

## OPTIMIZING CRM: A FRAMEWORK FOR ENHANCING PROFITABILITY AND INCREASING LIFETIME VALUE OF CUSTOMERS

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*A research model is presented which provides a framework for Customer Relationship Management (CRM) wherein the lifetime value (LTV) of customers is increased while enhancing ongoing profitability. Five propositions were developed suggesting how organizations may increase the probability of enhancing profitability and building long-term relationships. The customer centric propositions for enhancing lifetime value address provisions for better service information, tracking and managing the value of customers, having more information about their behavior, and having highly positive experiences with them.*

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### INTRODUCTION

Customer Relationship Management (CRM) is emerging as a core marketing activity. That emergence has been stimulated by studies that have shown that on average businesses spend six times more to acquire new customers than they do to keep them (Reichheld 1996; Gruen 1997). Responding to that type of information, many organizations have begun to pay increased attention to maintaining or even developing enhanced relationships with existing customers (Krasnikov, Jayachandran and Kumar 2009; Jayachandran et al. 2005). At the same time businesses must also try to attract new customers that are or which have the potential to become profitable in days to come (Homberg, Steiner and Totzek 2009; Thakur and Summey 2005). Retaining existing customers and building relationships with new customers can be made possible in today's competitive business environment by providing excellent customer service and care. But, how should that be accomplished?

Business managers probably know intuitively that providing quality customer care is essential if they are to achieve revenue growth, whether it is by attracting new customers or retaining

existing ones. The main idea that this article seeks to add to the initiatives underlying customer relationship management is the concept of using those processes to shape and enhance customers' perceptions of the organization and its products in a controlled and directed manner. That outcome can be achieved through knowledge gained by identifying customers, creating knowledge data bases about those customers, and using that information as a foundation for building committed customer relationships (Thakur and Summey 2005; Ragin and Greco 2003). The goal of customer relationship management then becomes the enhancement of the company's long-term sustainable competitive advantage and the achievement of superior revenue and profit growth through shaping and enhancing customers' perceptions of the benefits of being one's customer (e.g., Kumar and Shah 2009; Jayachandran and Kumar 2009; Fornell et al. 2006; Anderson, Fornell and Mazvancheryl 2004).

Before explaining how customer relationship management provides the basis for determining how to enhance the lifetime value (LTV) of a customer and sustain one's competitive advantage, let us define the two terms customer relationship management and lifetime value. Bolton (1998) defined customer relationship management as, "a strategy used to learn more

about customers' needs and behaviors in order to develop stronger relationships with the customers." The lifetime value of a customer represents the amount the customer will contribute to the bottom line of the organization over the span of the business relationship with them (Kumar and Shah 2009; Shaw 2001). In other words, the lifetime value of a customer is the value of the customer over the lifecycle of the relationship.

Relationship management requires that an organization view customer relationships as a means for learning about customers' needs and wants and how best to create, satisfy, and sustain those while concomitantly helping the organization to meet its revenue objectives and build long-lasting relationships (Thakur, Summey and Balasubramanian 2006; Ragin and Greco 2003; Bauer, Grether and Leach 2002). As a process, it should be geared toward increasing the value of customers over the lifetime of the relationship. Achieving that outcome requires systematic processes for attracting and retaining customers, prospects, business partners, and other constituents. It requires a core business strategy for managing and subsequently optimizing all customer interactions (Sowalskie 2001). If a firm manages its customer relationships better than its competitors, it can not only succeed at retaining existing customers, but also attract new customers as well (Thakur and Summey 2005). Simply stated, Customer Relationship Management is about systematically identifying, acquiring, and retaining profitable as well as potentially profitable customers.

One aspect of this more aggressive approach to customer relationship management is the provision of a more personal interface. An organization can give that personal touch to its customers through knowing their purchase behavior over time and by recognizing when that behavior is changing. The goal of personal touch is simple in concept, i.e., learn and understand what the customer really wants and needs and then insure that in responding, the customer gets the same look, feel, and message across every medium of contact with them. By

observing customers' buying patterns, contact history, and life events, businesses can better understand and extrapolate trends in their behavior (Hollowell and Verma 2002) and subsequently have a higher probability of sustaining a long-term relationship.

