CUSTOMERS MANAGEMENT AND RELATIONAL MARKETING

(DRAFT A.Y 2017-2018)

The chapter aims to underline the importance of managing lasting and profitable relationships with customers. The first part examines the economic and intangible benefits deriving from customer loyalty and also the possible risks associated with improper management of relationships. Subsequently, the analysis of the client portfolio is analysed in order to identify the most strategic clients for the company and also those who, on the contrary, could cause a loss of value. The main policy options for managing the portfolio of acquired clients and related loyalty tools for optimal relationship management are discussed below.

Introduction

Over the last twenty years, the way in which the most dynamic and competitive companies have approached the market and their customers has changed profoundly. Until the end of the 1990s, marketing management activities had as their main objectives the growth of market share, the constant acquisition of new customers or the opening of new sales channels; in recent times, however, there has been a need to shift the focus of activities from maximizing individual transactions in the short term and other conquest marketing practices, to building a long-term relationship with customers, both acquired and potential. Therefore, the role and weight that demand had in the strategic planning and marketing management processes in general has not changed, but the very concept of "customer" has changed: a person, either natural or legal, whose entire basket of needs and expectations must be known, and whose value, not only economic, can be estimated and generated throughout the relationship cycle, especially in the medium-long term.
It is on the basis of these premises that relational marketing is developed as a real philosophy for the management of the company: the development of a strategic orientation that focuses on the construction, development and maintenance of a base of loyal customers that are able to increase profitability in the medium-long term.

There are numerous factors in the scenario that have favoured the development of relational marketing within companies in various ways:

- the growth of client information power and the ability to influence the company's reputation. In particular, thanks to the diffusion of social networks and in general of the typical functions of web 2.0, the passed logic was radically reversed where it was the enterprise that communicated to the market in a one-to-many way. With regard to these phenomena, companies, especially the largest and most exposed in terms of brand image, have developed monitoring systems for the so-called "web reputation" aimed at estimating the extent to which reputation can be associated with attitudes, ideas and situations, positive or negative, expressed by the world of the network;

- the development of complex and integrated offers, where the identification of the product and service component becomes so lax that a clear distinction between them becomes complex. Since the mid-2000, the presence of products developed jointly by several companies or whose components are co-branded has been a constant in all those markets where integrated solutions are to be offered to satisfy a specific function of use. For example, in the car market, many car manufacturers are establishing partnerships with manufacturers of applications, smartphones and other services (e. g. newspaper or book publishers) to make car time more experiential; and the dissemination of ICT technologies. Another trend that is now strongly consolidated is represented by the increasing penetration, among all customer groups, of the use of technologies, structures and systems, able to connect millions of people, facilitating and increasing the cognitive power of individual customers. There are many markets where the purchasing process is strongly influenced by the information reported on the most popular social networks or infomediation sites (think, for example, of the scores assigned by hotel booking sites, tourist services, etc.);
- speed and responsiveness in short time. The development of interactive technologies incorporates, in many situations, the ability to respond quickly to external stimuli; even, many sites and/or applications available on smartphones suggest in advance to the customer information, or services, that he may need in the immediate future;
- competitive pressure. The crisis that is characterising the first years of the new century, as well as the intensification of globalization processes, are having the effect of further exacerbating the competitive dynamics and struggles to maintain the market positions acquired. In operational terms, this means that primary demand (see Chapter 6) in many markets will shrink and businesses will consequently have greater difficulties in acquiring new customers, and will focus their policies on existing customers.

1. THE RELATIONAL MARKETING AND LOYALTY ADVANTAGES

The emphasis on maintaining profitable relationships with customers over time, rather than only on the completion of individual sales transactions, has also influenced the way in which the most dynamic companies now organize their marketing activities, favouring the affirmation of what is commonly defined as "relational marketing". It is no coincidence that the American Marketing Association, in modifying the institutional definition of the term "marketing" in 2004, wanted to insert the need to manage relations between the prevailing marketing activities. Relational marketing can be understood as:"that complex of activities, processes and marketing tools, aimed at creating, consolidating and developing long-lasting and profitable relationships with customers and other partners, capable of increasing the value generated individually and as a whole".

Relational marketing has evolved gradually over the years, also in line with the strategic needs expressed by companies. In particular, we have moved from offers aimed almost indiscriminately at the mass of customers, to situations where, thanks also to the potential of interactive technologies, personalized proposals are marketed also on a large scale (in these cases we speak of mass customization).

It is clear that relational marketing has not spread in the same way and with the same intensity across all product sectors and geographical markets. Today, there are industrial sectors where companies operate almost exclusively with Customer Relationship Management (CRM) logics and others where such approaches are practically non-existent. Among the conditions that have in various ways encouraged a relationship marketing (compared to the so-called "conquest"), we can certainly highlight three of them:

1. characteristics of the supply side. Referring to the classic distinction between goods and services, it should be noted that service companies are typically more likely to interact with the final customer, even physically at sales/consumer locations, and even to know the customer's personal details when it is necessary to enter into a supply contract (e. g. telephone services, insurance, public utilities, hotel and sports services, etc.). This feature enables service companies to get to know the customer directly and therefore to collect, and possibly store, all the information on consumption behaviour and more or less explicitly expressed needs. In an ideal adoption scale, if services are at the top of the list, consumer goods, on the other hand, are those that present the greatest difficulties in interacting with the end customer (while the application opportunities remain unchanged if intermediate customers are considered);

2. numerous customers. It is clear that the number of customers, associated with the complexity of the product/service marketed, could represent an obstacle to the development of the relational "philosophy", especially in view of the large amount of data to be collected, archived and processed. Undoubtedly, when a company interacts, perhaps through an extensive network of intermediaries, with a large number of

customers, it may find it more difficult to process information and arrive at valid summary indicators;

3. competitive intensity and dynamic market dynamics. When a market shows signs and trends of development, it is quite common for companies to target new customers and practice what is identified as conquest marketing; on the contrary, when the market reaches a stage of maturity and even decline, marketing strategies are oriented to consolidate the existing and therefore the focus of activities moves towards a marketing relationship

In summary, the maximum practicability of a marketing strongly oriented to the management of personalized relationships, is when we find:

