

## MANAGING APPRECIATING AND DEPRECIATING CUSTOMER ASSETS

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*Customer asset management is a vital component of the CRM implementation process. This article suggests that customer valuation efforts should include the social influence (e.g., word-of-mouth and modeling) of customers in their profitability evaluation. Existing approaches to customer evaluation have failed to capture the social impact of customers and the potential impact of future customers. Additionally, previous research has blindly focused on the concept of loyalty without fully realizing that loyalty does not equal profitability. Using the traditional concepts of the product life cycle and the adoption-diffusion curve, the authors develop a framework that suggests timing benchmarks for the management of both profitable and unprofitable customers. Specifically, customer management activities should be split into two stages: an acclimation and evaluation stage and a discrimination and elimination stage. We identify six customer portfolio categories based on profitability, customer loyalty, and social influence along with providing tactics to manage each segment effectively. Finally, the authors conclude with a discussion of how to “fire” unprofitable customers.*

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### INTRODUCTION

Many recent frameworks for managing customer equity have been built around the firm's ability to identify individual customer value (profitability) and use that information to focus relationship-building efforts on the most valuable customers (e.g., Reinartz et al. 2004; Rust et al. 2005). The predominant emphasis in such frameworks is on improving or maintaining the profitable customers' relationships with the firm. However, the suggestion to consider a firm's customer relationship portfolio as a strategic marketing asset (e.g., Reinartz et al. 2004; Sheth and Sisodia 2002) entails the management of weak or “bad” customer relationships as well as strong ones.

The CRM literature has seldom explicitly considered how to manage poor customers for a firm (for exceptions, see Reinartz et al. 2004; Stauss and Friege 1999; Thomas et al. 2004). Eliminating the drag on company marketing

profitability by reducing customer retention efforts for unprofitable customers can provide a significant boost. For example, Thomas, Reinartz and Kumar (2004) report estimates for a catalog retailer that a 31percent *reduction* in direct-mail investment per customer would *increase* average customer profitability by approximately 29 percent. Reinartz, Kraft and Hoyer (2004) refer to the desire of firms to prevent a “Type II error” or “the wrongful classification of low-value customers as high-value customers and subsequent overspending of resources” (p.295).

This focus on acquiring and retaining the “right” kind of customers has never been more evident than in the recent actions of property insurance companies. With the increase in damage from hurricanes, flooding, and tornados, insurance companies are now being more selective with their customer base. In areas of high risk like the southern coast of the United States, insurance companies are refusing to insure new clients, while at the same time “firing” existing customers by raising policy premiums or refusing to renew policies in high risk areas.

Acquiring customers is not enough to sustain long term growth, a business must seek, acquire, and retain customers that provide direct benefits to the organization. This means that an organization must actively manage its customer base by protecting and nurturing profitable customers while finding ways to manage unprofitable customers into profitability or ultimately out of the organization.

This paper examines the process of customer asset management and proposes a framework for handling both appreciating and depreciating customer assets. In addition, we will suggest a logic whereby the timing of tactical decisions about management of customer relationship portfolios can be estimated. Management needs to be mindful of how to manage customers who are dragging down profits and requiring numerous hours of customer support while providing little or no value to the company.

This article first summarizes the different approaches that have been advocated for examining customer profitability and argues for inclusion of an additional component concerning customer social influences (i.e., word-of-mouth and attitudinal loyalty). Next, a conceptual framework incorporating the product life cycle and its companion concept, the adoption / diffusion process, will be used to suggest a way to time the decisions in the customer asset management process. Finally, we detail suggestions for managing profitable and non-profitable customers to sustain long-term growth and financial success.

### **CUSTOMER VALUATION APPROACHES**

Customer asset management rests on the foundation of the identification of individual customer value; either current (profitability) or future (customer lifetime value – CLV) (Blattberg and Deighton 1996). The classification of high- and low-value customers enables the development of effective tactics for the maintenance, enhancement, or elimination of customer relationships. Customer valuation

has witnessed the appearance of several different schools of thought concerning the “best” method of estimation. Some estimation approaches rely solely on exhibited customer purchase behavior, while other models incorporate estimates of future customer activity. Still other perspectives include consideration of customer loyalty or attitudinal indicators. Although each perspective has its supporters, there are also drawbacks to using each approach.