Although some researchers have analyzed lifetime behavior in contractual contexts (Allenby et al., 1999; Bolton 1998), research on customer lifetime duration and in particular profitable lifetime duration is scarce (Reinartz and Kumar 2003). None of the research to date has examined or shown how customer relationship management provides a basis for shaping relationships in order to enhance the lifetime value of customers. To fill this gap in the literature the objective of this study is to examine how CRM can provide a basis for determining how to enhance the lifetime value of a customer.

This study is structured as follows. First, existing literature on customer relationship management and how it can provide a basis for creating committed customers and enhancing the lifetime value of a customer is briefly presented. A theoretical model for examining how CRM relates to the lifetime value of the customer is presented with a goal of delimiting the elements contributing to shaping relationships and subsequently enhancing that value. Propositions are developed, and suggestions for future research are presented that are derived from the propositions.

## LITERATURE REVIEW

Ever since the influential study by Reichheld and Sasser (1990) showing the large impact on profitability of small increases in customer retention rates, the marketing community has been more conscious of the need to manage customer relationships in the long-term (Wilson, Daniel and McDonald 2002). The argument has been further strengthened by data on the low cost of better retention as compared with better acquisition (Blattberg and Deighton 1996; Filiatrault and Lapierre 1997), and the increasing profitability of customers the longer

a relationship lasts (Reichheld 1996). Companies that engage in CRM should stress building long-term relationships with their customers by knowing their needs and wants and by keeping them more satisfied than their competitors.

Customer relationship management (CRM), as a business strategy, should aim to understand, anticipate, and manage the needs of an organization's current and potential customers. It is a journey of shifting strategy processes and organizational as well as technical changes whereby a company seeks to better manage its own enterprise around customer behaviors (Lawrence and Francis 2002). It entails acquiring and deploying knowledge about one's customers and using that information across the various touch points to optimize the balance between revenue, profits, and maximum customer satisfaction.

To make the relationship between customers and organizations work, some marketers have adopted customer management orientations that emphasize the importance of customer lifetime analysis and retention, and the understanding the dynamic nature of each person's customer firm relationship over time (Kotler 1994).

The underpinning of CRM is that it helps businesses use technology and human resources to gain insight into the behavior of customers and to enhance the value of those customers. Using CRM processes a business can: (1) provide better customer service, (2) help sales staff close deals faster, (3) cross-sell products more effectively, (4) simplify marketing and sales processes, (5) discover new customers, (6) make call centers more efficient, and (7) increase customer revenues.

CRM involves the management of customer relations at every point of contact between the customer and the company in order to maximize the customer experience. It aims to provide product or service information that has unique value to a customer based on information about that individual customer. It is thus about maximizing customer value for

the firm by creating, building, and lengthening the customer relationship with a view to selling more of what they currently purchase, cross-selling of other products, and keeping customers longer. It is all about building customer bonds by creating dialogs to discover what consumer's needs and wants are and how the firm can be of service.

Reichheld (1996) and Gupta, Lehman and Stuart (2004) found that lifting customer retention rates by 5 percent could increase an organization's profit by 2 percent to 9 percent, a result that was mostly attributable to acquisition cost. In the beginning many customers are unprofitable. Only in later years when volume purchased has increased do some customers become profitable (Lawrence and Francis 2002). Thus, customers should not be viewed from the perspective of a single transaction, but as a potential lifetime income stream (Lawrence and Francis 2002). The customer life cycle definition of CRM often describes CRM as the ability to seamlessly interact with or market to the customer across a full lifetime (Kellen and Stefanczyk 2002).

Declines in growth rates and intensification of competition have motivated businesses to reduce costs and improve their effectiveness including enhanced maintenance of long-term relationships with existing customers. Studies have shown that while manufacturing costs declined from 5 percent to 3 percent and management cost declined from 2 percent to 1 percent, marketing costs increased from 2 percent to 5 percent (Sheth and Parvatiyar 1995). The practice of relationship marketing through CRM has the potential to improve marketing productivity through improved marketing efficiencies and effectiveness (see Sheth and Parvatiyar 1995).

This research proposes a model for enhancing the lifetime value of a customer. Most current models of customer equity, customer retention, and profitability in the marketing discipline have not incorporated the lifetime value of the customer for an organization. While the customer equity model of Lemon, Rust and

Zeithmal (2001) did incorporate a concept they called “life-term” value of the firm, it did not incorporate how the CRM concept enhanced the lifetime value of the customer. For example, Lemon, Rust and Zeithmal (2001) examined the drivers of customer equity in their model and concluded by saying that customer equity was the most important determinant of the long-term value of the firm, but they did not incorporate how the CRM concept enhanced the lifetime value of customers for an organization.