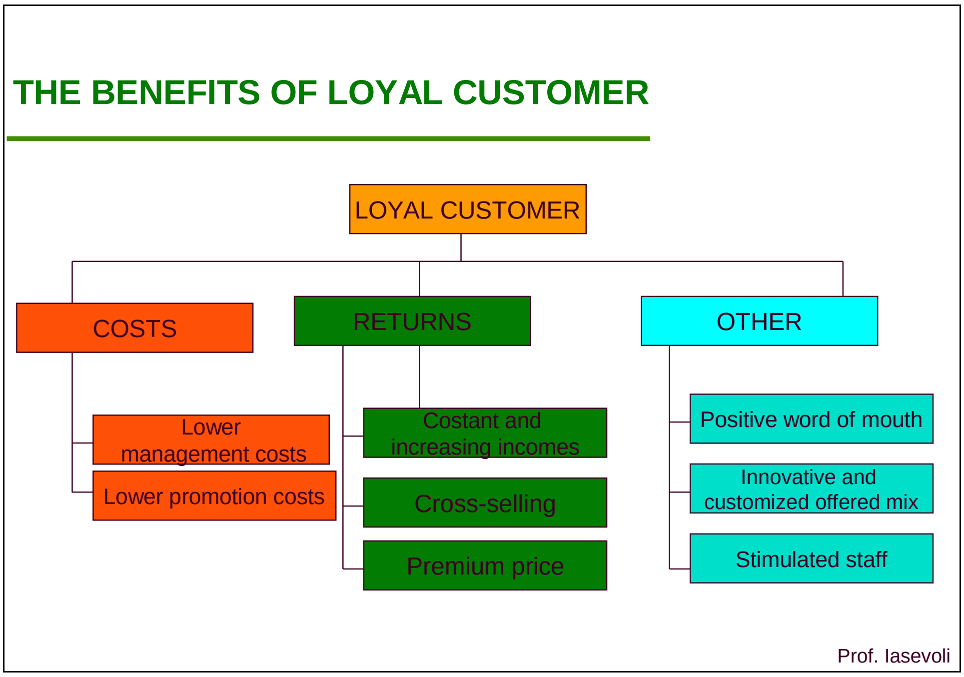
- service companies,
- which manage a small number of customers (think in BtoB contexts) and
- that compete in markets in the maturity or decline of the development cycle.

That's why, usually, the most advanced loyalty programmes are those offered by service companies, such as airlines (e. g. Alitalia's FrecciALATA), hotel chains (e. g. Hilton HHonors), fuel distribution chains (e. g. You&Eni), etc..

1.1 Benefits of customer loyalty

Beyond the intensity of adopting relational practices, companies that manage to prolong their relationships with their profitable customers over time are also those that show higher growth rates than the overall profitability.
Already since the 1990s, it has been demonstrated, by analysing the average income per customer, that the overall profitability of a company increases almost exponentially with the increase in the duration of the relationships it maintains with its customers.
The existence of a link between the duration of the relationship and overall profitability can be attributed to a number of aspects, the most relevant of which are (see Figure 2)
the increase in revenues;

- the increase in revenues;
- reduction of costs;
- an increase in intangible resources.



First of all, it should be considered that consolidating the relationship with customers, especially when the latter is based on mutual satisfaction, implies a greater willingness on the part of customers to

1. direct your portfolio towards higher-price or upselling offers; or
2. to purchase higher margin solutions for the company (so-called tranding up).

In addition, in addition to these two hypotheses, the company can further increase revenues by having the possibility to develop cross selling actions with greater effectiveness, i. e. to offer the faithful customer a mix of company products/services in addition to those already purchased, thereby increasing the value and overall margins of the relationship.

Higher revenues, or margins, may also derive from a lower presence of promotional policies or discounts; in particular, especially in those markets where competition is played out by taking customers away from competitors (think for example of the mobile phone market), loyal customers may not necessarily be the primary target of aggressive promotional (discounts) actions, since the latter are generally aimed at acquiring new customers.

There are also immediate advantages in managing acquired customers compared to other types of customers. First, it has been shown that the costs of maintaining a customer are significantly lower than those required to acquire a new one. Moreover, it also appears that promotion costs are generally lower, as companies, being already known to the customer, can orient their communication activities towards "behavioural" objectives (and therefore to stimulate the purchase) and reduce by a lot those aimed instead at merely "informative" objectives.

Finally, loyal customers, compared to newly acquired customers, also allow the company other advantages of a predominantly intangible nature, whose economic quantification is not always immediate and easy. First, when a customer has a fully satisfactory relationship with the supplier, it is quite likely to communicate his situation to other customers, thereby encouraging them to the company's products: this word of mouth based communication flow, if it is significant in substance, could contribute significantly to the improvement of the company's image and reputation in the markets in which the company operates. This is all the more significant if the process is activated through social networks, or through those tools that can easily connect thousands of potential consumers.

Another advantage for the intangible enterprise is the possibility of developing innovative solutions more easily. Especially when the company adopts processes of interconnection and customer involvement in product development and improvement processes, in a sort of mutual exchange of roles, the customer can propose or push for improvement solutions that in this way increase the propensity for innovation and therefore the competitiveness of the company itself.

Finally, a not inconsiderable aspect is the effect of customer satisfaction and loyalty on the internal business climate and the consequent greater satisfaction of employees, especially those working at the front office.

1.2 Loyalty traps

On the basis of very convincing indications about the advantages of managing long-term relationships with customers, companies have for years been oriented their investments towards programmes and structures aimed at managing loyal customers. As mentioned above, one of the most credited beliefs on the basis of which investments are intensified is that loyal customers are more profitable in the long term.

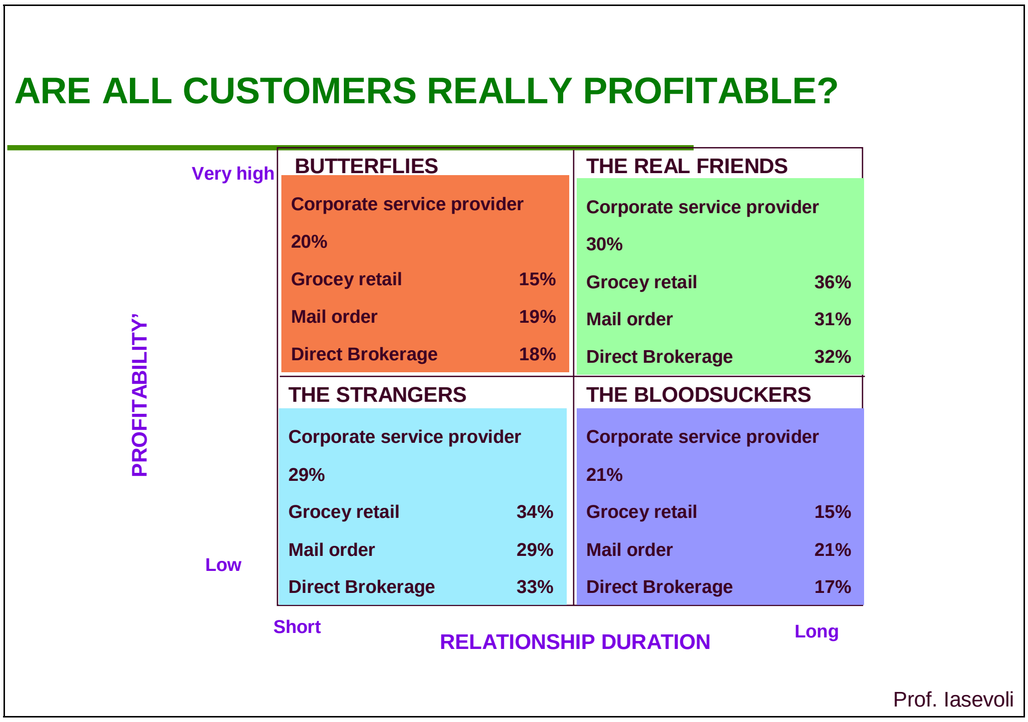
In fact, it cannot be excluded, given some specific characteristics of the market and of individual companies, that the loyalty may present' traps' and' false myths'. In some situations, in fact, it cannot be excluded a priori that the cost of managing a loyal customer, rather than reducing over time, may be subject to an even significant increase. In fact, especially in the BtoB markets, customers with greater bargaining power may become less profitable if they frequently request quantity or monetary discounts and if they require more personalised services at the same price. In fact, in the awareness of their high bargaining power (as loyal customers) they could legitimately try to translate it into a direct advantage in terms of lower overall purchase cost.

