Main Issues

- Dynamics of customer relationships
- Monitoring customer satisfaction
- Mass Customization
- Using Information Systems to manage customer relationships

Dynamics of Customer Relationships

- Satisfied customers
  - EV from consuming your product too high
  - Less willing to consider other alternatives or switch (BA example)
- Short-term vs. Long-term
  - Myopic one period profits vs. customers’ life time value
Related Jargon

- Acquisition costs
- Base profit – profit margin from an average customer
- Revenue growth – positively relationship between duration of relationship and profitability
- Refinancing home mortgage

Other Effects

- Operating costs – serving old customers is less expensive
- Word of mouth (WOM) – referrals
- Sensitivity to price – old customers less price sensitive

Net Effect

![Chart: Margins vs Age](chart.png)
How Much to Pay to Acquire a Customer?

- Present Value of a customer expected to be in a relationship for 4 years?
- Discount rate – r, 10%
- \[ PV = \frac{40}{1.1} + \frac{66}{(1.1)^2} + \frac{72}{(1.1)^3} + \frac{79}{(1.1)^4} = 198.96 \]
- Cost of acquiring a customer = $80
- Pay no more than – (198.96 – 80) = 118.96
- What if not all costs were borne upfront?

Retaining Customers

- Satisfied customers are loyal customers
- Expectation confirmation model
  - Is product performance consistent with expectations?
  - Differential between expectations and actual performance influences degree of satisfaction
- Expectation formation
  - Different information source, WOM, product advertising, past experience

Monitoring Satisfaction

- Survey based approaches
  - Measure satisfaction on a scale relative to expectations
  - Relative to competition
  - Track over time to uncover trends in the industry
  - Track consumer complaints
Value Management

- Customer value ↑ Profitability ↑
- Perceived Quality ↑ Customer Value ↑
- Increase value by increasing perceived quality or value of your package
- Can be achieved by changing customers’ preferences (Perdue Chicken)

Satisfaction and Service

- Service is critical in some product categories
  - Deere case – how Deere handles downtime will be critical in value delivered by the product
  - Service can help differentiate from competition
  - Firm-customer interactions numerous – some more critical than others

Challenges faced by Corporate Chains

- Free-riding in Franchising
  - Service levels affect corporate image
  - Individual operators may not have sufficient incentive
  - Cost of monitoring and lack of incentives may influence ownership
Loyalty Programs
- Reward card – Tom Thumb
- Frequent Flyer cards
- Sears - $100 or more club
- Generates customer information that can be used effectively

Mass Customization
- Recognition that customers are heterogeneous
- Product located closest to customers' ideal point in product space will have the highest value
- Shoes, Jeans, PCs, Websites customize look and feel

Information Systems
- Knowledge about household events – birth of a child etc.
- Use information to customize mailings and offers
- Database marketing