Marketing's New Paradigm: What's Really Happening Out There
Kotler, Philip
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Marketing's New Paradigm: What's Really Happening Out There

by Philip Kotler

Marketing has been defined by some as the art of getting and keeping customers. Much of marketing has been cast around the "getting" problem. We have neglected the "keeping" problem. Keeping requires some thought; it goes beyond what the customer service department does. It gets into how to satisfy the customer, how to get the customer to be a frequent buyer, and how to form links with customers that create exit barriers that make it more expensive to switch than stay. These things must be thought through because the first defense of any company is to keep its customers. Defection is the worst thing that can happen.

That is not to say all customers are worth keeping; interestingly enough, an organization's large customers sometimes fall into that category. For many companies, their medium-size customers are the most profitable ones; their larger customers usually want a deep discount and special services. In those situations the net yield may not be very good.

"The fact is, most companies neglect their customers once they have gotten them."

Most marketing theory is about how to make a sale. The whole notion of STP (Segmentation, Targeting, and Positioning), a strategic form of marketing, says very little about keeping the customer after the sale. The fact is, most companies neglect their customers once they have attracted them.

Companies need to practice wrap-around marketing, which encompasses both getting and retaining customers. Wrap-around marketing involves market and customer analysis before, during and after the selling effort. Even so, wrap-around marketers have to make sure customer lifetime value exceeds new customer acquisition costs.

For example, a bank recently announced that it will deposit $10 in each new account opened. What is their cost of customer acquisition? It is at least $10; it is probably more like $30 or $40 once all the advertising the bank has done to publicize their offer is taken into account. Their total marketing budget for this particular promotion divided by the number of new customers, plus $10 per customer, is their customer acquisition cost. The second number the bank needs to know is the lifetime value of each newly acquired customer. If a depositor opens a new account and then quits in a week or two, the bank has lost the entire cost of customer acquisition. If the bank does not do something to retain its new customer, the cost of acquisition will be greater than the customer lifetime value, and the bank will go out of business.

Consider another illustration. A high-tech company I have worked with discovered that it cost them $120,000 to support a salesperson — including salary, commissions, expenses and fringe benefits. At this company, the average salesperson could make 200 calls a year. They had to attend a lot of meetings and training, and therefore could not make a call a day. Based on those numbers, it cost the company roughly $600 to make a call on a prospect. On average, it took about three calls to convert a prospect into a customer. As a result, the company's new customer acquisition cost was $1,800. Actually, it is higher than that — that does not include the cost of promoting target market awareness and interest.

Suppose the average new customer spends $5,000 a year and remains loyal for three years. If the profit margin is 10 percent, the lifetime value of that customer is $1,500. In that case, the company lost money on the new customer.

Increasing Productivity

The way to improve such a situation consists of a number of steps. The answer is not to hire poorer-skilled, lower-paid salespeople; this would reduce sales productivity. Instead, the organization should try to get more face-to-face customer time — get the sales force out there with the customers. Each salesperson should be making more than 200 calls per year. Another possibility is to try to convert a prospect into a customer after two calls instead of three through pre-call activities such as advertising, direct mail, telemarketing — things that might predispose prospects into buying once the salesperson makes the call.

The organization could also try to better satisfy new customers so they stay loyal for a longer period of time. Customers may be persuaded to buy more volume, try new products, or switch to higher profit