Bolton (1998) examined the effects of satisfaction on customer retention, but he did not incorporate the concept of how to enhance the lifetime value of a customer. Similarly, Rust, Zahorik and Keiningham (1995) examined the effects of service quality and satisfaction on customer retention rates, but they did not incorporate the lifetime value concept. This study seeks to fill this void in the literature.

### A THEORETICAL CRM MODEL

Traditional decision models in the marketing discipline have assumed that both past and present-focused measures (such as overall satisfaction or perceived value) capture all aspects of the customer’s underlying utilities that factor into a decision (Lemon, White and Winer 2002). But none of the models in the marketing discipline has examined how to enhance the lifetime value (LTV) of a customer from the practitioner’s perspective (Thakur and Summey 2003). Research by Lemon et al. (2001) did find that customer equity was the most important determinant of life-time value for firm, but they did not explain how to enhance that lifetime value.

The focus of this article is on the additional explanatory power that the future-oriented factors in the model in Figure 1 contribute to knowledge of how to enhance the lifetime value of the customer for an organization. We do not purport that the model examines all the factors which may be of help in enhancing the lifetime value of a customer. Rather, the model makes

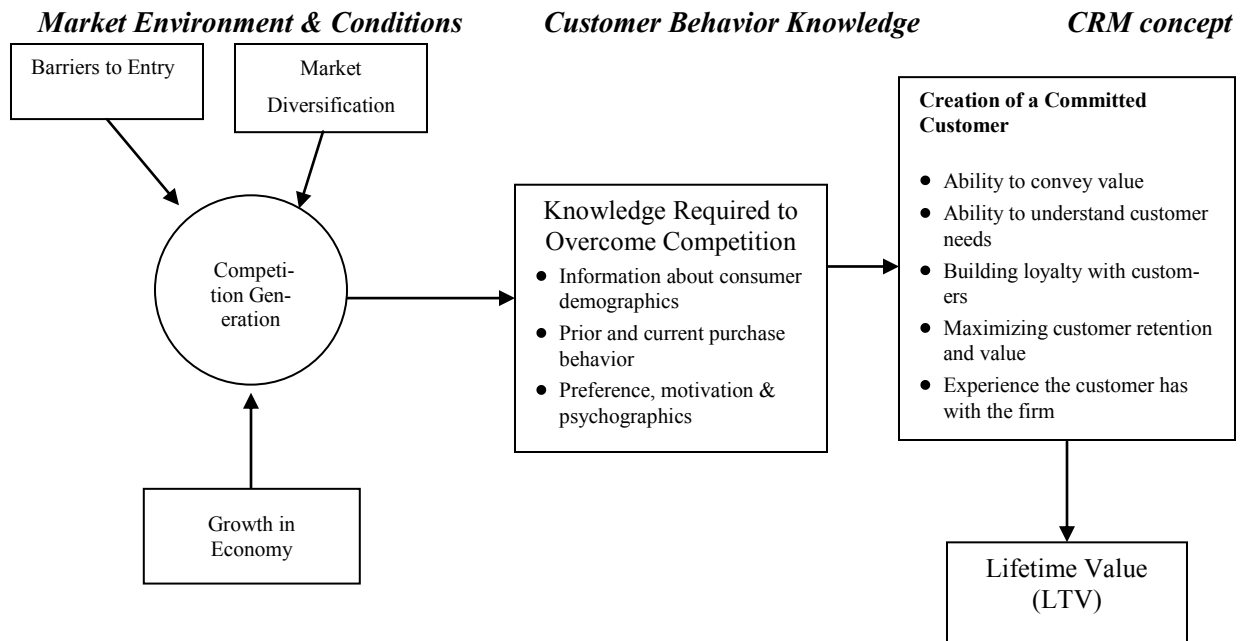
the simplifying assumption that the lifetime value of the customer for an organization can be enhanced on the basis of the following factors over which the firm has some control: (1) the company’s ability to convey value, (2) its ability to understand customer’s needs and wants, (3) loyalty from their customers, (4) maximization of customer retention, (5) the value of the experience the customers have with the firm.