In addition, especially if a customer has the possibility to connect with the company through different channels (so-called multichannel approach), it may happen that he prefers to move, always at the same price, from a channel

whose business costs are cheaper to one that requires higher corporate charges (even if probably more performing for the customer), and in this way risk making his relationship less profitable in the long term (e. g. when a customer prefers to make the most of the time).
Another "trap" that can arise in the management of loyal customers is the expectations for the process of word-of-mouth and support for company products. In reality, it cannot be ruled out that the word of mouth generated by loyal customers may be lower than that generated by customers who do not behave faithfully, i. e. those who, while continuing their relationship with the company, also address other competing companies at the same time (in that typical process known as' polygamist loyalty').
Building on these results, Reinartz and Kumar (2002) have shown that longer-term customers are not always those who generate the lowest costs compared to more recent customers, just as it is not always true that loyal customers are willing to buy' bundles' at higher prices.
As a result, companies need to pay more attention to data concerning individual customers and perhaps try to estimate the profit actually generated by each of them; this is all the more necessary if we consider that only a small percentage of "durable" customers are really profitable, as shown in following Figure.

Once the company has analysed the real opportunities arising from the management of the relationships, it must:".

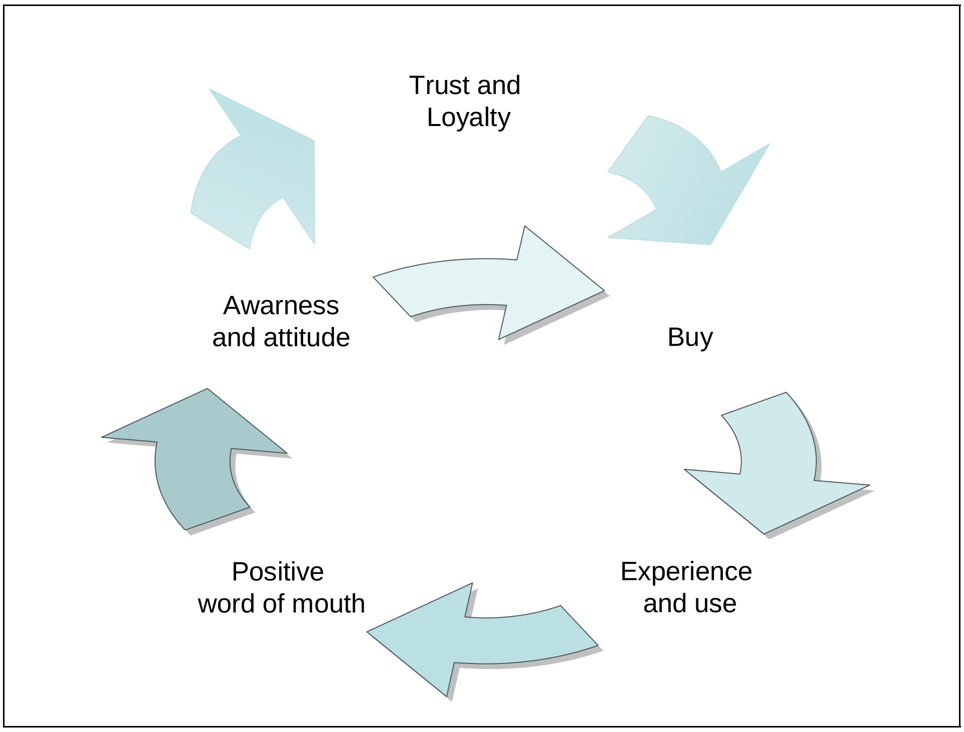
- focus its efforts first and foremost on the real value for money customers ("real friends");
- persuade customers who do not have an intense relationship with the company to consolidate their relationship over time;
- monitoring the profitability of demanding customers, both in terms of costs and revenues;
- maximising the individual transactions carried out by "foreign" customers or so-called "mercenaries".



2 THE COLLECTIONS CUSTOMERS' INFORMATION AND ANALYSIS

With relational marketing, we accept a true corporate philosophy, that is to say, that of placing the acquired customers at the centre of process management and giving the so-called customer loyalty a leading role in marketing strategies. In this context, favoured also by the development and decreasing cost of technologies, an increasing number of companies have switched from a sporadic and random collection and management of information, to a system aimed at systematically collecting and archiving data in all phases of the purchasing cycle, using specific management tools called customer databases or customer information files.
The complex aspect of these databases is the ability to merge a huge amount of data from different sources and contexts into a single collector, and then transform the data into useful information for marketing managers. The sources from which to extract data, as we know, can be very different from each other, both in terms of management processes and collection instruments used and above all they can be both internal and external to the marketing function. One of the main sources of data is undoubtedly the company's administrative/accounting function, given that it is always necessary to know the behaviour and economic-financial situation of customers. These data can be further integrated with data collected from other areas of the company and in

particular with data from all sales and customer service services (customer service, call center, etc.). Finally, the possibility of collecting data directly from the customer should not be overlooked, prompting him to fill in registration forms on and off line.
The heterogeneity of the data while it is advantageous for the enterprise on the one hand, and on the other hand it could make aggregation more complex, especially when the data have different characteristics. To solve this problem, it is quite common for companies to implement advanced datawarehousing (DW) processes, i. e. integration, homogenisation and historicization of the internal and external elementary data concerning individual customers. In particular, the Datawarehouse must be focused in the sense of including data relating to a single subject, even if grouped into areas or themes considered of interest (consumption, sales, costs, etc.). A DW must also be integrated or must guarantee that the data are homogeneous in terms of encoding and format, even if obviously differentiated in terms of contents and areas of the company; it must be variant over time, i. e. it must be able to include not only current but also future data, and finally it must also be non-volatile, i. e. it must be able to store the data permanently and above all in a way that cannot be altered by unauthorized persons, such as for example in the presence of hackerage attacks
In order to make the customer database as efficient and effective as possible, it is advisable for the company to find the right balance between the breadth and depth of the data: the first in particular concerns the number of phenomena to be monitored and information to be produced, while the second concerns the level of detail of individual data to be collected. The decision can be complex especially in situations where customers interact with the company at different times in the purchasing cycle and especially with different contact channels. As can be seen from Figure 17, the relationship cycle can be characterised by different moments: conceptually one starts from the phases of knowledge (awareness) and the client's attitude towards products and brands, and continues with the most strictly behavioural phases, such as those of experience in use and satisfaction. The relationship usually presents a cyclical path where, in the presence of high levels of satisfaction, the customer reprocesses the information related to the re-purchase cycles and thus creates relationships based on trust and loyalty.



