Identifying and Managing Valuable Prospects

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A high percentage of customers quit their relationship with a firm each year. Therefore companies constantly must acquire new customers and characterize valuable customers to avoid acquiring customers, constantly switching their relationship with a firm in response to competitive offerings. Certain models to assess the customer life value (CLV), the discounted difference between a customer’s revenue and sales costs, are available. However these models have certain limitations, for example ignoring acquisition. This paper investigates the importance of the acquisition phase for the CLV and sets up propositions related to CLV.

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ABSTRACT

In saturated markets up to 30% of customers quit their relationship with a firm each year. Therefore, companies must acquire valuable customers constantly and avoid customers that constantly switch their relationship with a firm in response to competitive offerings. Most models to assess the customer life value (CLV), the discounted difference between a customer’s revenue and sales costs, have limitations such as ignoring customer acquisition. This paper investigates the importance of the acquisition phase in the CLV and sets up propositions related to CLV.

EXTENDED ABSTRACT

To increase profits, firms reallocate their resources to valuable customers and avoid churners, customers that switch from competitor to competitor in response to attractive offers. Therefore, companies should quantify each existing or potential customer’s value in order to help maximize that customer’s lifetime value (CLV), the discounted difference between a customer’s revenue and sales costs (Cao and Gruca 2005; Lewis 2006).

Rather than a homogenous group, firms should consider customers as a heterogeneous asset in order to investigate how underlying factors influence the CLV and how marketing activities influence these underlying factors (Bolton et al. 2004). For example, which consumer behaviors suggest a high CLV and how can firms use this knowledge in the acquisition phase?

Research provides multiple models to calculate CLV, yet most models often ignore the importance of the acquisition stage and customer behavior (Bolton et al. 2004; Thomas 2001). For example, customers differ in motivations to consume. Some consume media randomly to kill time; others consume media selectively in a goal-directed manner (Hoffman and Novak 1996; Rubin 1984). Different consumption motivations, hedonic and utilitarian (Hirschman and Holbrook 1982) could influence CLV.

Yet to the authors’ knowledge, few studies have investigated how consumption modes relate to CLV. Differentiating customers according to their consumption preferences could help firms increase the accuracy of CLV predictions, allocate resources to acquire valuable prospects and retain valuable customers (Cao and Gruca 2005; Lewis 2006). For academia, the relationships among consumption modes and factors influencing CLV should reveal another consumer behavior aspect, the importance of consumption modes in customer relationship management.

Conceptual framework of factors influencing CLV

Purchase Behavior and Relationship Perceptions

Marketing activities in the customer acquisition and retention phases can influence both relationship perceptions - customer beliefs about firm attributes and performance - and purchase behaviors, which subsequently relate to CLV (Bolton et al. 2004). Purchase behavior reflects the length of the firm relationship, buying frequency and average purchase value. Purchase behavior differs in underlying motivations, utilitarian and hedonic (Childers et al. 2001; Hirschman and Holbrook 1982). Whereas a utilitarian consumer is goal-oriented, consumers focusing on hedonic dimensions seek entertainment and pleasure. Similarly, users consume media such as the worldwide web (Hoffman and Novak 1996) and TV (Rubin 1984) in utilitarian and hedonic modes.

Satisfaction, price perception and commitment help determine relationship perceptions (Bolton et al. 2004). Although marketers generally assume that satisfaction increases customer loyalty and relationship length, satisfied customers are not necessarily loyal (Oliver 1999). The relationship between satisfaction and loyalty is complex and non-linear as other factors, including price perception and commitment, influence relationship length, (Bolton et al. 2004). The importance of satisfaction seems to decrease with relationship length, at least for hedonic products (Chitturi et al. 2007). Whereas for utilitarian customers focused on the transaction, satisfaction is the premise for future intentions, trust and commitment are important for customers in a long-term relationship (Garbarino and Johnson 1999). Thus,

P1: Whereas customers in a hedonic mode are interested predominantly in trust, customers in a utilitarian mode are interested predominantly in satisfaction.

Price perceptions

Although satisfaction seems to play a major role in customer-firm relationships, price perceptions also help form relationship perceptions. Competitors’ prices for the same or similar products form a perceived ‘price fairness’ (Bolton et al. 2004). Furthermore, the initial price relates positively to customer lifetime (Dover and Murtha 2006), consistent with findings that promotionally acquired customers are low value (Lewis 2006; Scott 1976). Once acquired, firms offering affective commitment and loyalty programs with economic advantages can increase customer retention and the share of wallet a customer customer spends with a company (Verhoef 2003). Bolton et al. (2004) however question the positive effects of loyalty programs providing economic benefits, at least in the long run. They argue that programs with economic (utilitarian) benefits influence short term service use and social (hedonic) programs such as customer events influence long term service use. The role of price perceptions and hedonic versus utilitarian consumption modes may relate to customer acquisition and subsequent CLV. Thus,

P2: Firms can increase the CLV of hedonic (utilitarian) customers in the retention phase with social (economic) programs.

Commitment

Literature distinguishes affective and calculative commitment (Bolton et al. 2004). Whereas affective commitment stems from feelings, calculative commitment stems from rationale motives, such as costs. However there is ambiguity about the effects of commitment due to two commitment dimensions; the effects differ across markets. In relationships with companies offering hedonic experiences such as entertainment, affective commitment positively influences relationship length (Bolton et al. 2004). Yet the increasing experience of utilitarian focused customers (Bolton et al. 2004) may suggest a calculative commitment. This formed calculative commitment, however, depends on switching costs. Thus,
P3: As calculative commitment relates to price perception, consumers in a utilitarian consumption mode form a lower firm commitment than hedonic oriented consumers do and thus utilitarian oriented consumers have a lower CLV than hedonic oriented consumers.

CONCLUSION

The commitment of a consumer with a company and the relationship length could depend on the consumption mode — utilitarian or hedonic. Whereas price fairness and economic incentives interest utilitarian oriented consumers, affective incentives should interest the hedonic oriented consumer. Therefore most churners, consumers willing to change from one competitor to another, should tend towards utilitarian consumption. For the acquisition of new customers, it seems appropriate to focus on customers interested in a hedonic consumption. However, firms could acquire prospects interested in a utilitarian consumption, but with a high CLV, by offering loyalty programs in the retention phase.

Preferences for product types, e.g. movie genres in the movie industry, could show if a consumer has a hedonic or utilitarian orientation. Further research will test the propositions set up in this paper using attitudinal and behavioral data from an online DVD company, similar to Netflix (www.netflix.com) in the USA. A classification based on customers’ perception of a film being hedonic or utilitarian (Milkman et al. 2007) will serve as a proxy for consumption modes. Membership length and associated costs, such as customer audit costs and acquisition costs, will serve as a proxy for CLV.

REFERENCES


