to the brand) minus total brand-liability score (performance that lowers brand value). But it automatically arises the question about the determination of performances that lower or add value which are not answered. Nevertheless, the computation enables to track changes (including financial consequences) in brand equity over time and strategies can be built on these changes. Moreover, brand equity literature gives some insights about the development of relationships between consumers and companies.

Total brand-asset — Total brand-liability = Brand Equity

Figure 4: Brand Equity

However, the concept of brand equity is still product-oriented and the marketing expenditures are merely viewed as short-term expenses, as Kotler (2003) notes that branding is a major issue in product strategy. Furthermore, Ambler et al. (2002) state that the brand equity literature has been organized around products and therefore still does not take the financial contribution of the customer into account.

Conclusion

All above explained streams exhibit several limitations regarding the customer-centred approach. Therefore, the combination of direct marketing, service quality, brand management, and relationship marketing leads to integration of the current thinking on customer equity. According to Blattberg and Deighton (1996), customer equity is defined as the total of the discounted lifetime values summed over all of the company's customers. The idea of the customer equity approach shows the importance of understanding the value of a company's customer base and using this outcome to establish optimal marketing strategies and investments, especially in customer acquisition and retention. Finally, customer equity supposed to have the greatest impact on the value of a corporation.

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