2.1 Customer profiling and customers portfolio analysis

Knowledge and analysis of the behaviour of individual customers is a fundamental activity, in the field of relational marketing, for an effective management of the processes of acquisition, loyalty and, if necessary, recovery of customers. Through customer analysis, we want to be able to obtain information on the current and expected behaviour of individual customers, i. e. to know the products/services used, and to estimate the probability that customers will remain faithful over time, thereby increasing the overall value generated.

The analysis systems, also called customer profiling systems, in other words, allow an in-depth knowledge of individual customers and represent the basis on which to formulate and implement loyalty building strategies. Thanks to "profiling" activities, it will also be possible to identify the most effective marketing operational actions among those aimed at acquiring new customers and those aimed at preserving those acquired.

The ultimate objective of the examination of acquired customers is to estimate the real value developed by the client in his relationship cycle (customer life time value, CLTV) and thus to quantify more effectively the size of the investments also on the basis of the expected returns.

The analysis of clients as a whole, called customer portfolio analysis, can be carried out through different methods, which of course involve increasing levels of complexity and calculation and which start from the use of rather simplified analysis systems based on the use of a single variable. These systems, also known as the ABC analysis, provide for the final output to identify a kind of pyramid of the clientele whose top-level customers are generally the most profitable customers. If the analysis is to be further developed, two variables could be used and through them the so-called "customer portfolio matrices" could be constructed. It is also possible to envisage the application of three or more variables analysis (so-called multivariate analysis) which, with a highly articulated calculation methodology, are able to provide more detailed information on the prospective and current value of clients in the company portfolio.

2.1.1 Methods for analysing the customers portfolio

In the field of techniques that use only one variable to assess the importance of customers in the company portfolio (so-called ABC analysis), the most commonly used is based on the calculation of turnover generated over a given period of time. In this perspective, customers are classified in descending order according to the turnover generated by them; usually, it is noted, confirming the famous Pareto principle, that 20% of customers generate about 80% of total turnover. The analysis may show that, within the category of "top" customers, there are "diamond" customers who represent a small part of the portfolio (about 5%) but are able to guarantee 20-25% of total turnover.

Although from a conceptual point of view the ABC analysis is an easily understandable topic, what can be complex in its application, concerns the definition of the number of classes in which to divide the portfolio and consequently establish the turnover thresholds that distinguish one class from the other. The calculation methods can be different and it is therefore necessary to check each time which one best suits the characteristics and profile of the company carrying out the analysis.

A rather simplified method is based on the calculation of the average turnover of customers and therefore of the value through which to divide the customer portfolio into two distinct classes; for example, with reference to the box, it appears that the average turnover of the thirty customers in the portfolio is approximately 157 thousand euro, and that the customers encoded from 1 to 12, can be classified as the most strategic customers or clients of "A" class. Subsequently, it would be possible to divide the upper cohort into two other classes, by calculating a further arithmetic mean based on the turnover that fall between the maximum value and the previously identified average value (always with reference to the example shown in the Box, the average turnover of the first 12 customers is approximately 282 thousand Euros; in this way, the first class of "A" customers is between the maximum value and 282 thousand Euros; in this way, the first class of "A" customers is between the maximum value and 282 thousand Euros This calculation can of course also be made for the lower cohort, thus leading to the identification of four classes into which the entire portfolio should be divided (' A' and' B' above the general average and two other classes,' C' and' D', lower than the general average).

BOX Example of class identification of a client portfolio

CUSTOMERCODE	REVENUE
1	475.068,20
2	471.810,00
3	330.835,00
4	315.590,75
5	302.030,35
6	294.368,00
7	264.286,00
8	213.194,00
9	205.471,00
10	195.331,00
11	163.070,00
12	162.630,00
13	151.733,00
14	131.366,00
15	126.327,50
16	106.471,00
17	99.384,00
18	81.249,00
19	80.200,00
20	77.198,00
21	72.290,00
22	60.340,00
23	59.696,00
24	51.362,00
25	48.660,00
26	47.801,52
27	42.740,00
28	39.373,00
29	35.100,00
30	16.433,00

CUSTOMER “A”

Average of customer “1-12”= 282.807

CUSTOMERS “B”

Average of 30 customers= 157.380

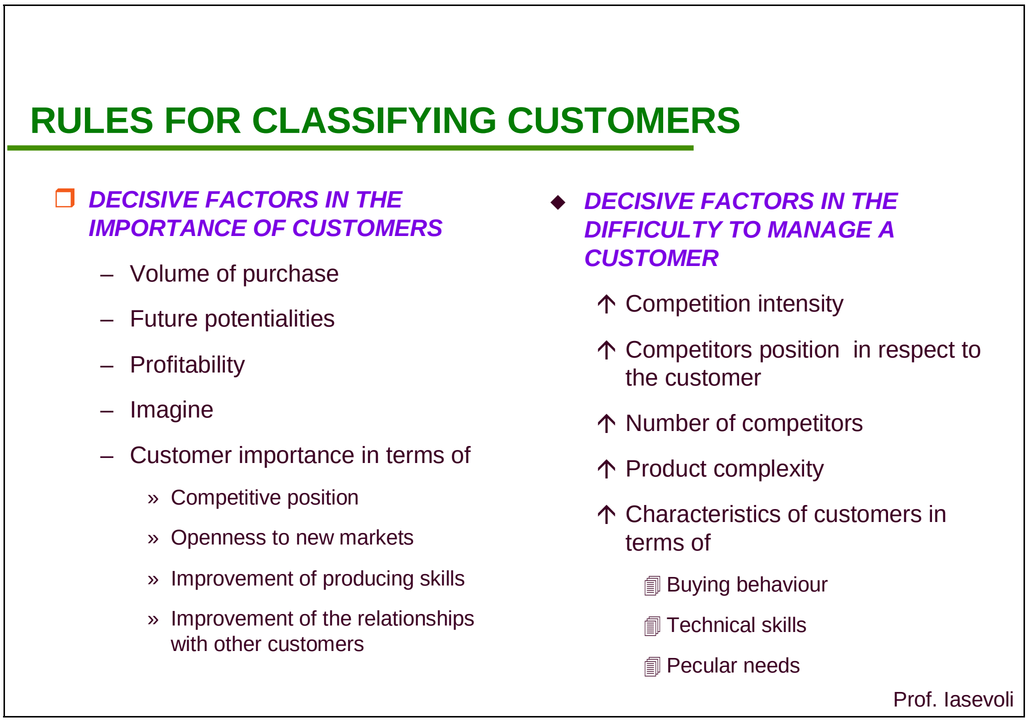
CUSTOMERS “C”

Average of customers “13-30” = 73.762

CUSYOMERS “D”

The ABC analysis can be usefully integrated by combining turnover with other information, including first and foremost cost and contribution margins, and thus be able to prepare the so-called "customer portfolio matrices", based on the use of two variables.

