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The Ways of Using CRM Systems; the Survey of Literature

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Summary

Although young science, marketing has passed through the row of changes since the start of its development. The 1990th of the last century brought big changes, firstly by the powerful penetration of information and communication technology. This trend has exerted influences on the development and application of marketing in both theory and practice. Thanks to the development and implementation of CRM systems, companies have had insight into the complete behavior of their customers, even in the situations where companies have a great number of different customers. However, many companies have not used these data in the right way. The work points to some of possible approaches in using data collected by means of CRM systems. Measuring the customer lifetime value, classification of the present customers, increasing customer retention rate, winning new “right” customers and the increase of product sale to the present customers are just some of activities exerting direct influence on companies’ business performance. Based on the survey of available literature, the work presents how to use the mentioned activities in the right way.

Keywords

CRM systems, customer lifetime value, classification of current customers, increasing customer retention rate, winning new right customers, product sales increase to current customers

1. Introduction

Many authors connect marketing development with the period of the 1950th, i.e. 1960th of the 20th century, as well with the famous Levitt’s (1960) sentence that the goal of marketing is to “create values for customers”. Since then, many changes have happened in the development of marketing theory, as well as in practice. Namely, there almost has been no decade without at least one important change in the observed scientific field.

According to Christopher, Payne and Ballantyne (1991), marketing began to develop in the 1950th of the last century, firstly in the field of consumer goods. Then, in the 1960th, industrial marketing began to develop. It was the reason why many authors at that time noticed that there were significant differences between product marketing intended for final consumers and product marketing intended for large business buyers. In the 1970th, the development of nonprofit organizations, which, before all, did not relate to the institutions having no profit as their primary goals, but to something else as preserving the human environment, welfare of the society, caring for people with special needs, etc. Then, service marketing followed, which developed in the 1980th of the 20th century, mostly thanks to differences in products and services, on the one side, and an increasing presence of the tertiary sector mostly in developed countries, on the other side. In the 1990th, the direction named relationship marketing developed with the idea that it was worthier to keep the current customers than constantly attract new ones, therefore, it was necessary to orient resources towards the customer retention rate.

However, the 1990th brought a big change that exerted great influence on marketing; it was the increasing powerful penetration of information and communication technology. Personal computers and the Internet connections were available to the great majority of the population enabling consumers a quick access to information. In addition, there appeared CRM systems enabling companies to collect data on their consumers, before all, on who, when, how and how many purchases they do. However, there is one a very logical question how to use all these data to improve companies’ business performance. The goal of this work is to answer this question based on the survey of the current professional literature. The rest of the work is structured in the following way. First, the ways of how to use the huge amount of information with a view of increasing the company’s performance are cited. Then, every of the cited ways is explained in detail and, at the end, concluding remarks are given.

2. Reasons for CRM Implementation

The basic goal of the companies to implement CRM systems and accept the logic of focusing to customers is business performance increase of the company in the form of profit increase and/or to increase the value of shares for stockholders. However, the question is how to attain the desired goal. There are several ways to answer these questions:

1. Measuring the customer lifetime value (CLV);
2. Current customer classification;
3. Consumer retention rate;
4. Winning new "right" customers;
5. Product sales increase to current customers.

3. Measuring the Customer Lifetime Value

There are many CLV definitions, but differences in defining are small. The survey of definitions of the most prominent authors is given in the following Table.

