RELATIONSHIP MARKETING

Exploring relational strategies in marketing

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Relationship marketing

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of retention. Statements such as ‘it costs five to ten times as much to get a new customer as it costs to keep an existing customer’ are regularly made in a wide range of general and relationship marketing texts (e.g. Christopher *et al.*, 1991, p. 157; Gummesson, 1999, p. 183). This widely accepted marketing maxim is, however, an oversimplification. It would certainly appear that some evidence supporting the proposal exists although it is highly selective. Research to date by consulting firms such as Bain and Co. (see Reichheld, 1996) has produced company-specific examples (Payne and Frow, 1997) in industries that have certain distinct and non-universal characteristics.

Front-end costs

The industries chosen most frequently as examples of the successful application of customer retention strategies appear all to have high front-end acquisition costs inherent in their make-up (e.g. banks, credit card and insurance). Important among these front-end costs are a number that occur frequently. These are:

- the high costs of personal selling;
- commission payments;
- direct and indirect costs of detailed information gathering;
- upfront supply of equipment;
- advertising and other communications expenditure.

Personal selling

Although most businesses are involved to some degree in personal selling, it is more significant in some businesses than in others. One particular area where this has always been seen as necessary is where there is a degree of complexity in the product or service. In the service sector this may be significant as intangibility adds to the complex nature of the offering. Mass marketing media does not generally handle complexity well. The salesperson has the ability to highlight and emphasise product or service features and respond to any questions that a customer may have. Personal selling is, therefore, a high-quality, marketing communications tool used in complex or high-value (for the purposes of negotiation) product or service sales.

The downside of personal selling is cost. Dependent on the industry, complexity, geography and other factors, salespeople who travel to visit customers can rarely meet more than a limited amount of potential new customers in a given period. Even salespeople based at fixed-site showrooms where customers do the travelling (e.g. a retail store) can only be expected to see limited numbers of new clients in an average day. An additional variable factor is that the **client conversion rate** (i.e. the rate at which prospects are converted into customers) may not be high. Such is the nature of personal selling that costs require constant monitoring if they are not to get out of control. All of these factors imply that the cost per customer acquisition will be high where personal selling is a major component in the customer’s decision-making process.

Commission

If commissions are payable (either internally or externally) on sales this may reduce the fixed costs of personal selling although the variable costs of acquisition increase. In circumstances where commissions are payable on initial sales it is likely that the cost of customer acquisition, relative to retention costs, will be high.

Data collection

Where the data collection required is significant and the issue of contracts or other expensive materials is involved, this may again contribute to high initial costs. In these cases (e.g. insurance) the company may not begin to make a profit on the product or service for one or more years into the lifetime of the contract.

Supply of equipment

This refers to long-term equipment hire (e.g. machine rental) or supply (e.g. the free or subsidised supply of satellite or digital TV receivers) where the investment is written off over the calculated lifetime of the contract. Any contract that terminates prior to the full write-off period is potentially loss making. In contrast, any contract which lasts beyond that point represents additional profit. The benefits of customer retention in such circumstances are obvious.

Advertising and other communication costs

Where advertising (particularly long-term brand-building) is used to promote 'front of mind awareness'[1] (to ensure a brand's prominence in the marketplace) then the cost of maintaining this awareness may, justifiably, be included in the cost of customer acquisition.

High front-end-cost industries

The likelihood is that, in industries where personal selling, commission, high data collection, equipment supply expenditure or high brand awareness investment (i.e. marketing communications) are involved, new customer acquisition costs will nearly always exceed the costs of retention. Logic suggests, therefore, that industries where the greater part of expenses are up-front would benefit from writing off these costs over an extended period of time (Figure 4.2). In these instances, the longer the relationship the lower the costs relative to income and the higher the profit is likely to be (see the section on lifetime value, p. 86). Grossman (1998, p. 31), for example, reports that it costs the credit card company MBNA approximately $100.00, on average, to attract a new customer. However, a customer who has been with them for five years represents about $100.00 profit per annum and a ten-year customer approximately $300.00 per year.

