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## Abstract

This paper is divided into three parts. In the first part we explain what is meant by relationship marketing and the reasons why marketing is evolving from a transactional to a relational approach. In the second part we review certain criticisms brought against relationship marketing and the reasons why it often proves unsuccessful in certain contexts. This leads on to a discussion of whether relationship marketing is equally valid for every kind of company, every type of product or service, every customer, and every market. If the answer is “probably not”, we need to determine exactly who can benefit from it most. To do that we outline a detailed analysis of the eight stages of relationship marketing, namely: identify, inform and attract, sell, serve, satisfy, build loyalty, develop, and create a user community. We conclude with an account of an experiment in which this method was used to analyze two IESE cases: “Spainsko” and “Hewlett-Packard DesignJet Online”.

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## IS RELATIONSHIP MARKETING RIGHT FOR MY COMPANY?<sup>1</sup>

For several years now, since even before the Internet explosion, marketing has been evolving from a “transactional” approach to a “relational” one.

According to the (still current) official American Marketing Association definition, “marketing is the process of planning and executing the conception, pricing, promotion, and distribution of ideas, goods, and services to create exchanges that satisfy individual and organizational objectives” (Kotler, 2000).

Within this transactional approach, companies often seem to act according to a paradigm which could be characterized as follows:

- Neither the supplier nor the customer have any memory. Each time the supplier decides to sell something, the process starts from zero.
- The customer is anonymous, or almost anonymous. One hears statements such as “Last year, our airline carried X million passengers”, ignoring the fact that these anonymous “passengers” very often will be the same people.
- Every sale has to be profitable in its own right.
- If we lose a customer, there are plenty more potential customers in the market who will be easy to acquire.
- It is easier and cheaper to acquire a new customer than to retain and develop existing customers.
- Essentially, companies launch products onto the market and customers buy them. Companies talk and customers listen. Products and advertising messages are mass-produced and undifferentiated.

However, it has gradually become apparent that this transactional approach is incapable of responding satisfactorily to the problems facing marketers today. At the same time, new possibilities have emerged, especially in the field of IT and telecommunications, opening horizons for a new type of marketing: relationship marketing.

Although the literature tends to credit Berry (1983) with having first introduced the concept of relationship marketing, the most widely accepted definition is probably the one proposed by

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<sup>1</sup> Article accepted for publication in the *Harvard Deusto Business Review*, no 111, November-December 2002.

Grönroos (1997): from a relationship perspective, “marketing is the process of identifying and establishing, maintaining, enhancing, and when necessary terminating relationships with customers and other stakeholders, at a profit, so that the objectives of all parties involved are met”. Ideally, these relationships will be long-term, interactive and value-generating.

So what’s new about relationship marketing?

Conceptually, possibly not a great deal, because as Sheth and Parvatiyar (1995) shrewdly point out, “it amounts to a revival of preindustrial business practices”.

That is to say, relationship marketing is what small traders have always done: serving customers face to face. But that is something most large companies stopped doing with the advent of the industrial era and mass marketing. Now, thanks to telecommunications systems, it is once again possible to conduct personalized relationships on a mass scale, on an ongoing basis, and across geographies. In other words, a company can aspire to offer personalized service to thousands of customers anywhere in the world, anytime.

Another important precursor of relationship marketing in the pre-Internet era was direct marketing, defined by the Direct Marketing Association as “an interactive marketing system that uses one or more advertising media to effect a measurable response or transaction at any location” (Stone, 1988). Yet, though conceptually overlapping in important respects, the two concepts do not fully coincide, as a direct marketing action may perfectly well be transactional, that is, a “one-shot” action.

## What are the defining characteristics of relationship marketing?

The main characteristics of relationship marketing are:

- *Interactivity.* The customer takes the initiative in making contact with the company, receiving and issuing communications, and initiating transactions.
- *Actions are addressable and, therefore, personalized.* Companies can address different messages and offer different products or services to different customers: precisely the product or service that best meets each individual customer’s needs and circumstances (see, for example, Peppers and Rogers, 1993).
- *Memory.* Each customer’s identity, data, characteristics and preferences, and details of previous interactions with that customer, are recorded in memory.
- *Receptivity.* Companies must talk less and listen more. And they must let the customer decide whether she wishes to maintain a relationship with the company or not, how the two will communicate with one another, and whether she wishes to continue the relationship or terminate it.
- *Customer orientation.* The emphasis is on a marketing and sales organization made up more of customer managers than of product managers. The company must concentrate more on consumers, their needs, and the processes it uses to satisfy those needs.
- The emphasis is on “customer share” rather than “market share”.