The literature shows that both market environment and conditions can lead to changes in the competitive environment. Organizational ecology research has shown that environmental forces in the market (like market diversification, growth in the economy, etc.) strongly influence organizations’ rates of birth and death (Gresov and Haveman 1993; Haveman 1993). Even the density dependence model of Hannan and Carroll (1992) has shown that market environments and conditions lead to changes in competition. Research has also shown that customers’ lack of knowledge when making purchase decisions is a competitive barrier to market entry (Sawyer 1997).

The concepts in the theoretical CRM model in Figure 1 can be used by a firm as a basis for determining how to create committed customers and enhance the lifetime value (LTV) of a customer. That model is divided into four parts. On the extreme left are the market environment and conditions, followed by customer behavior knowledge. On the extreme right side of the model is the CRM concept. The outcome of the process shown in the model is the LTV of the customer.

The extant literature has shown that the market environment and conditions such as barriers to entry, market diversification, and growth in the economy, result in increasing competition (Gresov and Haveman 1993). In order to overcome that competition, retain the customers, and remain in the market and earn profits, the firm needs to know more about the behavior of its existing customers. The firm can gain insight into the behavior of its existing customers by being informed about their

**FIGURE 1:**  
**A CRM Model for Determining How to Enhance the Lifetime Value of a Customer**



demographics, prior and current purchase behavior, preferences, motivations, and psychographics.

The information on market environment and conditions plus knowledge of customer behavior both help in the creation of committed customers. Committed customers can in turn lead to lifetime relationships with the firm and the subsequent generation of customer lifetime value (LTV) for the firm.

Figure 1 shows that creation of committed customers is possible if the firm addresses the following factors: conveying value to its existing and new customers, understanding the needs and wants of those customers, building loyalty with them so that they make repeat purchases, and maximizing customer retention and value leading to the building of a long-term relationship between the firm and its customers. This outcome has strong potential for increasing both the revenue and profits of the firm.

**RESEARCH PROPOSITIONS**

Five research propositions were derived from the model. Each was formulated on the basis of the presumed knowledge about customers’ behavior including information about existing consumers’ demographics and their prior and current purchase behavior. They show how the performance of the firm can be affected by implementing CRM. Improving customer satisfaction, retention, and long-term profitability can result from a powerful customer relationship management solution synchronized across the entire enterprise (Krasnikov, Jayachandran and Kumar 2009; Thakur and Summey 2005; Ragin and Greco 2003; Day 2003). Such a solution should empower sales channels and customer service organizations with a single, integrated, up-to-date view of prospects, customers, products, and service information.

Relationships are created over time and stem from the principles of sound customer service (Bazadona 2002). Service is the most important means by which customers measure

satisfaction with an organization. A strong foundation of customer service, therefore, is essential for building a strong relationship (Thakur and Summey 2003). Solid brands are built from this reputation (Bazadona 2002) which helps in building a strong image about the organization in the minds of customers and hence building trust in them for the organization (Reichheld 1996). Research has shown that the quality of customer service correlates directly with consumer trust. That in turn affects customers' inclinations to build a long term relationship with an organization (Winters 2002).

The success of a business not only depends on lowering costs, but also providing exceptional customer service, i.e., service better than that of its competitors. Better customer management can in fact result in a reduction in sales and service costs, create higher buyer retention, and subsequently lower customer replacement expenditures (Reichheld 1996) with an attendant increase in profit margin for the firm. Companies that provide a level of service which improves customer satisfaction grow both long-term loyalty and profitability (e.g., Krasnikov, Jayachandran and Kumar 2009; Honebein and Cammarano 2006; Reinartz, Thomas and Kumar 2005; Bolton 1998).

According to Thomas (2002) an organization must be more customer-focused and tailor its entire operation, from products to training, to meet customers' needs and wants. Effective CRM should form the backbone of this process. An organization should try to understand customers' purchase behavior if they want to influence them to make future purchases. Thus it is very important for a competitive organization to keep track of its customer needs and wants as they progress along their customer journey and to understand customer purchase behavior better than its competitors. Competitors who have a sophisticated relationship management strategy with their existing customers' are seizing such opportunities and thus show better financial performance than those organizations which do not keep track of their customers purchase

behavior (Lipsey 2002). A good way to evaluate the CRM investment is to see if it has brought about significant changes in customer acquisition, customer deployment, and customer retention (Kumar and Shah 2009; Gupta, Lehmann and Stuart 2004). This leads us to the following propositions:

**Proposition 1:** The better the quality of service the company provides to its existing customers, the better the lifetime value (LTV) relationship the company would establish with those existing customers, hence the firm can retain its satisfied customers and thus generate higher profits than those firms that do not provide better quality service.