#### **The RFM Approach**

An early perspective on customer valuation arose from the direct marketing field, which can be best characterized as the “Rearview Mirror” approach. This perspective focuses solely on past customer purchase behavior as the best indicator of customer value. Direct marketers have advocated the use of direct estimation of customer value through frameworks such as the RFM model (Recency, Frequency, and Monetary Value (Dwyer 1997)). Under this approach, customers are classified into value categories according to how recently, how frequently, and how much they spend with a firm. This framework has been criticized for its inability to account for the purchase pattern differences of individual customers (Reinartz and Kumar 2002). Additionally, Gupta et al. (2006) point out that the RFM framework predicts behavior only for the next quarter with no real long term prediction. As well, Reinartz and Kumar (2003) contend that frameworks such as the RFM approach encourage managers to regard high-frequency customers as the most attractive, while their study showed intermediate frequency purchasers were more likely to be long-run customers. Currently, the RFM framework is one of the most widespread frameworks used in many industries due to its simplicity to implement, though it has obvious flaws in prediction.

#### **The Cash Flow Approach**

Another school of thought related to the direct marketing RFM approach is the “Cash Flow” approach (e.g., Berger and Nasr 1998; Blattberg

and Deighton 1996; Reinartz et al. 2004). This approach focuses on revenues minus costs that customers will bring into the firm over their *predicted* tenure with the company. Customer Lifetime Value (CLV) is defined as the “present value of the future cash flows attributed to the customer relationship” (Peters 1988; Pfeifer et al. 2005). Consequently, it is a forward-looking metric focused on potential customer revenues.

This approach requires an estimation of customer duration / tenure with the firm (e.g., Berger and Nasr 1998; Reinartz et al. 2004). Various models have been proposed in which customers are assumed to be “lost for good” once they leave the firm and treated as new customers if they choose to rejoin in the future (e.g., Reinartz et al. 2004; Reinartz and Kumar 2000). Rust et al. (2004) criticized this assumption by arguing that the approach systematically underestimated CLV for customers who switched firms frequently.

Venkatesan and Kumar (2004) and Rust et al. (2004) both used an “always-a-share” approach to CLV estimation, which did not treat lapsed customers who returned as brand new consumers. Rust et al. (2004) included a customer brand switching pattern matrix as input to their estimation of CLV. Overall, the Cash Flow approach improves upon the historical perspective of the Rearview Mirror approach, but possesses its own weaknesses in prediction with the assumption that management knows the predicted tenure of a customer.

### **The “Loyal Customer” Approach**

A third approach to customer value estimation could be characterized as the “Loyal Customer” approach. This perspective advocates using customer loyalty as a proxy for estimated customer value. These models use a behaviorally-based definition of loyalty (e.g., a customer’s likelihood of re-purchase or purchase frequency (Tellis 1988)). Another contributing factor to the adoption of this approach is the relative ease of access to

historical customer purchase data from company records. Such a behaviorally oriented view of customer loyalty has been met with the criticism that it fails to capture the complexity of customer loyalty (e.g., Dowling and Uncles 1997; Kumar and Shah 2004; Oliver 1999; Reinartz et al. 2004). Customers who continue to patronize an organization because of switching barriers, convenience, or inertia are considered loyal customers under this perspective, although they may have little loyalty to the firm or be heavy purchasers.

The assumption that your most loyal customers are also your best customers is an intuitive one from the company’s standpoint, but ignores the possibility that your best customer may also be someone else’s “best customer” (e.g., Dowling and Uncles 1997). That is, many customers are multi-brand loyal. Many customers own multiple grocery loyalty cards and/or frequent flyer loyalty memberships. Consequently, customer behavior is not necessarily a precise indicator of customer commitment to a firm.

Reinartz and Kumar (2000) used data from a U.S. catalog retailer over a three-year time frame to show that customers who were completely or monogamously loyal to the company were only weakly correlated with profitability. The idea that profits will increase over time with loyal customers was found only with customers who generated low revenue streams and was rejected for loyal customers who generated high revenue for an organization. The study also found that loyal customers did not purchase at higher prices over time or were cheaper to serve. The authors concluded by stating that an organization’s best customers are not necessarily the most loyal customers.

### **CUSTOMER VALUATION: A NEW PERSPECTIVE**

We suggest the perspectives described above are too narrowly focused on an organization’s current customer base without considering the impact of future customers. Current research

has tried to understand the value of customers by treating each one as a distinct transaction without fully considering the social impact customers have on one another. A broader conceptualization of customer value needs to include not only the behavioral but also the attitudinal aspects of customer loyalty, such as customer commitment, word-of-mouth activity, and customer product adoption effects.

An early examination of the dimensionality of customer loyalty led Dick and Basu (1994) to conclude that loyalty included both a behavioral and an attitudinal component. Attitudinal loyalty is important because it can indicate the customer's propensity to recommend the company to their friends or colleagues (Reichheld 2003). Similarly, Reinartz and Kumar (2002) found that customers who were both behaviorally and attitudinally loyal were 54 percent more likely to spread active word of mouth and 33 percent more likely to spread passive word of mouth about an organization than customers who were just behaviorally loyal.