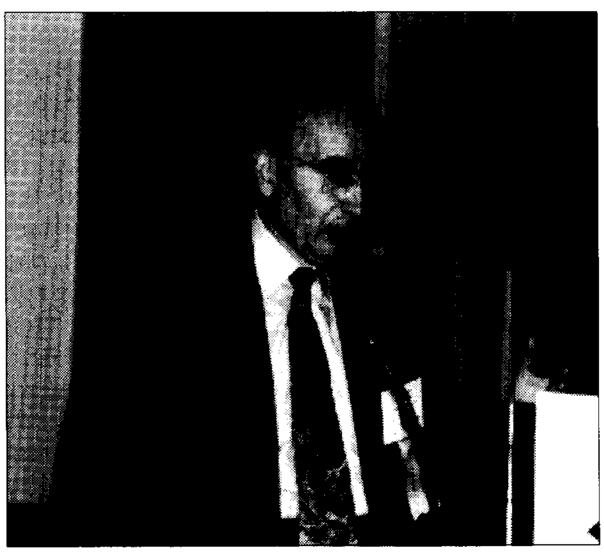
Philip Kotler, Ph.D., is the S.C. Johnson & Son Distinguished Professor of International Marketing at Northwestern University. He is widely regarded as a leading authority on marketing, and is a consultant to many organizations, including IBM and GE.

margin items. All of these strategies would either reduce the investment costs of getting a customer or increase the lifetime value of a customer.

Building Retention

How can companies build more retention and less customer defection? First, the company needs to know the customers' expectations. I did a study of how well one manufacturer satisfied his dealers. The dealers' criteria were: whether or not the manufacturer answered its phone calls promptly (within four rings), supplied the order in full, packed the order correctly, shipped the order on time and priced it accurately. At this particular company, these things were being achieved 23 percent of the time. In other words, there was a one-in-four chance that all five criteria would be satisfied in a single transaction.

What is the chance of satisfying a dealer completely three times in a row? Approximately one percent — $.23^3$. Why should the dealer stay with that manufacturer, especially if the dealer does not exclusively carry that manufacturer's products? After the results of the study were in, the manufacturer set a goal: to increase transaction integrity from 23 percent to 95 percent. If the manufacturer could accomplish that, then in three transactions in a row, service quality would be over 86 percent.



Philip Kotler

This raises the question of whether or not an organization should strive for zero-defect service. Many people believe that doing so costs too much. I think firms should at least strive to outperform their competitors, but that offering legendary service can be risky.

Every time an organization loses a customer, it costs money. Customer retention experts argue that if a firm can increase its customer retention by five percent, it will show on the bottom line as an increase of 25 to 100 percent. For example, consider what it would mean if a major transportation company has 64,000 accounts and loses five percent of them each year due to customer dissatisfaction. Five percent would be 3,200 accounts; if each account spent $40,000 per year and the company's profit margin is 10 percent, the company is losing $12.8 million a year due to bad service. Therefore, they should spend up to $12.8 million to improve service, especially if they can get to zero defections. Doing such a calculation is a way to determine how much any organization should spend to improve its service. Planners can thus calculate how specific reductions in the defection rate will help the bottom line.

Relationship Marketing

Clearly, organizations should build a stronger relationship with their profitable customers. There are five different levels of relationship marketing that can be practiced. The **basic** level does not really involve building a relationship — it is when a car salesperson smiles and sells you a car and waves good-bye as you drive it off the lot. You never see him again; if you need service you talk to someone in the service department. Very few auto dealership systems succeed in building such a strong bond between the dealership and the client that the client keeps buying from the same dealership — Lexus and Saturn are notable exceptions.

Reactive marketing is the next level of relating. At this level, as the salesperson waves good-bye to the customer, he says, "By the way, if there's any problem, please call me. You don't have to call the service department — I am responsible for your satisfaction."

A higher form of relationship is **accountability.** At this level, the salesperson calls the new car owner within two weeks of the sale and asks how he likes the car, and if there is any way the car could have been better. Those salespeople often get an earful. The customer might say, "I wish the door had a pocket for maps. I wish there was a rear window wiper." At that point, the dealer should ask, "How much would it have been worth to you if the car did have a map pocket in the door and a rear window wiper?" That type of information will help the automobile manufacturer continuously improve its product.

> **"Partnerships are the ultimate form of relationship marketing."**

Still, a higher level is **proactive,** where the salesperson will call the customer from time to time and say "The company has figured out a way to help you save fuel — it's something we can add to your engine and it will reduce your fuel costs." Customers get a sense that the company still is interested in their needs.