- The company must be willing to treat its most valued customers differentially. This requires sophisticated customer segmentation and classification, with different action plans for different types of customers.
- One of the main criteria for discriminating between customers is *customer lifetime value*, that is, the estimated value that each customer has for the company over the course of the customer's entire estimated useful life.
- And, obviously, relationship marketing does not apply only to B2C (business-to-consumer) situations, but also, and perhaps even more importantly, to B2B (business-to-business) relationships. And it applies as much or more to the marketing of services as to the marketing of tangible products.

## Why is relationship marketing becoming increasingly important?

- Because in today's context of hypercompetition, companies have found that it can cost up to five times more to identify and recruit a new customer than it does to keep an existing customer satisfied and loyal.
- Because products are becoming increasingly undifferentiable, so companies are tending to differentiate themselves more through the service that accompanies the product and the treatment the customer receives.
- Because the number of potential customers is limited, and in some cases even decreasing, partly as a result of widespread mergers and acquisitions. In Spain, six large banks have become two, as the acronyms BBVA and BSCH indicate.
- Because we can calculate the value of a satisfied customer over the course of the customer's useful life by multiplying her expected annual profitability by the number of years we expect her to remain a customer. This means we can invest in customer acquisition, because the investment can be depreciated over several years, or at least beyond the economic outcome of the initial transaction. And a base of satisfied customers has a measurable value.
- Because the value and profitability of a satisfied customer often increases with time, for several reasons: because the customer buys more of the same product; because she buys more products (cross-selling); because she buys more high-end, higher-margin products (up-selling); because certain costs of serving the customer decrease; because the customer may recommend our company to family and friends by word of mouth, etc.
- Consequently, as Reichheld (1996) pointed out in his book *The Loyalty Effect*, relatively small increases in customer loyalty may generate large improvements in the bottom line.

Diller (2000) sums it up in his proposed six principles of relationship marketing, the “6 I's”:

*Information*, based on building a reliable customer database;

*Invest* in the best customers;

*Individualize* or personalize offers and communications;

*Interact* systematically with customers;

*Integrate* or incorporate customers in the value creation process; and

*Intend* to create a unique and different relationship with each customer, one that differentiates the company from its competitors.

## Is relationship marketing all wine and roses?

No, it isn't. All that glitters is not gold. And not every company that tries to make relationship marketing work for it is successful.

Relationship marketing is very interesting and attractive in theory. In practice, however, it is prone to difficulties, or even rejection.

As Richard Tomkins recently reminded us in the *Financial Times*, two of the largest British supermarket chains (Asda and Safeway) chose to cancel their relationship marketing programs. Apparently, they came to the conclusion that the costs of operating such a program (which in the case of Safeway was around 60 million pounds a year) outweighed the benefits. Tomkins points out that when Safeway, instead, spent those 60 million pounds on attractive price promotions and other marketing actions aimed more directly at boosting customer satisfaction, it quickly saw an increase in sales and market share.

Fournier, Dobscha and Mick published an article in the January-February 1998 issue of the *Harvard Business Review*, significantly entitled "Preventing the premature death of relationship marketing". In this article they warned of the failures or mistakes some companies have made in applying the principles of relationship marketing. The mistakes were made because any given consumer is willing to maintain only a limited number of relationships; because companies often act unilaterally, thinking only of their own interests; and because, in practice, the relationships often are not friendly and cooperative but distrustful and hostile.

Similarly, in the February 2002 issue of the same magazine, Rigby, Reichheld and Schefter pointed to four reasons why so many relationship marketing projects fail:

1. Because companies try to start a relationship marketing strategy before they have even designed a customer strategy.
2. Because they start a relationship marketing strategy without sufficiently taking into account the changes they must make to their own organization.
3. Because they think that the more technology they use, the better. Or worse still, because they confuse the task of designing and implementing a relationship marketing strategy with the purchase of a particular piece of CRM software.
4. Because some companies badger, pester and browbeat their customers, instead of informing, attracting, convincing and delighting them.

