Service Marketing: A practical approach
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Lecture-31
Managing Customers

Hello! there. Welcome to this session on services marketing with a practical approach. My name is Dr. Biplab Datta and thank you for watching this video.

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Lesson 31 Managing Customers

Retaining Current Customers

Customer Lifetime Value

We go to the lesson of managing customers. Here we see 2 concepts, that is retaining current customers and customer lifetime value.

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Retaining Current Customers

A company gains from old loyal customers as they:

- purchase the services of the company repetitively,
- are cheaper to serve as they do not have to be educated for repeated service deliveries and play their roles accurately,
- are willing to pay a increased price for the same service as they are satisfied with it,
- purchase other services from the same company, and,
- refer the company to other people, who in-turn purchase from and add to the revenues of the company.

Retaining current customers, a company gains from old loyal customers as they purchase the services of the company repetitively, are cheaper to serve as they do not have to be educated for repeated service deliveries and play their roles accurately, are willing to pay a increased price for the same service as they are satisfied with it, they purchase other services from the same company, and refer the company to other people, who in turn purchase from and add to the revenues of the company.

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So retaining current customers. A customer can be retained when he or she becomes loyal to the company. A customer becomes loyal to the company when he or she is satisfied with the quality of the service delivered by the company and receives true economic value from the company. Professors Sunil Gupta and Valerie Zeithaml have written in 2006 that both customer satisfaction, and resulting customer retention, enhances financial performance of a firm. For instance 1% increase in the American Customer Satisfaction index can lead to a 240 dollar to 275 dollar million improvement in firm value.

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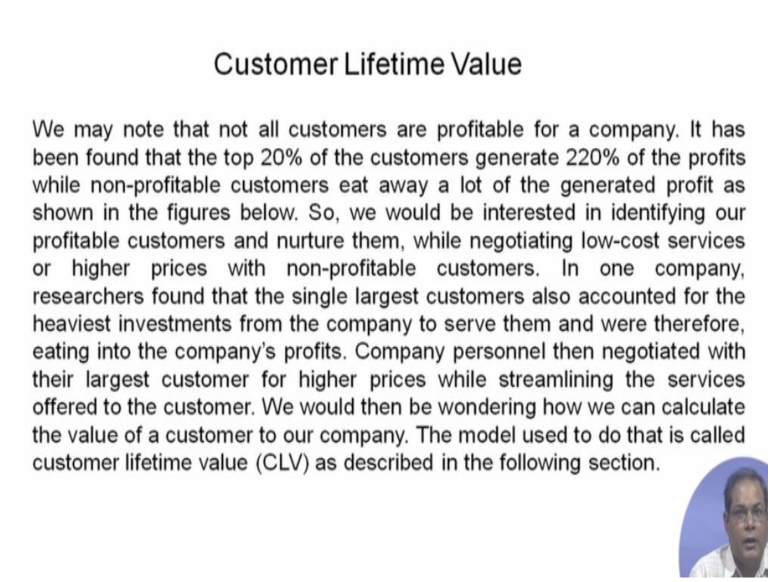

We may note that all customers are profitable for a company. It has been found that the top 20% of the customers generate 220% of the profits while non profitable customers eat away a lot of the generated profit as show in the figure later. So, we would be interested in identifying our profitable customers and nurture them, while negotiating low cost services or higher prices with non profitable customers.

In one company, researchers found that the single largest customers also accounted for the heaviest investments from the company to serve them and were therefore, eating into the company's profits. Company personnel then negotiated with their largest customer for higher prices while streamlining the services offered to the customer. We would then be wondering how we can calculate the value of a customer to our company. The model used to do that is called customer lifetime value or CLV as described in the following section.

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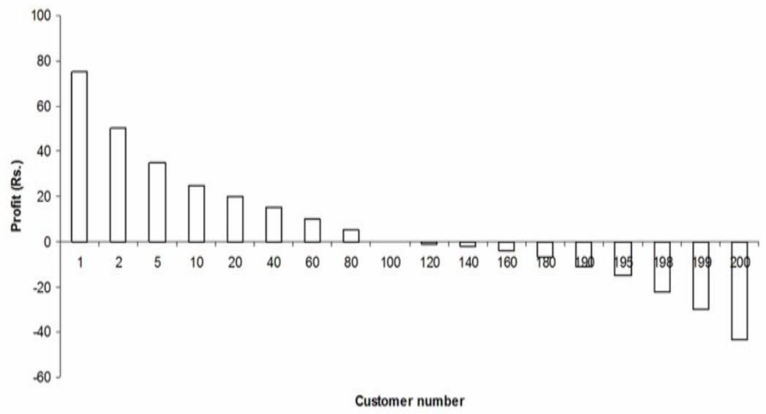

Customer Profitability Ranked from Most to Least Profitable Customers

So here is the graph we see that there is customer profitability is ranked from most to least profitable customers. So we find that the first 80 customers are profitable and first 10% of the customers are most profitable. Whereas the next out of 200 customers the next 10 customers are unprofitable are eat away from the profit.