**Proposition 2:** Companies that track/manage the value of each potential customer as they progress along the customer journey are more likely to maintain better relationships with customers for a longer period of time, show better financial performance, and create greater lifetime value (LTV) than those firms or companies that do not keep track of their customers.

CRM is a business approach that integrates people, processes, and technology to maximize the relations of an organization with all types of customers (Krasnikov, Jayachandran and Kumar 2009; Boulding et al. 2005). The true value of CRM is in transforming strategy, operational processes, and business functions in order to retain customers and increase customer loyalty. The goal of customer relationship management (CRM) is to enhance the company's long-term sustainable competitive advantage.

Research shows that the profitability of a firm can be improved through the increased retention and loyalty of customers. A study by the Gartner group found that profits could be raised 100 percent by retaining another 5 percent of customers (Nairn 2002). The Royal Bank of Scotland found that 20 percent of their customer base made 80 percent of their monthly contribution to profits (Nairn 2002).

Study has shown that it takes up to five times more money to acquire a new customer than to get an existing customer to make a purchase (Thomas 2002; Reichheld 1996).

A large body of research, in domains ranging from customer satisfaction (e.g., Fournier and Mick 1999), and relationship marketing (e.g., De Wulf, Odekerken-Schroder and Iacobucci 2001), to, more recently, CRM (e.g., Winer 2001), has tried to understand and delineate how firms, or the “people behind the brands” (McAlexander, Schouten and Koenig 2002, p. 50), can build deeper, more committed relationships with customers and can retain them for a longer period of time by providing value to them.

According to Bhattacharya and Sen (2003) customer intimacy, customer equity, and customer relationship management (CRM) are the marketing mantras of today. In their quest for sustained success in a marketplace characterized by product proliferation, communication clutter, and buyer disenchantment; more and more companies are attempting to build deep, meaningful, long-term relationships with their customers (Bhattacharya & Sen 2003). The deeper the relationship the company is able to build with its customers, the more trust those customers would have in that company and hence the more loyal they will be to the company. If the company is able to build deep, committed, and meaningful relationships with their customers, those customers are likely to identify, or feel a sense of belonging (Mael & Ashforth 1992) with a company, will be more loyal to that company, and will keep a relationship with the company for a longer period of time. The result should be higher LTV of the customer for the company and hence increased profitability. Thus we can say:

**Proposition 3:** The more competent the company is in retaining and giving value to its customers, the higher the customer loyalty and hence the higher the lifetime value (LTV) and the profitability of the customer to the company.

The Pareto Principle suggests that 20 percent of customers provide 80 percent of the value (Juran 1954; Sanders 1987; Thakur and Summey 2005; Kumar and Shah 2009). Thus it is important for the company to determine those customers who will give them the most profit over the longest period. Before any prediction of future value can be made, however, it is essential to have a clear picture of your past as well as your current customers and their previous and present-day worth (Thakur and Summey 2005). From there it is then possible to develop predictions of future value.

Because CRM measurement systems can be used to understand past and future customer behavior, the abilities of companies to convert that knowledge into business results can be a significant form of competitive advantage (Peppers and Rogers 1997). Some of the world’s top brands use marketing tools and techniques to get, keep, and grow customers for a lifetime, and then optimize the return on those investments by understanding their customers well. An organization can understand its customers by keeping an intimate profile and history of each one and providing personalized competent service at every stage in their relationship.

Focusing on behavior, i.e., knowing how your customers react and develop will enable you to pre-empt any defection of customers to the competition, to predict their next purchase and its timing, and to market to them accordingly (Thakur and Summey 2003, 2005). An organization can increase its revenues and profits by understanding customers’ evolving needs and buying trends and by introducing responsive new products and service offerings to serve those needs. Such actions should have a significant impact on developing a long-term relationship with customers. Knowing the purchase behavior of the customers enables and guides the organization in deciding who is worth marketing to and whether they are now or can be converted to long-term customers. Thus we can say:

**Proposition 4:** The higher the ability the firm has for managing and

accounting for LTV contribution of individual customers and the more information the company has about the behavior of its potential customers, the higher the profit of the organization will be.