Table 1 CLV definitions

CLV definition
Current value of all the future profit generated by consumers (Gupta & Lehmann, 2003, pp. 9-24)
Customer lifetime value represents the direct, monetary customer value (Ryals, 2008, pp. 847- 864)
Net income or loss of the company from the customers' transactions with the company during thei lifetime (Roberts & Berger, 1989)
Sum of cumulative profit that the company makes in business with an individual consumer for their mutual relationship, discounted on the resent day (Kumar, Bharath, 2009, pp. 1-18).
Expected profit from customers without costs for customer management (Blattberg & Deighton, 1996, pp. 136-144)
Total discounted net profit that the customer generates in his lifetime (Bitran & Mondscheim, 1996, pp. 1364-1381).
Current net value of the flow contributing to profit, being the result of consumers' transactions and contacts with the company (Pearson,1996)
Current net value of the future flow of general costs and profit expected from customers (Jackson, 1994, pp. 9-17)
Current net value of all the future profit and costs expected from customers (Roberts & Berger, 1989)

Having in mind the previous definitions, we can conclude that CVL is considered to be the current value of all the future profits generated from the relationship of the customer with the firm. CLV is similar approach to the discounted money flow used in finance.

Namely, one of the challenges marketing faces is the lack of matrix for measuring the consequences of its activities. All the previously used matrices as market participation, consciousness or attitude of brand, amount of sale, even profit proved to be insufficiently well (Gupta et al, 2006, p. 140). The cited represents a big challenge for the role of marketing in companies, especially if we take into consideration Kaplan and Norton's motto (1993) "if you cannot measure something, you cannot manage it". The essence of the problem is that if some marketing decision is made, its consequences relate to the future, in both the short-term and the long-term period, and none of used marketing matrices can cover both periods. If this problem is solved, the presented CLV matrix has, among other things, a goal to connect marketing activities with business results of the company. Thanks to the development of CRM systems, it is possible today to measure CRV of customers, even when there are hundreds of thousands, even millions of customers.

4. Qualification of the Current Customers

As already cited in Introduction, it is not worthwhile for the companies to create the long-term relationships with all consumers. Research showed (Kale, 2004) that in some cases 3% of consumers yielded even 90% of profit, while the of 97% of consumers yielded small profit; it only covered the costs of company's business or inflicts losses. For example, the FedEx Company has divided its consumers into three groups: the good, the bad and the ugly based exclusively on their profitability. Different strategy is created for every of the cited groups. The high quality of service is rendered to the good, the bad are encouraged to join the good group, and the ugly are discouraged to continue business with the company.

The US sixth largest company, First Union "colors" the page on the computer for their customers dependent on their profitability. Green belongs to the customers being the most profitable and they get the best service, the "red" customers inflict losses to the bank and, therefore, they have no right to services, or services are paid.

The cited companies, as many others (as US West, GE Capital, and Bank of America) understand that it is not profitable to render services to all the customers. Many customers are too expensive to be attracted or they have small potential to be profitable in the future. Although banks want to render good services to all the customers, many of them understand that it is impossible and not profitable to fulfill all consumers' expectations.

All the cited has contributed to the development of the so-called "customer pyramid" (Rust, Zeithaml, & Lemon, 2000). According to this approach, companies can divide and label their customers into four tiers: Platinum, Gold, Iron and Lead (**Illustration 1**).

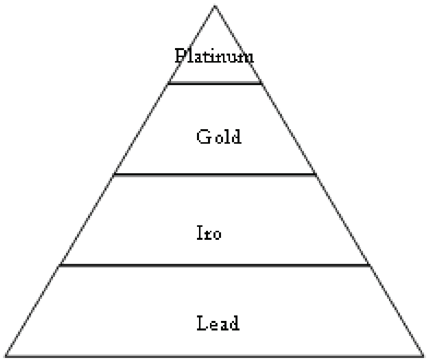

Illustration 1 Customer Pyramid
Source: Rust, Zeithaml, & Lemon, 2000.

Customers are classified into tiers according to their behavior:

1. Platinum tier. The most profitable customers belong to this tier. These people are very loyal; frequency of their purchase is high, as well as the quantity of bought products. They are not sensitive to the price and are willing to try the company's new products.
2. Gold tier. The difference between this group of customers and the previous one is on the level of profitability. Namely, these customers purchase regularly, but they are much more sensible to the price and are inclined to purchase goods with fewer margins. In addition, this group likes to wait for the company to reduce prices. Besides, these consumers are very loyal and like to purchase these products from different suppliers.
3. Iron tier. Consumers not loyal are classified into this group, do not spend much and they are not very profitable for the company. Observed statistically, most consumers belong to this tier, and profit from the company's standpoint is that they cover significant part of the company's fixed costs.
4. Lead tier. Consumers belonging to this tier cause losses, i.e. their CLV is negative. In addition, these customers are often problematic because they do not only cause losses but they spread bad rumors about the company. Very often, it is worthier to eliminate such consumers than try to satisfy their needs.