We argue that a neglected aspect of customer valuation is the impact of customer word-of-mouth activity (both active and passive) by early adopters of a product (Hogan et al. 2003). None of the perspectives described above incorporate the potential value to the company derived from customers spreading positive word-of-mouth about its product(s). Hogan, Lemon and Libai (2003) developed a customer valuation model to estimate the value of a lost customer which included the impact of social influence (i.e., word-of-mouth and product diffusion modeling effects). They used the Bass new product growth model (Bass 1969; Mahajan et al. 2000) to model product category sales at any point in the diffusion process as a function of external influence (e.g., advertising or mass-media) and internal influence (e.g., word-of-mouth or imitation). Next, they estimated firm profitability by deriving its *market share* of the product category sales both with and without target customers. The value of lost customers is given by the difference in the profitability of the firm between the two cases.

Hogan, Lemon and Libai's (2003) approach enables the estimation of customer profitability which includes the consideration of social influence effects as a result of attitudinal loyalty. As they explain:

The earlier a customer disadopts, the more money the company loses. Early in the product's life, there is only a small pool of users available to affect future adopters through word of mouth and other social effects, and thus a single disadoption can have a significant effect on the rate of future customer acquisitions. This effect diminishes later when many more adopters join the pool that can influence, and thus the indirect effect of a single adoption goes down. (p. 201)

Hogan et al. (2003) used this model to estimate the value of a lost customer for the online banking industry. Using industry-level data for penetration rates in the year 2000, along with average firm-level estimates for on-line transaction profits, and customer lifetime, they estimated average customer profitability. Their results showed that up until Year 4 (of an average 5-year customer tenure), the indirect social influence of a lost customer on estimated value is larger than the direct effect of lost sales if that customer leaves early in the product life cycle. After Year 4, the direct effects of sales losses are greater than indirect social effects. Hogan et al. (2003) also estimated the average 5-year customer profitability for each of the adopter categories proposed by Rogers (1995) in a Monte Carlo simulation of on-line banking customers. They found that innovators had an average value of \$850 compared to an estimated value of \$200 for customers in the laggard category.

The point is that customer valuation methods should incorporate both behavioral dimensions (e.g., present value of estimated customer lifetime revenues) as well as attitudinal dimensions (i.e., estimated value of social (indirect) effects for early product adopters). Current consumer valuation methods such as RFM and standard CLV models fail to

incorporate such components and may produce misleading customer value estimates. Simply examining the past behaviors of customers will at best represent the current value of a customer base but without examining forward looking metrics such as satisfaction, word of mouth, and attitudinal loyalty, little insight can be gained about the future value of a customer.

### The Profitability Lifecycle Approach

A key component in understanding how to manage a customer base into long term profitability is knowing how and when to discriminate between customers. For an organization to understand who is the “right” customer it must first understand who is the “wrong” customer. Little insight has been given on when customers should be treated differently in order to maximize the profitability of highly valued customers while actively managing unprofitable customers out of the organization. The authors propose a two stage framework that addresses the timing of assessing and discriminating between customers: Stage I: customer acclimation and evaluation and Stage II: customer discrimination and elimination. This framework provides a comprehensive review of how to manage a customer asset base by including not only the behavioral but also the attitudinal dimensions of a customer base. Lastly, another seldom addressed issue is the selection of tactics to manage unprofitable customers out of an organization without having a negative backlash. Numerous academic research has denoted how to manage profitable customers while very little attention has been given on how to manage a customer out of an organization. Understanding how to divest unprofitable customer assets can be just as important to a company’s long term success as successfully managing highly valued customers.

With the inclusion of future customers into the consideration of managing customer assets, the two stage framework uses a diffusion model approach by understanding how to manage customers within a product lifecycle.

### Stage 1: Acclimate and Evaluate Customers

*Tactics for the Introductory Stage.* In the initial or introductory stage of a product, many organizations fall into the trap of thinking that all customers are good customers. Blindly focusing on acquiring customers instead of the “right” customers can be a recipe for financial ruin. This was extremely evident in the dot.com bust in early 2000 as companies such as Pets.com and CDNow spent large amounts of money on acquiring customers but soon afterwards found themselves hemorrhaging financially while trying to satisfy low margin customers. The first step of any organization should be to initially have an idea on how to target the right kind of customers. Early in a product’s lifecycle it is too early to determine the lifetime value of a customer but an organization can initially try to target the “right” kind of customers in order to avoid spending time and resources on customers that provide little value.

In the introductory phase of a product, an organization must “acclimate” its customers. This means that organizations must not only expose, but teach customers how to use a product and what value it will add for them. Hogan et al. (2003) suggest that losing customers early in the product lifecycle can have far greater financial consequences to a firm than losing a customer later in a product lifecycle. Consequently, they suggest emphasizing “... retention and postpurchase support at the earliest stages of the product life cycle.” (p. 206).