For his part, James R. Rosenfield, writing in *Direct Marketing* magazine in May 1999, counted off the "nine big mistakes" companies make in their relationship marketing efforts:

1. Taking it for granted that customers want a relationship.
2. Taking it for granted that customers are willing to do part of the work and make life difficult for themselves.
3. Taking it for granted that customers will be fair and reasonable.
4. Confusing satisfaction with loyalty.
5. Creating too many customer categories (normal, good, extra good...).
6. Instilling a “pariah” complex in normal customers, or creating problems when a customer is “demoted” from a higher category with greater privileges to a lower category with less favorable treatment.
7. Changing the rules of the game when the program is already in place.
8. Giving prizes or rewards when customers behave in a particular way, even though many of them may well have behaved that way anyway, without any incentive or reward.
9. Confusing captive customers (who reluctantly keep on buying from the company because they have no choice) with “loyal” customers (who buy from the company because they are satisfied with it and stay with it despite having other options).

All this suggests we should exercise caution with regard to relational marketing strategies and their supposed universal applicability.

However, being cautious should not mean doing nothing, because, on the other hand, there is no denying that many companies have achieved excellent, even brilliant, results using well designed and well executed relationship marketing strategies.

A sensible way to start would be to ask whether the concept and practice of relationship marketing is suitable for all kinds of companies. Is relationship marketing “good” for all companies? Or is it only to be recommended to some?

In the rest of this article we shall try to answer this question.

## **Is relationship marketing useful for any company selling any product or service to any type of customer in any market?**

From an economic point of view, adopting a relationship marketing strategy and implementing relationship marketing programs will be an attractive option only if the benefits outweigh the costs.

But the benefits and costs are not easy to calculate.

At first sight, it ought to be possible to calculate a customer’s lifetime value. We could say that a customer’s lifetime value is the net present value of all the customers’ purchases each year, less the cost of the products or services purchased (cost of service), throughout the customer’s useful life. Then, from the net present value of the contributions made by a given customer over N years we must deduct the cost of acquiring the customer in year zero.

And if we can calculate the net present value of one customer, we can calculate the net present value of a portfolio of customers.

Yet this formula does not tell us the whole truth. Without aiming to cover all the possibilities, we can state at least six reasons why the formula just mentioned does not reflect the whole truth:

1. Because it does not take overhead costs into account. Often, a relationship marketing strategy requires major changes to the company's organization and operational structure. In particular, it may require substantial investments and expenditures in human resources, computer software and hardware, and marketing to communicate and execute the strategy.
2. Because designing and implementing a relationship marketing strategy necessarily involves carrying out a certain number of programs over the course of the year to help stimulate sales, retain customers, etc.
3. Because, according to the basic premises of relationship marketing, the sales revenue a customer generates and the costs the company incurs in serving that customer tend to vary over time. Often there will be cross-selling and up-selling. This can make it very difficult to predict the value of a customer's purchases in a given year in the future. Amazon, for example, started out selling books, but now sells books, CDs, DVDs, cameras, magazine subscriptions, etc.
4. Because certain advantages or benefits of a relationship marketing strategy may be difficult to measure or clearly attribute to that strategy. Improvements in the company's image, for example, or in its products. Or the word-of-mouth generated by satisfied customers.
5. Because the above formula should be amended to take account of the fact that different customer segments often receive different treatment, with different costs (both direct costs and investment and fixed costs). An example would be the "VIP" rooms at airports.
6. Because as markets and competitors change, so too do consumer buying habits.
7. And lastly because when a company is trying to decide whether to design and implement a relationship marketing strategy, the specific content of the programs to be carried out in the future is most likely still undecided. That makes it very risky to predict possible benefits.

So how can I decide whether a relationship marketing strategy is right for my company?

## **The eight stages of relationship marketing**

My proposal is that a company that wishes to decide whether or not to design and implement a relationship marketing program should organize its thoughts around the eight stages of the design and implementation process.

For each stage, management must try to decide:



- a. What are the processes to be carried out at this stage? What operational difficulties do they involve? And what is the likely cost?
- b. What benefits or results can the company expect to achieve?
- c. Lastly, to what extent does each stage make the company better or worse suited to adopt a relationship marketing strategy? What qualitative and quantitative reasons are there for adopting such a strategy? And what sources of differentiation or sustainable advantage may the company generate by implementing a relationship marketing program?

For example, the company's managers may try to evaluate each stage of the process on a scale from 0 to 10, according to how easy and beneficial (or how difficult and fruitless) implementing that stage is likely to be for the company.

The eight stages of a relationship marketing process to be considered and evaluated are:

### **Stage 1: Identify**

At this stage, the aim is to assess how easy or difficult it will be to identify the universe of customers who would be the target of a relationship marketing strategy.