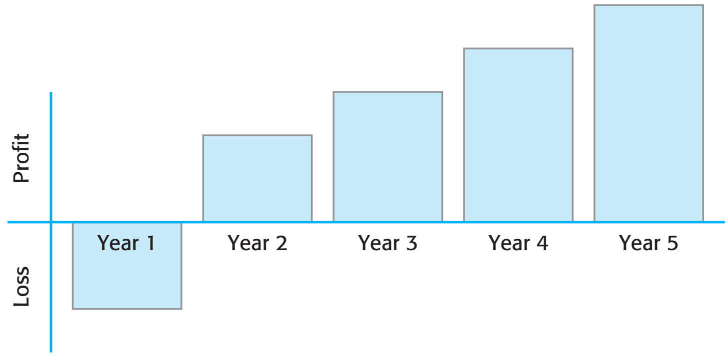


Figure 4.2 Typical profit pattern in financial services and other high acquisition cost industries

(Not to scale; for illustration only)

Low front-end-cost industries

At the other end of the acquisition costs spectrum are sectors (e.g. FMCG retailing) where the costs of customer acquisition appear marginal as intense personal selling, commissions, detailed information gathering and/or equipment supply are not always necessary to make an individual sale. The FMCG consumer would only seem to require one or more of a limited number of drivers, such as location, perceived service quality, price competitiveness, product range and quality and/or promotional offerings, to stimulate a sale. These are also the factors seen to influence the customer retention process.

Advertising and other (non-personal selling) marketing communication costs, commonly included in the customer acquisition calculations, again do not fully justify the up-front cost argument. High advertising and sales promotion costs attributed to customer acquisition fail to acknowledge the part played by those same messages in the retention process. Advertising serves to remind buyers of their purchasing preferences (East, 2000, p. 96) and may, therefore, often work defensively to protect the existing customer base rather than aggressively to bring in new buyers (Barnard and Ehrenberg, 1997, p. 38).

If drivers promoting sales to potential new customers are similar or the same as those for existing clients then the cost of acquisition must closely equal the cost of retention. Indeed, if the supplier introduces schemes that reward repeat buying over and above the single purchase (the basis of most retail and airline loyalty schemes) then the cost of retention may exceed the cost of acquisition.

Economics of retention strategies

RM appears to be an expensive alternative to mass marketing and, as such, marketers' commitment to such strategies are only valid when they are deemed to be affordable and practical (Berry, 2000, p. 154). Yet much of the current discussion about RM management ignores how the economic effects of establishing such relationships can be or are measured (Blois, 1999, p. 91). Indeed much of the RM literature depends on the mostly implicit, suggestion that a causal effect of relationships is always effective performance (Ambler and Styles, 2000, p. 499). The economics of costly relational techniques must, in circumstances where **acquisition/retention cost ratios** are small, be closely scrutinised. This is particularly evident in the case of many costly loyalty schemes which are, perhaps ironically, most prevalent in those sectors where the validity of relational strategies is most highly questionable (e.g. FMCG retailing). Incentives to retention in these schemes are costs that (if profitability is to be maintained) lead ultimately to higher prices. In such markets differentials may occur in costs between the 'loyalty incentivisors' and their lower-priced competition (Palmer and Beggs, 1997). The phenomenon is not new. The history of British supermarket retailing is peppered by swings between price wars and differential advantage strategies. The airline industry too is experiencing this anomaly in the competition between established and 'low-cost' airlines.

The evidence that exists suggests that, in industries where recognisable high front-end costs are involved, these are drivers to relational strategies that promote customer retention over customer acquisition. Where acquisition costs are low and/or where the real difference between acquisition and retention costs is marginal, the introduction of costly relational strategies may become a burden.

Claims about the effectiveness of improved retention may also frequently be overblown. According to East (2000, p. 11), authors (e.g. Doyle, 1998, p. 44; Kotler *et al.*, 1999, p. 44) who make claims of 25–85 per cent profit increases based upon increasing retention by as little as 5 per cent rarely consider how difficult (and potentially costly) this is to achieve.

Long-term benefits

Retention economics are also promoted as a time-based form of competitive advantage through the suggestion that investment in long-term relationships brings long-term advantages (Murphy, 1997, p. 1). Relationship investment refers to the time, effort and resources that the supplier invests in building stronger investments (Palmatier *et al.*, 2006, p. 140). Gummesson (1999, p. 183) has coined the phrase '**return on relationships**' **(ROR)** to describe the expectation that there would be a return on this investment. ROR he defines as 'the long-term net financial outcome caused by the establishment and maintenance of an organisation's network of relationships'. The long-term orientation is often emphasised because it is believed that loyalty is cumulative (Reichheld, 1993, p. 65).

Long-term benefits may be considered from two perspectives:

- relationship stages;
- the lifetime value of the customer.

Relationship stages

As noted in our earlier definition, relationship marketing is seen as a means of identifying, establishing, maintaining, enhancing and, where necessary, terminating relationships (Grönroos, 1996, p. 7). This definition anticipates that, once a company starts thinking about individual customers (as opposed to mass markets), it will recognise that different customers are at different stages of relational development. Importantly, it also implies that each customer type (e.g. prospect, customer, former customer) should be handled in a different way. This may include different targeted messages (rather than mass communication) and different 'value options' (e.g. rewards) from the exchange.