The authors support this statement by noting that profitability can be hurt by the “indirect effects” of losing customers early in a product’s life. In the early adoption of a product, social factors play a extremely important role of reducing perceived risks of adoption and lowering cognitive dissonance levels (Hogan et al. 2002). Customers who adopt a product early in its lifecycle are instrumental in promoting customer “string purchases” or purchases that are linked by the word of mouth of an existing customer (Hogan et al. 2004).

As stated earlier, the introductory stage of a product lifecycle is not the time to begin discriminating between existing customers. The focus of management in this stage is to acclimate customers to the product offering in order to promote positive word of mouth and imitation to the potential customer base. In the introduction of a new product, management should focus its attention on trial and repeat purchases. At this stage, management does not have enough information about the historical behavior of its customers nor has the customer formed a solid evaluation about the offering.

Managing customers in this stage of the product lifecycle is very similar to Ehrenberg's leaky bucket theory in that a company needs to initially maintain a level of sales at a higher level than those who are leaving or "leaking" away to sustain the product and build a solid foundation for recruiting new customers through social interaction (Ehrenberg and Goodhardt 1977). Oftentimes, customers in this phase of the product lifecycle can be classified as innovators and/or early adopters whose goal is often to be an opinion leader about a product. These individuals are rarely long lasting customers due to their novelty seeking behavior but their social interaction with others can have a tremendous impact on future customers. Further emphasizing that these customers simply need to be acclimated to the product in order to promote further acquisition of customers through social interaction with existing customers. In the introduction phase of a product, a company is simply establishing a customer base for future evaluation. Initially, acclimating customers to the value proposition of the product should be the main goal of a company in order to promote further growth from direct effects of the company and the indirect effects of existing customers.

*Tactics for the Growth Stage.* After a product has transitioned from an introductory phase to a growth phase (i.e., an increasing rate of sales growth), an organization needs to actively start taking steps to "evaluate" its customer base in order to distinguish between profitable and

unprofitable groups. In this stage, the social influence of customers takes on a more prominent role as more and more customers are adopting the product. In the growth stage of a product, a company can now start to assess historical patterns of purchasing behavior. As well, customers are starting to have more concrete opinions about the quality of and satisfaction with the product or service. The growth stage of a product is where a company should actively try to evaluate the lifetime value of its customer base in order to accurately target promotions to high valued customers while at the same time examining how to manage up or out potentially unprofitable customers. In this stage, management needs to start collecting and analyzing information about its customer base in order to start evaluating and, ultimately, segmenting customers based on profitability in order to effectively manage these different groups.

Quite often, organizations who have noncontractual customers can not provide one-to-one marketing support to its customers due to financial and time restrictions. Consequently, in order to manage its customer assets, organizations may need to segment groups of consumers based on profitability and loyalty in order to calculate an average customer lifetime value for the group (Berger et al. 2002). Assessing a customer's potential future value is not a simple process. Reinartz and Kumar (2000) speculate that three years of customer data might still be insufficient to accurately calculate a customer's lifetime value. Management need not rush into segmenting customers into groups without having enough long term information to accurately categorize customers. This information includes not only the rearview metrics such as previous purchase patterns but forward looking metrics such as positive word of mouth, satisfaction levels, and attitudinal loyalty to a company.

The end of the growth phase of a product life cycle (i.e., when the rate of sales growth increase is starting to slow down), is where customer behaviors tend to stabilize and are

more conducive to segmenting customers based on their projected long term value to an organization. Rogers' (1995) diffusion framework suggests that the growth stage of the product lifecycle is where the innovation diffusion category of the early majority tends to adopt a product. At this point, management should conduct in-depth analysis to identify those customers with the highest current value, as well as those customers with the highest potential for long-term contributions. By the growth stage, management should now be able to assess the switching patterns of customers and how receptive customers are to cross buying offerings which should provide more insight into the long term profitability of a customer. Many businesses, unwisely, wait until a product is in the maturity phase before deciding to segment and discriminate among their customers. The growth phase is where a business can assess its long term value of a customer through both behavioral and social metrics. A company would be better off to capture and evaluate customers in the growth stage so that when a product is in the maturity stage a company is already discriminating between its best customers in order to prevent wasteful spending on marketing campaign to those customers that are unprofitable or unlikely to respond.