The assessment will be positive if the company has already clearly identified the target customers. For a company in the pharmaceutical industry, for example, it may be relatively easy to find out the identifying details of all the pharmacies in Spain. For a retailer, it may be relatively easy to identify who its customers are. But it may be that some customers pay in cash and do not want to identify themselves, or do not want to apply for the customer card, or do not always carry it with them when shopping, etc.

Conversely, the score for this stage will be low in cases where it is difficult or even impossible to identify customers; or where doing so is complicated and costly for the company. In some cases, the company may have no other option than reactive customer identification, or self-identification. That is, it may be very difficult for the company to establish criteria for identifying a priori and proactively who its potential customers are; the only option may be to increase the company's visibility and that of its products, and wait for potential customers to identify themselves through requests for information or through purchases.

### **Stage 2: Inform and attract**

At this stage, the aim is to assess how easy or difficult it will be for the company to build awareness of itself and its products or services, and also how attractive its products are.

Often, a well established and well respected company may put this stage high on the scale if its products already have a substantial market share, even before launching a relationship marketing strategy. Presumably, this would have been the situation when Iberia launched its Iberia Plus loyalty program.

In other cases, the company may be in a situation where informing and attracting potential customers is difficult, expensive, and uncertain. In that case, this stage will be scored low.

### **Stage 3: Sell**

Here, the company must assess how easy or difficult it will be to turn an identified and aware potential customer into an actual customer; in other words, how easy or difficult it will be to close a first sale with that customer or customer segment. And then, how easy or difficult it will be to get that customer to sign up to a relationship marketing program.

Some companies offer customers the possibility of enrolling in the relationship marketing program for free.

Other times, apart from buying the company's products or services, the customer must also pay to join the relationship marketing program. American Express Membership Rewards is an example.

### **Stage 4: Serve**

Once a sale has been made, the company may find it easier or more difficult to serve that customer. For example, delivering a standard or mass-produced product that customers buy in a store and take home with them may be very easy. But customers will be more difficult to serve if they demand that the product be delivered to their homes.

In some cases, the product may have to be installed, or even adjusted and adapted to customers' particular needs. In other cases, ongoing service may be required, involving readjusting and rectifying the product.

The company should assess the ease or difficulty of serving customers after the first sale on a scale of 0 to 10.

### **Stage 5: Satisfy**

The aim at this stage is to assess how easy or difficult it will be for the company to keep its customers satisfied with the product or service they have bought. A customer's satisfaction usually depends on the degree to which the company succeeds in meeting, or even exceeding, the expectations the customer had at the time of purchase.

In some cases, companies are highly confident that their customers will be reasonably satisfied. An example might be companies selling upmarket cars or home appliances.

In other cases, however, the degree of customer satisfaction may be unpredictable, due to differences between customers, variability of the products or services sold, or uncontrollable outside influences. For example, a long plane journey may be a pleasure or a misery, depending on the passenger we happen to have sitting next to us.

Consequently, if a company is reasonably sure that a large proportion of customers will be satisfied with the product or service, it will give this stage a score close to 10. Otherwise, the score will be low.

### **Stage 6: Build loyalty**

At this stage, the company must assess its chances of turning satisfied customers into loyal customers.

In some industries, and in some companies, the fact that a customer is satisfied with a particular product or service does not necessarily mean she will repeat her purchase in the future. In some products, such as wines, consumers tend to show “polygamous loyalty”. In other words, they have a relatively long list of acceptable suppliers whose products they will buy, depending on circumstances, momentary fancy, special offers and promotions, etc. If that is the case, a company’s assessment of this stage will be lower the less likely customers are to be loyal and repeat their purchase, even if they were satisfied with their initial purchase.

In other products or services, loyalty may be greater, even close to 100%, if customers have discovered that a certain brand fully satisfies their needs. Some customers may adopt a “loyal purchase routine” whereby they invariably buy a certain brand or model. Apparently, this happens with razors and razor blades. In such cases, the score for this stage will be close to 10.

## **Stage 7: Develop**

At this stage, the aim is to assess the extent to which, once a company has sold a product or service to a customer and the customer is satisfied and loyal, the company is likely to find opportunities to extend and deepen its relationship with the customer.

A customer relationship may develop by various means or mechanisms:

- A customer may become more loyal by becoming less “disloyal”, that is, by buying other brands less frequently.
- Or she may buy larger quantities of the same product or service. For example, as a customer grows accustomed to using a credit card, she may start to make more credit card purchases, and so generate more fee income for the issuing bank.
- Or the customer may buy other products or services of the same company. This often happens in banking and insurance.
- The customer may start to buy higher-margin or higher value added products or services from the same company.
- In some industries, or in some companies, it may be possible to speed up the rate at which customers replace capital goods or consumer durables.