The recognition of different relational stages in RM also includes the implicit assumption that the higher the stage of development the greater the profitability to the organisation and consequentially the greater the benefits to the organisation. As we will discuss later, this may be an over-simplification in some industries.

Stages models

Various models exist that illustrate this concept (see Figure 4.3) and that may be seen to approximately equate to both consumer and business-to-business relationships. Dwyer *et al*. (1987, p. 15) suggest a five-stage model where each phase represents a major transition in how parties in a relationship regard each other. These are:

- awareness;
- exploration;
- expansion;
- commitment;
- dissolution.

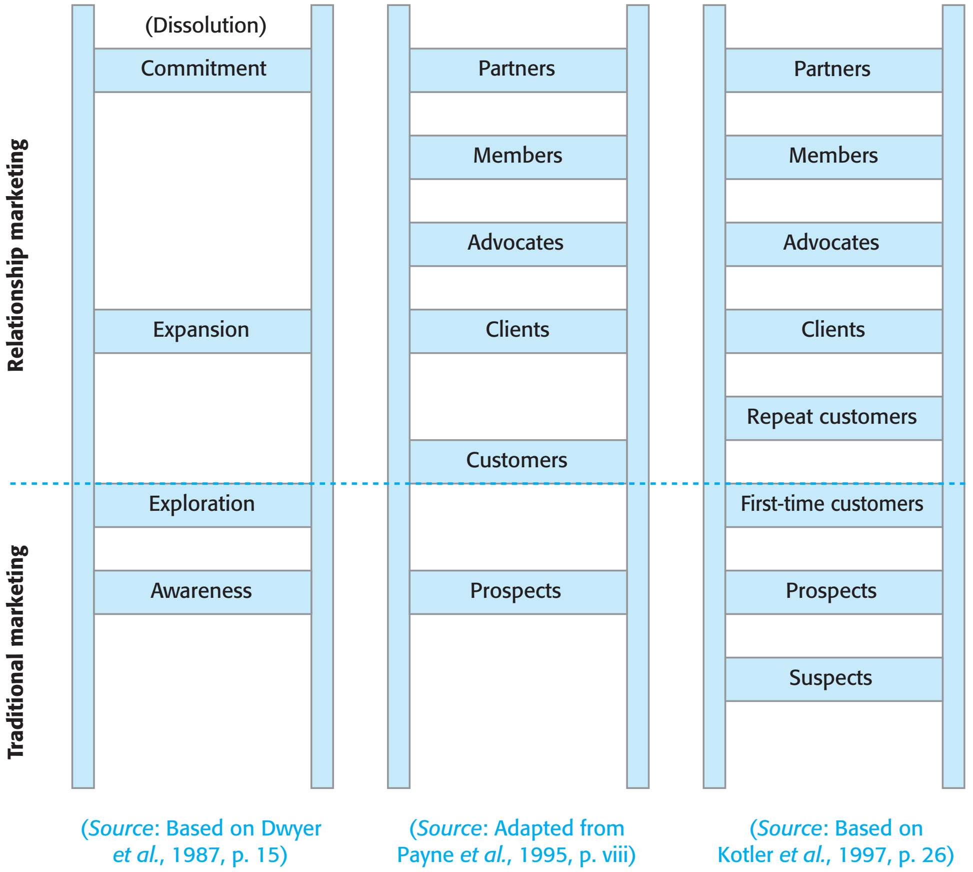
Awareness

Awareness is where one party recognises that the other party is a 'feasible exchange partner'. Interaction has not yet taken place although there may be 'positioning' and 'posturing' by the parties to enhance their attractiveness.

Exploration

Exploration refers to the 'research and trial stage' in the exchange. At this level potential partners consider obligations, benefits and burdens of the exchange. This may well include the psychological and actual costs involved. Dwyer *et al*. suggest that this stage includes sub-phases such as attraction, communication and bargaining, development and exercise of power (see Chapter 9), norm development (e.g. contractual arrangements) and expectation development (e.g. trust and commitment; see Chapter 6).

Figure 4.3 Relationship ladders or stages



Expansion

Expansion refers to the period where there is a continual increase in benefits obtained by exchange partners and where they become increasingly interdependent.

Commitment

Commitment relates to the implicit or explicit pledge of relational continuity between the parties.

Dissolution

The inclusion in the model of a dissolution stage reminds us that disengagement always remains a possibility in any relationship.

Dwyer *et al*. (1987, p. 25) make the important point that, although all transactions have relational properties, it makes sense to consider many exchanges as 'practically discrete' (or non-relational). In other words, relationship stages, such as those described, are not automatic and can only exist where both parties recognise the potential