### **Stage II: Discriminate and Eliminate**

Peppers and Rogers (1997) put it best when they said some customers are more equal than others. Many organizations are realizing that treating all customers equally is not a sound financial plan nor an appropriate use of resources. The fact is, many companies' "best" customers get higher quality service, better offers, and quicker response to questions or problems. For example, restaurants will give their best customers choice seating, brokerages routinely provide dedicated resources to large investment clients, and sales divisions often take their best clients to sporting events and trips to tropical locations, while mildly profitable customers are simply called on by the sales staff.

In order to increase an organization's profitability over the long term, it must be able to distinguish between its customers in order to allocate resources in proportion to the profitability obtained from each customer. Zeithaml et al. (2001) state that many quality zealots disagree with the notion of providing a lesser service to some of its customers, but in reality this approach often provides more value to both the company and its customer base.

By the time a product reaches the maturity stage, an organization should already be managing its customer assets by discriminating between clients. Waiting until this stage to start evaluating customers will often lead to lower profits with inaccurate and inefficient targeting of profitable customers. According to Rogers' (1995) diffusion framework, the late majority and laggard customers begin to purchase the product at this point. Here, the organization needs to spend little time acclimating the customer to the company and its product. At this point, management should have developed a profile of the various types of "right" customers. Considerations of word-of-mouth activity, though still important, are not such a crucial concern with these types of customers.

The focus of the maturity stage is to actively manage all of its customer segments in order to prolong the maturity stage. This is done by finding and retaining the customers that have a long term potential for profitability. Relationships with profitable customers need to be enhanced and relationships with customers who have long-term profit potential need to be developed. Zeithaml et al. (2001) referred to this management process as "customer alchemy"- turning "iron" customers into "gold" and "gold" customers into "platinum" customers, and ultimately, getting the "lead" out.

*Tactics for the Maturity Stage.* Once a product has left the growth stage, an organization should have already evaluated its customer base in order to start discriminating among its clients. In order to further clarify the

challenges in discriminating between clients, we developed a classification system for customers to help identify management tactics that are suitable for use in the maturity and even decline stage of the product life cycle (see Table 1). As we argued earlier in the paper, a complete picture of customer valuation needs to include attitudinal loyalty as well as purchase behavior. Including customer loyalty helps value the customer’s potential contributions from social influence effects. Consequently, we have labeled customer classes as either “Monogamous” (i.e., loyalty / commitment to a single, primary firm by the customer), or “Polygamous” (i.e., loyalty / commitment to multiple firms by the customer). For purposes of simplification, customers with no alligance to any particular firm are classified as “Polygamous”, even though they may not have any attitudinal loyalty to any firms.

In the sections that follow, we suggest appropriate tactics for the different customer groups. Few studies have examined how to manage a customer asset that is loyal but still unprofitable, we provide further suggestions on

how to manage customers, both loyal and non-loyal, who are profitable and unprofitable. This holistic perspective should enable a more complete understanding of how to manage *all* of an organization’s assets not just the profitable ones.

**Cell 1: Monogamous Loyalty – Profitable**

Consumers who are attitudinally and behaviorally loyal and at the same time highly profitable can be considered an organization’s best customers. These individuals not only purchase their products solely from but are also highly valuable customers. For this group, the goal should be to extend the customer’s association with the firm. Cell 1 customers’ share of wallet (by definition) is high, so attempting to increase purchase volume may not be a fruitful option.

An organization should try to keep these customers satisfied, while at the same time, attempting to find ways to extend their tenure with the company. A frequent tactic used by firms is to offer loyalty programs that reward

**TABLE 1:**  
**Managing Customer Assets Based on Profitability and Loyalty**

	<b>Profitable</b>	<b>Potential for Profitability</b>	<b>Unprofitable</b>
<p><b>Monogamous Loyal</b></p> <p>(Commitment to single firm—large share of wallet)</p>	<p><i>Goal: Extending customer life with firm</i></p> <ol style="list-style-type: none"> <li>1) Loyalty programs</li> <li>2) Customer support programs</li> <li>3) Special promotions</li> <li>4) Promote new uses for product</li> </ol> <p style="text-align: center;"><b>1</b></p>	<p><i>Goal: Increasing purchase levels/Invest for future potential</i></p> <ol style="list-style-type: none"> <li>1) Increase self-service levels</li> <li>2) Unbundle products</li> <li>3) Emphasize WOM promotions</li> </ol> <p style="text-align: center;"><b>3</b></p>	<p><i>Goal: Raising prices/cutting costs to reach profitability or outsourcing to other firms</i></p> <ol style="list-style-type: none"> <li>1) Raise Price</li> <li>2) Outsource Customers</li> </ol> <p style="text-align: center;"><b>5</b></p>
<p><b>Polygamous Loyal *</b></p> <p>(Commitment to multiple firms—small share of wallet)</p>	<p><i>Goal: Increasing purchase Levels</i></p> <ol style="list-style-type: none"> <li>1) Special offers—Bundling</li> <li>2) Frequent purchase programs</li> <li>3) Additional service levels</li> <li>4) Promote new uses for product</li> </ol> <p style="text-align: center;"><b>2</b></p>	<p><i>Goal: Increasing purchase levels/cutting costs</i></p> <ol style="list-style-type: none"> <li>1) Increase self-service levels</li> <li>2) Unbundle products</li> </ol> <p style="text-align: center;"><b>4</b></p>	<p><i>Goal: Raising prices/ outsource to other firms/avoid targeting</i></p> <ol style="list-style-type: none"> <li>1) Raise Prices</li> <li>2) Outsource customers</li> <li>3) Lower service levels</li> <li>4) Refuse to renew business</li> </ol> <p style="text-align: center;"><b>6</b></p>