Matrix representation has the primary advantage, compared to the ABC method, of refining the analysis and also of facilitating the identification of customers by assigning easily distinguishable colours and names to the different dials. The criticality in this case lies in the selection of variables to be used in abscissa and ordered, among the countless information bases available to the company and adequately present in the customer database. Also in this case, each company will have to classify its clients by selecting the two variables considered to be the most qualifying for its business; in the following figure a series of items are shown that, suitably crossed, can allow the construction of infinite matrices through which to classify the corporate clientele.



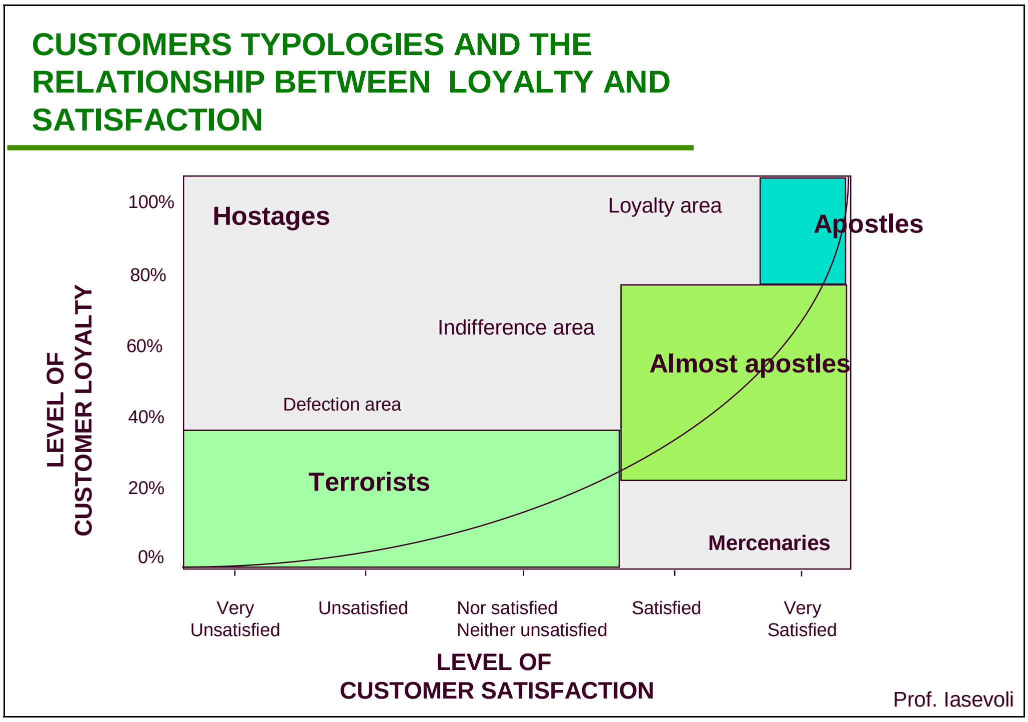
In principle, it is possible to group the customer analysis matrices into three macro-categories, namely

- the matrixes of customer profitability analysis. These matrices are based on the use of economic variables and aim to identify those customers who contribute most to the creation of economic value (or who, on the contrary, deplete the company's capital);
- the matrixes for analysing the competitive situation of customers. Through these matrices, the aim is to estimate the competitiveness of customers in their respective reference markets and also the complexity of overseeing relationships with customers, especially where there is strong competition that targets the same customer base;
- the matrices of customer relationship analysis. The evaluation of relationships with individual customers can also be represented by

variables that are not necessarily of an economic nature (e. g. level of satisfaction, number of complaints, ease of management, etc.), but that allow to express the potential behaviour of the customer.

Among the matrices that over time have become more successful, also due to the effect of the types of customers represented, there is certainly one based on the level of satisfaction and loyalty. In particular, customers with respect to these two "relational" variables can be classified into four types:

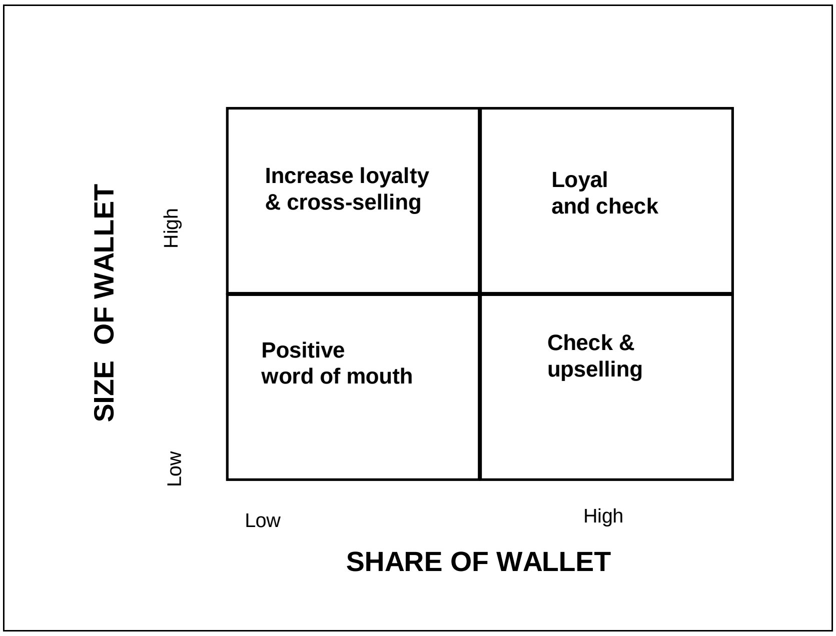
- apostles, i. e. those who are completely satisfied with both the basic and ancillary services and at the same time show absolute fidelity to the company; - apostles, i. e. those who are completely satisfied with the fundamental and ancillary services.
- hostages, i. e. customers who are highly dissatisfied with the company's offerings, but who nevertheless continue to have a relationship with the company because of poor supply alternatives or high transaction costs;
- mercenaries, i. e. those who are highly satisfied but are strongly attracted by other offers (generally characterised by lower prices), thus demonstrating a low level of affection for the company;
- terrorists, deeply dissatisfied customers who have purchase alternatives that abandon the company and at the same time activate an intense process of negative word of mouth.



Another similarly effective matrix, especially when the information available permits its construction, is that based on the following variables:

- size of wallet, i. e. the amount of resources that the customer allocates to the purchase of a specific good or service. In this sense, the customer can be classified as a so-called "big spender" or in a "light spend" according to whether his budget is large or small respectively;.
- share of wallet, i. e. the proportion of expenditure relating to a good/service specifically allocated to the supplier undertaking carrying out the analysis. It will be said that the portfolio share is high if the customer only or almost exclusively addresses the undertaking carrying out the analysis, which in practice becomes the sole supplier of the asset/service; on the contrary, the portfolio share will be extremely small when the undertaking carrying out the analysis provides a marginal amount when compared with that of other competing undertakings.