It is known that consumers' reaction to a firm's errors differs depending on the length of the relationship the customer has with them. Studies have examined the individual's likelihood to forgive in ongoing relationships (Rusbult, Zembrodt and Gunn 1982), as well as the effects of positive and negative experiences on existing customer relationships (Bolton 1998; Boulding et al. 1993). It has been found that those consumers who have prior positive experience with a firm tend to be more "forgiving", whereas newer customers will be less likely to forgive (Greenleaf and Winer 2002). There is empirical evidence in a contractual context that satisfied customers have longer relationships with their service providers (Bolton 1998) and higher usage levels of service usage (Bolton and Lemon 1999). Thus we can say:

**Proposition 5:** The more positive the experiences and relationships an existing customer has with the organization and the better the long-term relationship of the customer with the organization, the higher is the chance that the customer may forgive an organization for its faults. They should still be more willing to maintain a long-term relationship than those customers who have less positive or no previous experience with the organization.

From the above propositions it can be said that the better the quality of service to customers, then the higher is the value of the relationship with the organization in the minds of those customers. More detailed information about its customer's purchase behavior and higher positive experiences with the firm will enable the establishment of more profitable, longer-term relationships between the firm and the customer.

## DISCUSSION

To be effective, a CRM strategy requires that an organization provide customer value that is superior to that of its competitors (Thakur and Summey 2003). Gaining clearer insight and more intimate understanding of customers' buying behaviors will help in building an effective competitive advantage (Ragin and Greco 2003). CRM helps the process of getting in-depth knowledge about customers' habits and what the customers likes and dislikes are and thus can give the organization an edge over its competitors. The information that the organization has about its customers can be used to create an ongoing relationship thus retaining its customers for a longer period of time. It has been shown that businesses have to spend up to six times more to acquire new customers than they do to keep them, so investments in customer retention have high potential returns.

CRM can enhance the creation of committed customers. Companies have started putting more effort into maintaining existing customers than getting new ones. In research conducted among 100 customer service managers from the financial services industry it was discovered that 53 percent of respondents communicated with their existing customers on a daily basis while only 40 percent communicated daily with their prospects (Torcy 2002).

More than simply a repeat purchaser, the committed customer has an emotional attachment to the seller (Lim 1997; Dick and Basu 1994). These emotions can include trust, liking, and believing in the organization's ability to respond effectively and promptly to customer problems (Fournier 1998). Quality products, removal of geographic boundaries, on-time delivery and responsive service are what customers want in the present competitive environment (Ragin and Greco 2003).

Building an effective customer relationship management system should result in generating enhanced lifetime value (LTV) since a trusting or loyal customer will stick with the brand. It



should be difficult for the competitors to switch them unless and until they provide a higher quality product and better service.

### CONCLUSION

Customer Relationship Management is an alluring marketing strategy (Krasnikov, Jayachandran and Kumar 2009; Boulding et al. 2005). It can be a basis for a competitive edge which can sustain growth in a competitive environment. It seeks to build a long-term relationship with its existing customers. Properly implemented Customer Relationship Management (CRM) can help create and maintain a long-term sustainable competitive advantage.

The organization should, of course, continue to try to attract the new customers, but increased emphasis is being placed on retaining existing customers. This may best be accomplished by knowing the purchase behavior of customers over time and using that knowledge as a basis for formulating strategies that glue those existing customers to them.

For an organization to develop a long-term relationship with its customers it should first understand their needs and wants. Secondly, the firm should try to differentiate its more homogenous customers from the larger, heterogeneous, potential market. The organization can then concentrate on those homogenous customers whom they can serve in a better way and then work to retain them for a long period of time thus building a higher lifetime value (LTV). Thus we can say that customer relationship management provides a basis for creating and enhancing the lifetime value of customers.

Two areas which have not been examined in this paper are how the organization responds when it makes a mistake and what form of tangible or intangible amends may be provided to those offended customers in-order to maintain a long-term relationship with them in such a case. Further research should also be carried out to see if attention by the firm to the

lifetime value (LTV) of the relationship leads to the generation of increased competition.

From a practitioner's view point, research could be carried out to learn how to achieve the best return from a CRM/LTV marketing strategy. Research could also be carried out to determine how to know who the customers of the organization are who would be most valuable in the long term and which type of customers the firm should target for long term relationships.

Our proposition inventory and integrative framework represent an effort to build a foundation for the systematic development of a theory of CRM which provides a basis for enhancing the LTV of a customer. The objective of this research was theory construction rather than theory testing. This foundation now provides a basis for efforts to develop a suitable measure of LTV and empirically testing the propositions presented.

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