\*Includes customers who exhibit no loyalty to any particular firm.



these customers for their behavior. Dowling and Uncles (1997) note that you do not need to blow the customer away with the magnitude of the rewards from a loyalty program. Relationship management activities should focus on maintaining the customer's established satisfaction with the company and building higher switching barriers to extend their relationship with the firm.

Management of customer relationships with cell 1 customers can be accomplished by offering satisfaction guarantees, providing customer feedback initiatives to make sure the customer is satisfied, and offering special promotions for these customers such as giving these "premium" customers the ability to purchase items before the rest of the public, or making sure to remember customer preferences for products. Lastly, management needs to take an active role in forming a relationship with these customers. Monogomously loyal customers want a company to recognize them as valued customers which means doing the little things such as recognizing these individuals by name and thanking them for their continued patronage. These individuals already have an elevated impression on the company and management needs to simply maintain the high level of satisfaction that has already been achieved by previous visits.

### **Cell 2: Polygamous Loyalty – Profitable**

This group of consumers, called butterflies by Reinartz and Kumar (2000), is a highly profitable group, but do not purchase from just one company. This segment has a large growth potential, but is expensive to target because they tend to be extremely price conscious and/or variety seekers (Reinartz and Kumar 2000). Though cell 2 customers are not loyal to one company, the benefits these customers bring can be substantial. The presence of these cell 2 customers may provide the sales volume needed for the company to achieve the available economies of scale in its operations. Johnson and Selnes (2004) point out that for firms whose offerings fall closer to the

commodities category, these types of customers may represent the primary type of segment.

The goal for management with cell 2 customers is to increase their purchase levels and allocate a larger share of wallet to the firm. These customers often need an incentive to switch their business from competing firms. Targeting this group with special promotions and offers such as bundling products for price discounts are suitable tactics. Additionally, this group may require a higher service level in order to acquire more of their business. Other tactics for targeting this group are to offer frequent purchase programs, and as with cell 1 customers, a company can look for new ways to market their product to this group via different uses.

This group can be highly profitable for a firm, but it is harder to estimate its long-term value due to its inconsistency of purchase behavior. While cell 2 customers may be profitable to pursue, they will be harder to convert to monogamous customers. The long term key for this segment is to find what each customer values, whether it is price discounts, variety of choices, or increased service levels in order to target this highly profitable group. In order to obtain cell 2 customers' business, an organization must provide a distinct or unique offer in order to promote further switching behaviors. These customers are highly coveted by numerous firms and will not be easily swayed by "me too" offers. An organization must provide an offer or incentive that distinguishes it from the rest of the organizations vying for their business. An organization that is not only trying to acquire, but also to retain these type of customers, must think in new and challenging ways in order to increase the frequency and consistency of these customers purchasing with the firm.

### **Cell 3: Monogamous Loyalty – Potential for Profitability**

Some consumers are highly loyal to an organization, but do not produce profits for an organization in the short run. This customer

segment may be highly profitable customers in the future, but right now an organization might have to go through some “growing pains” with the customer. College student customers in the banking industry are a prime example of this category. Commercial banks make very little money serving college students, but their goal is to focus on the long term possibilities for this group. Cocheo and Harris (2005) noted that seven out of ten organizations in banking actively try to manage customers into profitability rather than nudging them out the door.

An organization needs to take active steps in managing its customer base to leverage the existing loyalty of its customers, while at the same time looking for ways to make this group more profitable. Implementing word of mouth programs where the customer gets a discount for referrals is a way to increase an organization’s customer base while at the same time nurturing customers into more profitable segments.

The lack of profitability of this group in the short run can also be addressed by having customers take on more of the traditional employee roles through the use of self-service technology. In this approach, the customer is absorbing some of the service cost by performing part of the service process themselves, which directly impacts the profitability of the firm. Another technique used to make cell 3 customers more profitable in the short run is to unbundle products and make the consumer pay for each aspect of the product. The added revenue from component product/service can compensate for the lack of frequency or purchase amount.