One of the conditions without which it is impossible classify consumers into the cited tiers is to have CRM systems. Namely, to divide customers according to the tiers, it is necessary to have exact information on incomes and costs for every customer individually. Incomes are measures by filing every transaction with the customer, filing the goods he purchases, how much and where. Based on these data, it is possible to calculate the exact income being realized. On the other side, cost calculation can represent the challenge, before all, for the allocation of fixed costs. According to some authors (Ryals, 2009), there are three kinds of costs, which can be connected to every customer:

1. Product costs in production;
2. Service costs (marketing, sales, administration, etc);
3. Fixed costs connected with customers (storing, logistics, service teams, etc.).

To understand easier the cited division of costs, it is necessary to comprehend that the profitability of consumers depend on marketing activities, sales, and services connected with products, not only from production of these products. Production costs record reductions trends because of an increasing frequency of moving the plants from developed countries to developing countries, while the other cited costs record growth in the total structure because of increasing role of after selling services and packets of products and services offered to customers.

5. Increasing the Customer Retention Rate

The length of business relationships with customers mostly define the customer lifetime. The longer this relationship, the longer customer lifetime is. It contributes to profitability increase. In addition, the longer this relationship, the fewer costs and the bigger volume of purchase are. The cited says that it is far more profitable invest resources in increasing the consumer retention rate than to orient toward transactions and attracting new consumers. There are several essential reasons to confirm it (Villanueva & Hanssens, 2007):

1. It is cheaper to retain current customers than winning new ones;
2. Service costs of long-term customers are lower than the costs to serve new customers;
3. Existing customers contribute the increase of the company's reputation and attract new customers by widening the so-called word of mouth;

4. Long-term customers are less sensible to price changes and are ready to pay higher price for products;
5. Long-term customers more often purchase bigger amount of products so it is possible to improve business by offering product assortment, which the current customers have not yet bought (cross purchase).

Some empirical researches have proved the cited advantages of investments in customer retention. Thus, for instance, Gupta, Lehmann and Stuart (2004) have proved that it is far worthier to increase the consumer retention rate for 1% than to increase the rate of attracting new customers or reduce the margin and increase the discount rate (Gupta et al. 2006). This is based on public available data from five large companies (Amazon, Ameritrade, Capital One, eBay and E*Trade).

Companies	Percent increase of customer value during improvement of 1%			
	Retention rate	Attraction rate	Margins	Discount rate
Amazon	2.45	0.07	1.07	0.46
Ameritrade	6.75	0.03	1.03	1.17
Capital One	5.12	0.32	1.32	1.11
eBay	3.42	0.08	1.08	0.63
E*Trade	6.67	0.02	1.02	1.14

Illustration 2 Profitability of investments per consumer retention rate, consumer attraction rate, margin reduction and discount rate
Source: Gupta, Lehmann, & Stuart, 2004.

As Table 1 illustrates, the increase of the consumer retention rate exerts the strongest influence on increasing the customer value base, which is in a direct correlation with the aggregate profitability of the company. Some other researches (Reichheld & Sasser Jr, 1990) have shown that companies can increase profit for 100% by increasing the retention rate for 5%. Therefore, one American company doing business on credit card market MBNA, created the complete business strategy focusing on the maximization of the customer retention rate.