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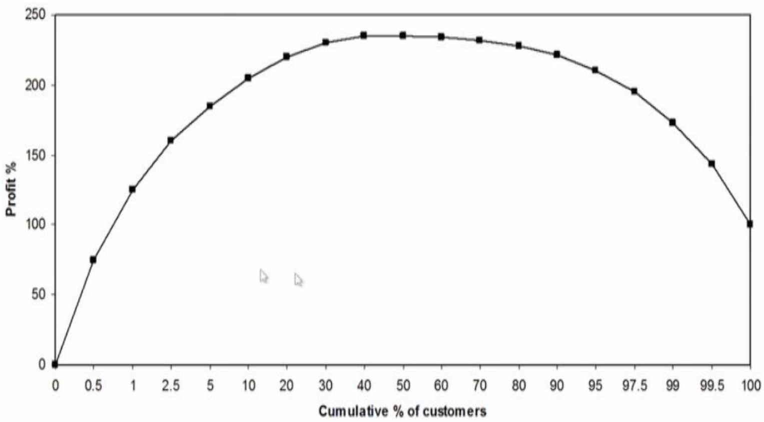

Whale Curve showing Customer Profitability

So this is the whale curve shows the cumulative profit percentage and here we see cumulative number of customers percentage, so while the first 1% or 5% of the customers do not make a profit we find that around 95% of customers also eat away from the profits received earlier. So, this is the whale curve which shows that it to manage customers so they are not on profitable for the company.

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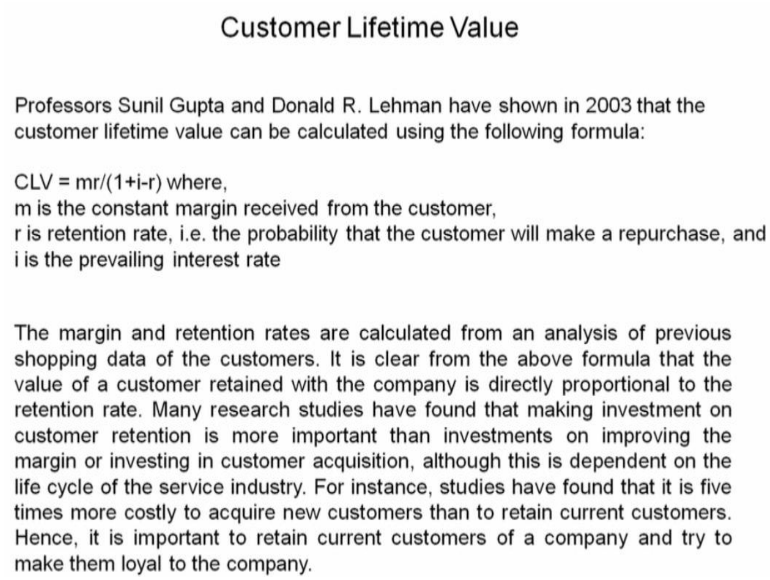

So, professors Sunil Gupta and Donald Lehman have shown in 2003 that the customer lifetime value can be calculated using the following formula CLV is equal to mr by one plus i minus r where, m is the constant margin received form the customer, r is retention rate, that is the probability that the customer will make a repurchase, and i is the prevailing interest rate.

The margin and retention rates are calculated from an analysis of previous shopping data of the customers. It is clear from the above formula that the value of the customer retained with the company is directly proportional to the retention rate. Many research has found that making investments on customer retention is more important than investments on improving the margin or investing in customer acquisition, although this is dependent on the life cycle of the service industry.

For instance, studies have found that it is 5 times more costly to acquire new customers than to retain current customers. Hence, it is important to retain current customers of a company and try to make them loyal to the company.

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In this lesson we have discussed the issues of retaining customers and the method of measuring the lifetime value of a customer to a service business in order to retain the right customers. In case something goes wrong with the service delivered to a customer, the damages have to be corrected through a process called service recovery. The issue of service recovery is dealt with in the next lesson.

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