Partnerships are the ultimate form of relationship marketing. They involve actually living with the customer and are mostly confined to business-to-business relationships. For example, Procter & Gamble now has approximately 20 people living in Bentonville, Arkansas, at Wal-Mart headquarters. They are there full-time as partners, trying to figure out better package sizes, logistics and marketing approaches.

> "The important thing is to know where your competitors stand — what is their profile with respect to relationship investments ..."

Each level requires more cost, so it is important for organizations to determine when it is worth going to the next level. Two dimensions that are particularly critical are the margin that the firm makes on the business and the number of customers making purchases. For example, a low-margin business with many customers — i.e., selling toothpaste — would operate at the basic level. The organization has so many customers for that product and makes so little per unit that it would not be cost-effective to develop a high-level relationship.

At the other extreme, whenever Boeing sells airplanes to Delta, they should have a real partnership. Boeing does not have millions of customers, and their margins are comparatively high. They ought to customize the interior of the plane, its features and functions and performance qualities in conjunction with their customers' wishes.

Applying Retention Tools

Each major customer retention tool can be utilized at each of the five levels. For example, consider technical assistance. What is the minimum amount an organization should provide? An owner's manual. At the reactive level, perhaps a help line. At the level of accountability, perhaps an occasional visit to the customer to see if the customer is using the product correctly and efficiently. Training would be appropriate at the proactive level; partnering might require a few members of the organization to live at the customer's facility and serve as a source of expertise until the learning curve is overcome.

> "To remain competitive, organizations must continually amplify or enhance their value-added package."

Clearly, there are five levels of response for each customer service and retention tool. Those levels vary within companies; an organization might be reactive with respect to technical assistance, accountable with respect to service and basic in terms of value-added. The important thing is to know where your competitors stand — what is their profile with respect to relationship investments, and what things should you do to be superior to the target market?

One of my favorite examples of relationship marketing is Milliken & Company, the textile manufacturer. Milliken should not have survived in this part of the world because of the lower production cost of textiles in other parts of the world. Not only have they survived, but they are also able to charge a premium for their towels, carpets and fabrics and still achieve a leading market share. How do they do this?

In one of their businesses they are a major supplier to industrial laundries who buy towels. These towels are then rented out to factories that have to clean equipment and tools. An industrial laundry is willing to pay 10 percent more to Milliken, even though it can buy towels that look equivalent from someone else. Why? Because Milliken is a value-adder. It has developed a bundle of benefits and turned its customers into "Partners for Profit."

Winning Through Value-Added

When an industrial laundry buys its towels from Milliken, it gets a computerized routing program which is a key to competing efficiently and successfully. The program maps out the most efficient route to take through a given city to make all the needed pick-ups and deliveries.

Milliken also equips the laundry with software that provides guidance on how to manage its balance sheet and income statement. Milliken also provides the laundry with leads and marketing research information. In addition, Milliken provides free sales training to laundry representatives. Clearly, Milliken helps its customers succeed.

Two questions usually come up with this illustration. First, what does Milliken do about opportunistic buyers who buy towels from them just to get the software and the sales training, and then switch to a lower-cost supplier. I asked this of CEO Roger Milliken; he said customers do not take advantage of the company because they do not get any of the value-added items without signing a five-year contract. In addition to locking the customers in, the contract specifies how many towels that laundry will buy over the term of the agreement. Milliken then knows how many towels its customer base will need over a five-year period, so that it can expand its manufacturing facilities more confidently.

What about after five years, when the customers have extracted all the value they can out of the value-added items and now want to avoid that 10 percent price premium by buying their towels from another supplier? Roger Milliken said that they do not, because by the time the contract expires, the value-added package has been greatly improved. If the laundry switches to another supplier, it will not get superior sales training or the latest software.

Customers change; competitors change. To remain competitive, organizations must continually amplify or enhance their value-added package. This is the key to relationship marketing: organizations do not sell products alone. The bundle of benefits that the firm puts together is what keeps the customers for life. ✦