Based on the customer's position in the matrix, the most effective loyalty strategies can be defined. For example, with regard to customers with a high share of the portfolio but low overall expenditure (bottom right in the matrix), it might be useful to implement loyalty actions or proposals that stimulate average spending (so-called up-selling); on the contrary, with regard to customers with a low share of the portfolio and high expenditure (top left), it might be useful to direct cross-selling proposals that are able to increase the share of the portfolio and thus erode sales quotas to competing companies.



Another criterion used to identify the most strategic customers is the so-called Frequency-Recency-Monetary (FRM), which is based on the use of three variables:

1. the so-called frequency refers to the frequency of purchase attributable to a specific period of time
2. the recency is linked to the last purchase made
3. monetary concerns the monetary value of purchases generated during the same period of time.

In order to arrive at an estimate of the customer's potential, it will first be necessary to index the three variables that otherwise could not be compared by having different units of measurement (the frequency has as unit the number of times, the recency adopts as unit the date of purchase and monetary uses a currency). At the same time, weights must be assigned to the three variables and then the values referred to individual customers must be calculated. In this way, it will be possible to identify the customers with the greatest potential for which more significant resources and attention may be allocated (as shown in the following table).

CUSTOMERS ANALYSIS BASED ON 3 VARIABLES (FRM METHOD)

CUSTOMER	*Frequency*	*Recency*	*Monetary*	Score *frequency*	Score *recency*	Score *monetary*	TOTAL
Auto rossi	1	July	400.000	5	10	16	31
Moto Bianchi	2	April	150.000	10	5	6	21
Verdi Elettro	2	February	550.000	10	5	22	37

HYPOTHESIS

Recency = 15 for the third 4 months period; 10 for the second; 5 for thr first

Frequency = number od agreements dealed in the period X 5

Monetary = 0,004% of the value

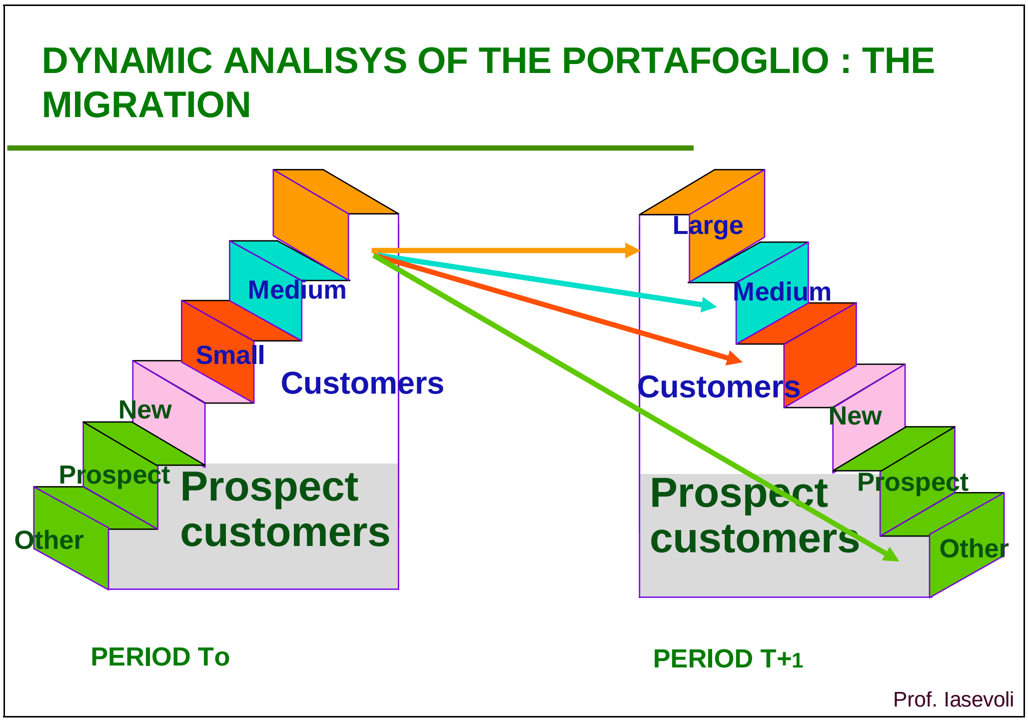
Prof. Iasevoli

In addition to the static analysis of customers and the construction of matrices or pyramids, the company can also perform a dynamic analysis and in this way verify the displacements (so-called "migrations") that each individual customer

may have made between one period and another and above all identify the class to which it has migrated.
In particular, it is possible to identify five different migration flows within a client portfolio (following figure):

- rate of "static" customers, i. e. those who remain in the starting class;
- a "growing" customer rate, i. e. those who migrate to higher classes;
- rate of "declining" customers, i. e. those who migrate to lower classes;
- defection rate, i. e. the rate of defection of customers who permanently abandon the enterprise;
- acquisition rate, i. e. new customers acquired during the period.

These indicators can be calculated on the entire portfolio, but also by taking individual classes as a reference, and thus provide an even more detailed picture of the dynamism of corporate customers.



2.1.2 Other indicators for the analysis of customer loyalty and value

The complexity of the purchase and consumption trends to be controlled, as well as the increased competitive pressure from many industrial sectors, have stimulated companies to identify new and more in-depth ways of measuring customer loyalty and the value of individual customers in general. Nowadays, the case law is sufficiently broad to allow a first distinction based on the

temporal factor, i. e. methods that tend to evaluate past fidelity compared to those that estimate fidelity or prospective value.
When organising a summary framework of instruments or building a so-called' dashboard for monitoring loyalty', there must be a clear awareness that individual indicators provide partial and often non-comparable information. In this sense, the ideal situation would be to set up a formalized system, based on continuous measurements and on the contextual use of instruments of a different nature and meaning. The most frequently used indicators are (Iasevoli, 2000a; Kumar, 2008):

- the Customer Retention Rate
- the average customer service
- the Churn Rate
- the probability of repurchase.