In spite of the cited, some authors (Reinartz & Kumar, 2002) think that the length of relationships with customers need not lead to profitability increase. Namely, the study, based on over 1.600 respondents in three different industries, shows that the length of relationships with customers does not exert positive influence on the company's profitability increase. After all the cited, there appears a question of who is right and if there is any connection between the consumer retention rate and the company's profitability. The answer to this question is Yes, but not in the way on which most companies have worked. Managers and researchers have made the mistake measuring the aggregate consumer retention rate. Although the previously cited that not all the customers were equally profitable, it is clear now that the customer retention rate on the company's level need not exert positive influence on profitability. The solution could be in measuring the customer retention rate for every individual case. Managers of the company could improve the company's performance by investing resources of the company in increasing the customer retention rate at the highest tiers of the customer pyramid (Ryals, 2005), that is the Platinum and Gold tiers. On the other side, the negative rate of customer retention of the lowest tier (Lead) could have a positive effect on the company's business result.

One more interesting thing of the CRM rate and consumer retention rate relates to costs. Namely, although it was considered that CRM systems exerted positive influence on cost reduction, the newest researches (Krasnikov, Jayachandran, & Kumar, 2009) have shown that they increase business costs, but, at the same time, they also increase the company's profitability. Authors of this research interpreted cost increase by offering personalized products, and it, as a rule, caused cost rise. On the other side, the personalized offer brings to the increase of consumer satisfaction. Therefore, they are ready to pay more for such an offer. Thus, it has a progressive profit growth in relation to the rise of costs. Based on the cited, we can conclude that the implementation of CRM systems makes sense if the company decides to create the value for its customers, but not when the company's strategy is based on low business costs and targeting on the "low-costs hunter".

6. Winning the New, "Right" Customers

In spite of the fact that it is worth investing in customer retention, there are some situations when the cited strategy is not justified. On markets, where the customer retention rate is naturally low, it is more profitable to invest in winning new customers. In addition, on markets, where the cycle of purchasing is extremely long, investments in the customer retention rate make no sense. Let us take a real estate agency, as an example. It would be nonsense for them to invest resources in retaining current customers because the chances are small that the observed customers will make decision to purchase again. However, it does not mean that companies penetrating these markets should not take care about their customers' satisfaction. In case, customers are not satisfied, the bad rumor would mostly make attracting new customers difficult, and conversely. It is possible to attract number of new customers by their good impression and spreading the good rumor on the company. There are several situations when it is worth investing resources in attracting new customers (Villeneuve & Hanssens, 2007):

1. Costs of transfer are high. On markets where there are high costs of transfer, significant investments and winning new customers happen. It happens because the change of suppliers requires additional costs for customers; therefore, the customer retention rate is high in these situations.
2. Low transfer costs and non-differentiated products. When there are no costs of transfer and products are non-differentiated, it is very easy to 'kidnap' customers from competition, even with small price discount. This group of products includes products of mass production as newspapers, sugar production, water, oil, etc. The strategy of creating relationships with customer for this group of products would be wrong because customers are not so willing to create long-term relationships with producers of toilet papers or even noncarbonated water.
3. The beginning phase of the product life cycle. When on market, new products have not their customers; therefore, it is impossible in these situations to invest the company's resources in retaining the current customers. Thus, in such situations, the whole company's budget is invested in winning new customers, mostly targeting innovators (Rogers, 1962). When the company succeed in attracting new customers, it is necessary to make decision, which parts of the budget to invest in attracting new customers and for retaining the current ones.
4. Products purchased regularly. For some products, the cycle of purchasing is very long, therefore it is not profitable to create relationships with customers and the budget is used to attract new customers.
5. Access to new markets. Companies that already joined new markets have not their base of customers; therefore, it is necessary to invest in order to attract customers from their competitors. An example for it can be access of the third mobile operator on the market of Serbia (VIP Mobile) which tries by its promotion campaign to win a great number of customers.

Attracting new customers had been considered before the CRM systems appeared. The development of information technology enabled targeting real customers.