Cell 3 customers can be considered “small wallet” individuals. These customers are committed to the firm, but do not have the resources at the present time to be considered a profitable segment. If an organization determines that a group of consumers has the potential to be profitable in the future, it would serve them well to find ways to make this group more profitable in the short run while

investing to maintain the relationship for the long run possibilities.

#### **Cell 4: Polygamous Loyalty – Potential for Profitability**

Cell 4 customers are among the hardest group to classify and evaluate in terms of long term value. These customers purchase infrequently and are not a valuable segment to the firm. An organization needs to determine if this customer has a “small wallet” or if the organization is only capturing a small “share of wallet”.

The firm should try to explore the reasons for the multi-firm loyalty by cell 4 customers and estimate if efforts to encourage switching are likely to be successful. Reinartz and Kumar (2000) warn against “chasing” these types of customers for too long and driving the customer asset base’s value down. Tactics for cell 4 customers are similar to those for cell 3 customers, with the exception that WOM promotions are unlikely to be successful. The use of more self-service technology and product unbundling to cut service costs for this group is a recommended approach. As well, short term cross buying promotions and frequency programs may be used to gauge the value of a customer in this segment. These promotions will give an organization the ability to determine if this potential profitability will actually turn into reality in the future.

#### **Cell 5: Monogamous Loyalty – Unprofitable**

Monogamous customers who are unprofitable to service from a long term perspective are a financial hinderance on an organization’s growth and future success. A consumer who keeps coming back, but purchases very little and requires extensive time and effort from an organization can be the root of many problems. Serving a disproportionate amount of time with customers who are ultimately unprofitable to service hinders and masks the overall success of an organization with its other customer groups. Customers who have been determined to be unprofitable from a long term perspective

need to be managed up or out. Zeithaml et al. (2001) noted that highly profitable customers were roughly 18 times more profitable than the bottom 20 percent of customers that were often nonprofitable to service.

One way to manage cell 5 customers into profitability is to raise the price charged for the product or service. Increasing the price of a product to a level that allows an unprofitable customer to make a contribution to firm profits obviously benefits the company, but also allows customers to decide if they want to stay with the firm.

Another technique firms are using more and more frequently is to outsource cell 5 customers to other organizations. This outsourcing activity can be transparent to the customer or explicitly identified by the firm. In the first instance, the customer may still believe that they are doing business with the organization, but a subcontractor is actually handling the business in a seamless manner. For example, many of the popular overnight package delivery firms use this approach for its rural package customers. Instead of delivering a single package to a remote location in a rural community, these companies simply deliver their packages to the local postoffice and pay the postage for the local mail carrier to deliver the package. The original sender of the package has no idea that the overnight carrier did not actually deliver the package. In this instance, the organization does not try to drive off the customer, but uses a more cost effective outsourcing method to service these customer groups.

Retaining unprofitable consumers for the simple reason that they are loyal to the company is a recipe for financial ruin. An organization needs to be mindful of who the right customers are and take proactive steps to quickly manage the wrong customers appropriately. Ignoring the presence of unprofitable customers in cell 5 will not make the problem go away and ultimately masks the true profitability of a firm. Nonprofitable and profitable customers must be actively managed

in order to secure the long term success of an organization.

### **Cell 6: Polygamous Loyalty – Unprofitable**

Consumers who not only are unprofitable, but have no loyalty to a company are the worst kind of customers for an organization to maintain. These customers use time and energy resources in a disproportionate amount, and the company does not even get the word of mouth benefits that monogamous customers provide. An organization can take steps such as raising prices, and outsourcing services, but at times a more direct action is needed to resolve the problem.

The service level provided to these customers might be intentionally lowered to cut costs. In addition, lower service levels might give these customers an incentive to seek other providers. Financial brokerages use this technique by calling back their best customers within minutes, while small and/or unprofitable clients can wait much longer for a return phone call. An organization may also need to take an active approach in managing its customer assets by eliminating or firing customers from an organization. The next section will specifically address “firing” customers

### **ELIMINATING DEVALUED CUSTOMER ASSETS**

When a product is entering the mature or decline stage of the product life cycle, a firm needs to take a more direct route in managing its customer assets. Maintaining profitability is a more critical issue in these stages because sales are slowing and concerns for long term growth are a prominent issue. In this stage, an organization needs to actively identify and “fire” customers that have no long or short term profitability. The idea of firing customers seems like a foreign concept with the recent emphasis from CRM on customer retention. Acting decisively to eliminate unprofitable customers and their drag on the value of the firm’s customer assets is a necessary part of managing for long-run value.