Among the indicators that estimate loyalty in past terms and that refer to the overall portfolio (or a part of it) is above all the Customer Retention Rate (CRR), which expresses the number of customers who remained loyal at the end of the period compared to those who existed at the beginning of the period and to new customers acquired. Although the CRR is useful to provide a clear view of the client portfolio or a part of it (e. g. only for top or marginal clients), this rate does not give any indication of the importance of customers who have left/continued the relationship. However, this limit could be exceeded by using the weighted CRR, which takes into account not only the number of customers but also the volume of expenditure generated by them.
Starting from the CRR, it is possible to estimate another "past" indicator of loyalty, i. e."average seniority of customers", which identifies the average duration in years of the relationship (it is obtained by subtracting the CRR from 1). In particular, it can be shown that by slightly increasing the fidelity rate, for example from 80% to 85%, more than significant increases in average length of service are achieved, since seniority increases from 5 years to 6.67 years.
An indicator rather similar to CRR is the so-called Churn Rate, i. e. the one that estimates the rate of customer abandonment in favour of a specific competitor; in this case, using also special matrices defined as "acquisition-defection", it is possible to estimate how much part of the clientele has migrated to a competitor. Similarly, the number of customers compared to the total portfolio acquired by competitors (so-called Acquisition Rate) can also be estimated.
Among the indicators that tend to estimate prospective loyalty, it is useful to introduce first of all the so-called "Active probability" (also known as P active), i. e. the probability that the customer will remain active also in the following months; for example, if a customer has made 7 purchases in a year, and the last purchase goes back to the ninth month, one can reasonably estimate that the "P Active" will be 0.133 (or P active = (9/12)7).
An indicator that is also aimed at estimating future loyalty and that is always based on past purchases is the so-called Interpurchase Time (IPT), i. e. the

average time between purchases. For example, if the average repurchase time is estimated to be three months and a customer has not been repurchasing for five months, it can reasonably be assumed that his loyalty is at risk or even prone to zero.

Also on the basis of the information provided by these indicators, the company will have to try to estimate the value generated by the customer over time, both in past and prospective terms. Each individual customer can represent a source of value generation for the company, which can be estimated through the calculation of the so-called Customer Life Time Value (CLTV). A rather simplified estimate of CLTV is the one obtained in the following way: average unit purchase value x frequency of purchase in the period x average duration of the relationship.

In reality, this formula does not take into account the probability that the customer will remain active in the future and above all the real contribution margins generated over time. A more advanced formula, which takes these elements into account in part, is as follows:

$$\text{CLTV}= \sum_{t=1}^{T} \text{P active} \frac{\text{MMdC}_{it}}{(1+d)^{t}}$$

where:

MMdC = Average contribution margin in the period t also calculated with respect to previous periods

P active = Probability that the customer i-th is active at time t

i = customer index

t = period for which the CLTV is estimated

T = number of periods exceeding t

d = average discount rate.

However, the customer's net present value, calculated in this way, has some major simplifications that could be included in the formula. First, it does not take into account the attraction and acquisition costs of customers, which may in some cases be very high, and then hardly takes into account a precise allocation of fixed and structural costs (unless the average values are used) between different types of customers. Determining the value of the customer correctly can help the company to formulate marketing strategies that are more focused on individual customers and, above all, can provide a valid support for the implementation of relational marketing strategies whose effects can be estimated in terms of changes in value generated over time.

INDEXS OF CUSTOMER LOYALTY

Customer Retention Rate (CRR) = $\left[\dfrac{\text{Customers at the end of period - New Customers}}{\text{Customers at the beginning}}\right]$

Ex. Customers at the beginning of the period = 100; Customers at the end of the period=120; Customers acquired in the period =40
CRR = (120-400)/100 = 80%

Defection rate of customers = $[1 - \text{CRR}]$

Es. CRR =80%
Detection rate = (1- 0,80) = 20%

Average life relation of customers = $\left[\dfrac{1}{1 - \text{CRR}}\right]$

Es. CRR =80%
Average life relation = 1/(1- 0,80) = 5 years

Churn rate = $\left[\dfrac{\text{Customers migrated vs competitor "X"}}{\text{Tot. customers in portfolio}}\right]$

Ex. Number of customers migrated =60
Number of customers in portfolio =200
Chrun Rate = 30%

Acquisition rate = $\left[\dfrac{\text{Customers acquired from competitor "X"}}{\text{Tot. customers in portfolio}}\right]$

Ex. Number of customers acquired by competitors =40
Number of customers in portfolio =200
Rate acquisition = 20%

P Active = $\left[\dfrac{\text{Time of lastest purchase}}{\text{Reference period of time}}\right]^{\text{Nr. purchases during period}}$

Ex. Number of purchases per year =7
Last purchase = ninth month over twelve months
Reference period = calendar year
P Active = 13.3%

Interpurchase Time = $\left[\dfrac{\text{Nr. purchases since the beginning of period}}{\text{Reference period of time}}\right]$

Ex. Number of purchases since the beginning of the period = 12
Reference period = 8 weeks
Interpurchase time = 1.5 weeks

3. THE LOYALTY STRATEGIES ORIENTATED

Very often companies do not have detailed information on the profitability of their customers and therefore they adopt marketing strategies focused exclusively on the supply attributes (e. g. improvement of the quality offered), which do not always represent the best alternative to increase the overall value of the company if compared with what can actually generate individual customers.

If the ultimate goal is to maximize value for the enterprise and the customer, then, in assessing and selecting strategic alternatives in a truly clientocentric way, it would be useful to estimate the effects of individual initiatives on overall profit, taking into account the profile of individual customers or at least the classes to which they belong.

The first step will be to identify the target to which the relationship actions should be directed, i. e. to establish which of the classes of clients present in the portfolio should be managed as a priority with a view to increasing value. Subsequently, it will be possible to evaluate the various strategic alternatives and in particular how much part of the budget destined for loyalty should be destined to the actions of "growth" (meaning, for the latter, those aimed at increasing customers in the pyramids),"maintenance" (meaning, to consolidate the position of customers in the pyramid) and "recovery" (meaning, for former customers who have decided to leave the relationship with the company). In this context, the company, in addition to its traditional objective of acquiring new customers and expanding its customer base, will also have to define the relational marketing objectives it intends to pursue in terms of number and type of customers who can grow in the pyramid:

- number and type of customers who can grow in the pyramid;
- number and type of clients who may remain in the same class; - number and type of clients
- the number and type of ex-customers to be recovered among those who have abandoned or indicated that they are leaving the company.

Also in this case, the selection of strategic alternatives can be solved by comparing the expenses to be incurred with the possible returns generated by clients in the class (an example is shown in the box below).

In assessing alternatives, managers will also need to consider which solutions could be most effective in achieving the objectives. In particular, starting from the concept of CLTV and the elements that determine its construction, the so-called drivers through which to obtain an increase in the value of the customer could be as follows:

- to increase the level of expenditure, i. e. the amount that the customer sustains with the supplier company;
- increasing cross-buying, i. e. encouraging the customer to buy other products/services in the company's range;

- Incentives the client, in a manner consistent with the cross-buying effect, to diversify his purchases and in any case his interests also towards categories other than that of his exclusive interest;
- Encourage customers to reduce the average re-purchase time by using loyalty tools;
- Encourage the customer to reduce the number of refurbishments/returns requested by customers
- Encourage the customer to reduce the frequency of contacts or, in any case, to push them towards communication channels at a lower management cost.