It resulted in significant reduction of costs for attracting customers

Table 2 The application of an analytical CRM

	with CRM	**without CRM**
Number of sent catalogues	1000	5000
Mail costs	3000 GBP	15000 GBP
Number of new customers in 1998	65	45
Percent of won customers	6.5%	0.09%
Sale per new customer	180 GBP	120 GBP
Profit from product sale to new customers	11700 GBP	5400 GBP
Costs of winning new customers per customer	46.15 GBP	333.33 GBP
Average sale from 1998 to 2001.	7500 GBP	2200 GBP
Average margin	3000 GBP	880 GBP
Percent of won customers in 1998 being still active in 2001.	80%	30%

Example of the British company 'UK Business Direct'
Source: Buttler, 2004.

It is possible to reduce costs of winning new customers by several ways. Let us take, as an example, a typical campaign where direct marketing is used as the way of communication with customers. As a rule, it has six steps. The first step presents determining the basic set with which the company would communicate. Then, the second step follows where a fewer pattern is taken from the basic set to send offers. The third step means measuring the number of customers with whom the company communicated and who positively answered the offer. The fourth step defines the characteristics of customers who positively answered on consumers' habits, demographic characteristics, geographic characteristics, life style, sex, education and similar. In the fifth step, the characteristics of customers from the basic set are compared with the characteristics of customers who positively answered the offer. At the end, the company sends the offer only to those customers whose characteristics mostly match the characteristics of customers who answered the company's offer.

What is the problem here? Some researchers have shown (Cao & Gruca, 2005) that in these situations, the companies often attract "unwanted" customers; therefore, it happens that after attracting new customers, part of the same companies must dissuade them from getting the status of consumers. Development of CRM systems has enabled the company to use two criteria during contacting potential customers: chances to answer and potential profitability.

However, we wonder why companies do not use only the second criterion, the degree of profitability, as a filter to select customers. The answer is very simple. The same research has shown that the most profitable customers often have a number of offers, thus it is more difficult to attract them than other customers. If the company does not use the first criterion, the winning of new customers will be very expensive. A small number of contacted customers would answer the offer.

7. Increasing Sales from Existing Customers

As already cited, some research has shown (Villanueva & Hanssens, 2007) that customers with whom business is done for long are inclined to purchase more products than the current customers do. The cited process is known as additional sale and is based on increased sale because of the following effects:

1. Cross selling is the practice of selling those products among existing buyers, which they have not bought yet. Take, for instance, the company dealing with computers and equipment sales. Suppose Company A is the buyer in the observed company and it purchases about 20 computers per year. Cross selling in this case would mean that the seller offers Company A printers and scanners.
2. The above sale represents the sale of the same or similar products, which have higher individual value or higher margin rate. On the previous example, it would mean that the company offers to its existing customer some other type of computers having better performances and, of course, the higher price.
3. The sale of number of products is the attempt to sell to the existing customers of the same products but in bigger amount. Say, the seller of computers tries to sell 30 computers per year to Company A.

Additional sales are one of the most essential factors to maximize the customer lifetime, i.e. to improve the company's total business. In addition, one company succeeded to increase the lifetime value of its customers for 40% offering six different products to the current customers, which they had not bought earlier. Additional sales can appear as a natural process (satisfied customer will buy bigger amount of products or more different products). However, the companies with diversified production program mostly carry out the strategy to stimulate customers to purchase bigger amount and different products as much as possible.

8. Conclusion

It is known that every big change can bring opportunities and danger. The 1990th enabled companies to collect a large number of data on customers, even in the situations when the number of customers was extremely big. Many companies did not know how to use data efficiently, therefore there were cases when the decisions they made caused more damage than benefit. The work represents some ways based on which it is possible to use data collected on customers. They are customer lifetime value, classification of the existing customers, increase of the customer retention rate, winning the new, "real" customers and the increase of product sales to the existing customers. Research has shown that companies, if they use one or more products of these activities in the right way can significantly improve their business performances. To many companies, today's business without using CRM systems looks impossible because the complete business process lead to some of the cited activities.

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