Insofar as a company sees major opportunities to develop its relationships with satisfied and loyal customers, this stage will receive a high score.

Conversely, in some industries or companies, it may be difficult to sell additional products or services even to highly satisfied and loyal customers. An example would be a restaurant or a traditional shoe shop. In that case, the score for this stage will be low.

## **Stage 8: Opportunities to create a user community**

Although this stage does not appear in Grönroos’s definition quoted earlier, authors such as McAlexander, Schouten and Koenig in the January 2002 issue of the *Journal of Marketing* have pointed out that some brands succeed in creating a user community for their products or services.

In a community, a web of relational ties between customers, the company, and its products and brands forms and grows stronger. Direct links between customers emerge and develop. Internet forums and chatrooms mushroom. User clubs or fan clubs appear, in which people exchange knowledge, ideas and experiences of the product or service. Older customers volunteer to teach and train new customers. Markets are created for secondhand products, or products complementary to the main product, etc.

One of the examples most commonly cited in the literature is the Harley-Davidson clubs. For the members of these clubs, the motorcycles and the “world of Harley Davidson” become a lifestyle, which they share with other users of the same brand.

Another example closer to home is that of the Lladró Privilege club, which grants certain privileges to members, such as first option on limited editions of the company’s porcelain figurines, a members’ magazine, preferential treatment on visits to the City of Porcelain, tickets for concerts, exhibitions and other cultural events, etc.

Any company that reaches this last stage –creating a user community for its products– is likely to enjoy the benefits of stronger loyalty, lower communication costs, etc. For all these reasons, a company that has succeeded in creating a user community should give this stage a high score.

Conversely, if, as is the case with most products and services, customers’ interest in and reasons for buying are purely functional, without any emotional or lifestyle attributes; and if the users of the product do not know one another and therefore are unlikely ever to form a community with the company, then the score for this stage will be close to zero.

## Final evaluation

If a company is wondering whether or not to design and implement a relationship marketing strategy, a good way to start would be to analyze each of the eight stages just described and evaluate them on a scale of 0 to 10.

If the sum of the eight scores is over 40 and approaching 80 (the maximum), the company can be confident that it will benefit from adopting a relationship marketing strategy.

Conversely, if the total is less than 40, the company may conclude that a relationship marketing strategy is unlikely to yield significant benefits in terms of turnover, margins or selling costs.

## A first experiment

In this paper we have presented a possible approach to analyzing the suitability and benefits of relationship marketing for a particular company.

It may be that the procedure will have to be expanded and improved in order to establish assessment criteria for each of the eight stages, so that the results are reasonably consistent for different companies, industries and circumstances.

In a recent seminar on relationship marketing taught at IESE, the author conducted a first experiment.

The seminar participants assessed the relationship marketing strategies of two very different companies by analyzing and discussing in class the “Spainsko” and “Hewlett-Packard DesignJet Online” cases<sup>2</sup>.

The “Spainsko” case describes the problems facing a family business that imports and sells a type of comfort shoe in Spain, using direct marketing methods.

The “Hewlett-Packard DesignJet Online” case describes the dilemmas surrounding the creation by HP of a new website, aimed at establishing a direct, permanent and interactive channel of communication between the marketing team at HP’s Barcelona Division and existing users of its large-format printers.

After discussing both cases in depth, the author asked the seminar participants to evaluate each of the eight stages of the relationship marketing programs carried out by these two companies on a scale of 0 to 10.

The results showed that the seminar participants were at least able to clearly discriminate the attractiveness of a relationship marketing strategy for these two companies: with regard to its situation, circumstances and opportunities for relationship marketing, Spainsko scored slightly above 20 points in total, while HP’s large-format printers received an average score close to 60.

In other words, after analyzing the two cases, the participants saw very clearly that relationship marketing was more likely to produce satisfactory results for HP DesignJet than for Spainsko.

We have a long way to go before we can say that we have a reliable method for determining how attractive a relationship marketing strategy may be for different companies. But the procedure described in this article may be a first step toward explaining why relationship marketing is not “right” for all companies, and also why a relationship marketing strategy may be more or less attractive to a company that is considering implementing one.

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<sup>2</sup> The full text of both cases may be obtained from IESE Publishing, <http://www.iese.com>, IESE, Avda. Pearson 21, 08034 Barcelona, tel.: 93 253 42 00.

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