It is clear that, in order to adequately support the implementation of relational strategies, the company must at the same time promote the development of a corporate culture that is truly focused on the customer and create coherent and adequate organisational structures. For example, in this area, it is quite frequent to set up offices specifically responsible for managing the most strategic customers, especially with regard to after-sales services. The role of what are usually referred to as "Key Account Managers" (KAMs) is essentially to consolidate relationships with key customers, in a logic of mutual interdependence, increasing the value of all the actors involved. Compared to a traditional sales office, KAM pursues the objective of maximizing the share of wallet in the first place, at the same time as increasing the size of the wallet. Certainly, KAM has a medium-long term time horizon and considers the exchange of information as a strategic lever for optimising the relationship and, in general, for improving the respective businesses.

CUSTOMER STRATEGY ASSESSMENT

Take the following situation as an example:
a company owns a portfolio of approximately 1,000 dealers; - a company owns a portfolio of approximately 1,000 dealers
achieves a total turnover of more than €11 million;
with a loyalty rate of 80% and an average profit margin of 14% from A (Top), 16% from B (Medium) and 12% from C (Marginal) customers.

In particular, the portfolio analysis shows the following data:

	Clienti A	Clienti B	Clienti C	Totale
Nr Dealers	180	320	540	1.040
Revenue total (000)	7000	2900	1200	11.100
Margin (%)	14%	16%	12%	

Taking into account the data emerging from the analysis, and reducing the available alternatives, we want to evaluate which of the following hypotheses could generate a greater increase in value for the company:

1. increase by 5% the number of A customers. Increased incentives to the sales force (in the form of acquisition bonuses) would have cost approximately 400 thousand in the first year;
2. convert 20% of secondary customers (B) into primary (A). In order to migrate B customers to A, it was necessary to organise an initiative with premiums for customers (increasing rates in relation to purchase volumes). Such an action would have cost around 1.7 million in the first year;
3. persuade C customers to buy higher priced products. To increase the unit value of purchases by 20%, it was necessary to spend about 200,000 in the first year on gifts and cross-selling initiatives;
4. reduce the total defection rate from 20% to 15% per year. To increase loyalty, a dedicated in-house retention team was needed, which would generate costs of around 700 million in the first year.

Comparing the four alternatives, it appears that the first hypothesis could generate a loss of value of about 50 thousand; the second one could generate an increase of 200 thousand, the third one an increase of about 140 thousand and the fourth one an increase of about 150 thousand. In this respect, it would appear that in the short term the second most advantageous solution would be the short term. It is clear that the results could be radically different if projected over a longer period of time where CLTV should be used as a basis for calculation.

4. MANAGEMENT TOOLS OF RELATIONS AND LOYALTY

The awareness of the importance of effectively managing customer relations and controlling and counteracting the growing mobility of customers in the most competitive markets has led companies to identify and create new loyalty actions based on the value generated over time by individual customers.

Nowadays, the range of instruments has undoubtedly been enriched to the point that classifications can also be made; first, relational tools can be usefully divided into two macro-categories based on the benefits offered to customers (Bhattacharya and Bolton 2000; Dabholkar, Johnston and Cathey 1994):

- tools which offer predominantly economic benefits, such as free additional services, economic premiums or discounts, etc.; and
- tools that offer predominantly immaterial and social benefits, such as participation in forums, club membership, prizes for participation in events, etc.

These same tools could also be subdivided according to the moment in which the benefit is granted (Dowing and Uncles, 1997), i. e. in instruments that provide an immediate advantage to the customer compared to those that require a longer period (e. g. loyalty programs) before the customer can obtain possession of them.

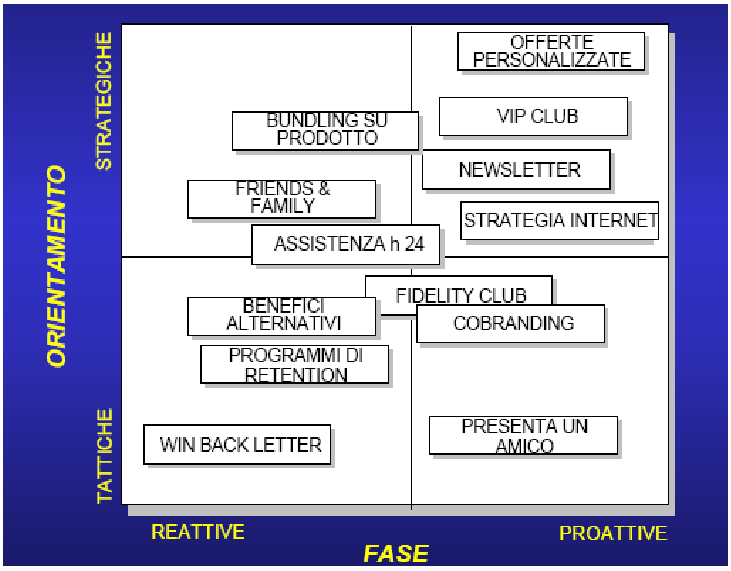
A further classification of the instruments is based on the management and optimisation objectives of customer relations; in particular, we can imagine three different categories:

- instruments aimed at extending the duration of the relationship, which correspond to attempts to consolidate loyalty and the probability that the client will continue to maintain the relationship with the company for as long as possible;
- instruments aimed at and extending the scope of the relationship, which concern the ways to favour the so-called cross-bying, i. e. the purchase by the customer of company products/services different from those already used;
- instruments aimed at extending the depth of the relationship, i. e. instruments that favour a more intense frequency of use and purchase or, in any case, that concern decisions to update or purchase premium price products compared to those at the lowest cost.

A further classification of loyalty-building and relationship management actions is the one that distinguishes between the tools according to the degree of organizational impact and the ability to exploit distinctive corporate skills (strategic or tactical actions) and according to the stage of the relationship and the expected responses (proactive or reactive actions).

In this sense, four different macro-categories of actions can be identified, as shown in next figure (Busacca A., 2002):

- strategic-active strategies, i. e. instruments that pursue the aim of managing the client especially in the first phase of the relationship and to increase the value granted with respect to competitors (e. g. welcome calls, personalised instructions for use, dedicated information tools, etc.) or to prevent problems or abandonment intentions (customer clubs, panels, customer forums, etc.) or in any case to increase the perception and satisfaction with the services received (incentives to buy back, member get-member initiatives, etc.)
- strategic-reactive, i. e. actions aimed at a timely and personalized management of a potential problem caused by the customer; this category includes actions to manage customer service assistance and complaints, as well as operations to rebuild and replace products;
- proactive tactics, i. e. actions aimed at reducing friction, also by creating barriers to transition to another competitor. The latter category includes the majority of traditional loyalty programmes, such as product/service or customer bundling initiatives (it tends to link customers belonging to the same household, company, etc.), or the raising of so-called transaction costs (penalties, contract time constraints, etc.);
- tactical-reactive tactics, which include the classic authoritative management actions of a possible cancellation. This includes, for example, very personalized telephone calls or mailing programs aimed at substantially reducing customer dissatisfaction and therefore negative word of mouth, or even actions aimed at recovering customers (so-called win-back actions) based on the offer of more advantageous solutions for the customer.



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