

## Driving Customer Equity

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October 15, 2007

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### **Abstract**

Firms adopting customer-centric views can derive the antecedents to customer equity (commitment and trust); firms not adopting this view can not.

What drives customer equity? Rust and colleagues (2000) pedantically offer value equity, brand equity, and retention equity as the antecedents of customer equity. Although important, do these hypothetical drivers actually create customer equity? Jayachandran and colleagues (2005) define commitment and trust (Morgan and Hunt 1994) as drivers of customer equity. This customer-centric view embodies the significance of the customer as a patron, as well as accounts for both applicable definitions of equity—one as economic value, and the other representing the fairness perceived by the customer.

If “all marketing activities directed toward establishing, developing, and maintaining successful relational exchanges” (Morgan and Hunt 1994, page 34) are vital to a firm’s success, how indispensable are the relationships a firm creates with its customers? Ironically, contemporary marketing practices do not reveal such trends. Coviello and colleagues (2002), based on MBA students’ perceptions of their firms, reveal that many customer service firms do not practice relational marketing.

Firms in specific consumer service industries have even been accused of “consciously and cynically” exploiting their customers for economic gains at the seemingly unimportant dissatisfaction of their customers (McGovern and Moon 2007). Firms are preying on the ignorance of their customers, locking them into contracts, then profiting from severe penalties such as overages (McGovern and Moon 2007, page 80, emphasis added):

Companies in these industries [...] find that their transparent, customer-centric strategies for *delivering* value have evolved into opaque, company-centric strategies for *extracting* it. Although this approach may work for a while—many notable practitioners are highly profitable—businesses that prey on customers are perpetually vulnerable to their pent-up hostility. At any time, customers may retaliate with vitriol, lawsuits, and defection.

Over-appropriating created value (Mizik and Jacobson 2003) may lead to mass defections, provided there is a transparent and friendly alternative.

Netflix became such an alternative in the movie rental business. In January 2005, in order to compete, Blockbuster relinquished a third of its revenues (~\$300M), by dropping late fees. Netflix as the “transparent and friendly” alternative, however, soon vanished. Netflix, using data from customer usage, created a policy to delay shipment of rentals to those calculated to be the least profitable, thereby reducing timely service.

Reinartz and colleagues (2004) describe this practice as a termination strategy in the CRM process. Although their international results did not reveal statistical significance, managers of firms (as informants) have substantial motives *not* to admit such practices (which may have amplified their lack of appreciation for the request for second-informant validation). The oligopoly concentration of industries, along with the enormous pressures to meet quarterly expectations, creates the “slippery slope” that jettisons the firm from their intended customer-centric strategy to an antagonistic value-extracting behemoth (McGovern and Moon 2007).

The CLV calculations embedded in CRM strategies are based on calculating the NPV (net-present value) of future customer cash-flows. Such calculations, in many consumer industries, logically suggest maximizing CLV by penalizing customers now with exorbitant fees (Payne and Frow 2005, page 168, emphasis added):

CRM is a strategic approach that is concerned with *creating improved shareholder value* through the development of *appropriate* relationships with key customers and customer segments. [...] This requires a cross-functional integration of processes, people, operations, and marketing capabilities that is enabled through information, technology, and applications.

Such tempting practices minimize the spirit of CRM, customer equity driven by commitment and trust.

Managing the information without losing sight of the customer is a challenge. Data-focus can supersede customer-focus. Demands for value appropriation can overwhelm value creation. Most of this myopia can be explained by the lack of authentic market orientation of firms. Detailed information about prior purchase behavior could be beneficial if properly used. As proposed by Boulding and colleagues (2005), CRM is an evolution—an integration of technology with marketing practices. Fulfilling consumer needs with core and augmented products based on customer's perceived value is evolving due to the data available through modern technologies. In the 1980s data explosion came from scannable barcodes; in the 90s from club cards, in this decade it appears enormous amounts of data will be generated from RFID technology.

Trust and fairness need to be carefully considered when making short-term and logical decisions about differential treatment (Boulding et al. 2005). A firm should identify why a customer purchases from them, and then disperse that information internally and externally, a marketing activity. Theoretically, this should improve a firm's market orientation. However, as demonstrated, the data-driven short-term financial focus has short-sighted this approach. Only 36% and 51% of the board of directors of firms even *ask for* (technically *receive*, but it can be argued that it is not important to them) customer satisfaction and customer retention data, respectively (Payne and Frow 2005).

What Jayachandran and colleagues (2005) describe as the importance of customer relationship performance, measured by customer satisfaction and retention, defined as “customer

satisfaction via consumption-related fulfillment” is far from a reality. Communication between the firm and the customer represents an antecedent to trust, which collective information-exchange interactions determine of commitment (Jayachandran et al. 2005, page 178). They plainly demonstrate the importance of customer-centric orientation as a precursor to communicated indicators of trust and customer relationship performance.

It is apparent that financial performance is important to firms, but what about customer relationship performance? Is it really important, or “lip-service” to the perceived current management fad? As established, customer equity is explicitly important, but with the tremendous pressures of short-term financial success, tacitly it is disregarded.

For authentic “customer-oriented” and “market-oriented” firms, the current value of CRM is substantial, and the future is promising. Most recently, Kumar and colleagues (2007) have extended customer equity thought by evaluating the importance of “word of mouth” referrals. In addition to CLV, they calculate CRV (customer referral value). Their research unveils insights into the different behaviors of high-low performers across both CLV and CRV, using familiar descriptors: Affluents, Champions, Misers, and Advocates. Using this information, they suggest strategies to move each segment forward, eventually encouraging all customers to become Champions (see Kumar et al. 2007, page 146). Those firms that do not get lost in the data, or the pressures of short-term financial success, will increasingly have more information available to them to improve customer relationship performance; essential to building authentic customer equity (Rogers 2005, page 162): “If you're my customer and I get you to talk to me and remember what you say, I can know something about you that my competitor does not know and do something for you that my competitor cannot do”.

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