One way for a company to divest its undesirable customers is to outsource the service of these customers to other organizations. Outsourcing is an opportunity to lower costs while allowing the firm to focus its efforts, time, and resources towards the customers that have the highest likelihood of increasing sales and generating more profitability. As we suggested earlier, this outsourcing tactic can be managed transparently for the customer if the objective is to keep the customer. In some instances, long standing customers who are both attitudinally and behaviorally loyal to a company can migrate to a financially undesirable segment, but due to the social interaction and relationship building opportunities of these customers it is still advantageous to keep up the appearance of servicing these customers. By outsourcing these customers to another company, an organization has fired a customer without them ever knowing this has taken place.

However, if the firm wants to “signal” to the customer that their business is of marginal value to the firm, the outsourcing decision can be identified to the customer in advance. For example, a retailer may communicate to a marginal customer that their order is processed off-site to save costs. The assurance of quality in product performance needs to be maintained, but the customer can be informed that the outsourcing activity is motivated by a desire to cut costs. This type of outsourcing activity is common in the trucking and dry cleaning industry. Trucking companies will often outsource a small delivery to an independent trucker rather than constrain the ability to use its trucks on a more profitable delivery. As well, drycleaners will often outsource their service to other companies for infrequent cleaning orders on clothing items.

Previous research has stated that offering lower service levels to undesirable clients is an appropriate method of managing customers out of an organization (Zeithaml et al. 2001). This is very similar to a dating situation where one party wants to break up and slowly stops

calling in the hopes that the relationship will just fade away without a direct confrontation. This can be a very favorable tactic to use for an organization if the customer is not highly involved or attitudinally loyal to an organization. If a customer is highly invested in patronizing an organization and it slowly starts lowering its service, the customer will initially protest and complain about the lack of service. In this instance, both the customer and now the company are unhappy about the situation because the organization is still dealing with the nuisance of a dissatisfied client that they don't want to service while the customer is looking for resolution and justice to the lack of service being given. By letting highly loyal customers become slowly dissatisfied with a company, the potential for negative word of mouth increases tremendously. These customers not only feel as if they are being ignored but that the company has slowly become incompetent to satisfy their needs.

In some cases, an organization must take an active approach to firing unprofitable customers by directly communicating to the customer that it is no longer financially desirable to service this segment of customers. Due to the negative backlash of directly firing customers, an organization must put some forethought into finding a potential home for these displaced customers to avoid negative word of mouth. By providing an attractive alternative for the customer, an organization can soften the blow to the customer. No customer is going to be happy about being fired but if a company can provide an alternative that might actually dedicate more resources to servicing the customer, then ill feelings about the departure will be lessened. Though this direct method of “firing” customers can be blunt, some customers would rather know the relationship is no longer wanted than have to struggle through the frustration and dissatisfaction of a long goodbye.

## CONCLUSION

Numerous studies in the past have made claims that determining the lifetime value of the customer is the essential key for long term success. Determining who are valued customers is just one part of managing an organization's customer asset base. An organization must understand its clients' behaviors and choices in order to fully understand who are the "right" and "wrong" customers.

An equally important part to managing a customer asset base is the ability to determine what can be done to move customers to a more profitable state or to manage unprofitable customers out of an organization. The days of focusing on just loyal customers are gone. With the recent increases in diversification, few businesses purchase products and services exclusively from one organization. A company's "best" customer can also be the customer of your competitor. Loyalty, or the tenure a customer has with an organization, is an ineffective measure for the allocation of financial resources. Some consumers can be extremely loyal to an organization and at the same time be a financial burden for an organization to continually service.

This paper examined not only how to evaluate the lifetime value of a consumer, but also how to manage a company's asset base by discriminating and, if necessary, eliminating different types of customers. Using the innovation diffusion categories and the product life cycle, we have provided a framework for managers to understand which segments of consumers need time to be acclimated and evaluated to a product, along with which segments need more of a focus on discrimination and elimination.

The two stage approach proposed in this paper provides a more comprehensive perspective to customer asset management by providing the ability to decide both *how* and *when* to distinguish between different types of customers. At the beginning of a product's life

cycle, firms need to focus on acclimating customers to the product. As the product life cycle proceeds into the growth stage, an organization needs to take an active step in tracking and evaluating its customer base to determine who are its best customers. At the end of the growth stage, an organization should now be fully discriminating between its customer assets. If the maturity stage of a product is to be prolonged, an organization must actively manage its customers into the most profitable segments. As a product reaches the decline stage, the elimination of the wrong type of customers takes on an added emphasis in order to sustain the life of the product. Customers are truly assets of a firm and it is the responsibility of an organization to manage appreciating assets into more profitable categories, while at the same time disposing of assets that have no residual value anymore.

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