



CUSTOMER EQUITY MANAGEMENT: THE NEW BUSINESS PHILOSOPHY

D. Pavlova*

Industrial Business, University of Economics – Varna, Bulgaria

ABSTRACT

The increasing pressure on businesses in the last decade caused by competition, technological development, and easy access to detailed information about consumers, necessitated a number of changes and rethinking of market processes and relationships. Their expression is the new management approach, implementing customer-oriented strategies at the expense of traditional product-oriented focus. The purpose of this paper is to present a theoretical framework for Customer Equity and different approaches about Customer Equity Management, suggested by the literature. Based on the review, comparative, and critical analysis of theoretical achievements, this paper presents: 1) the benefits of the concept resort for companies; 2) the strengths and weaknesses of the reviewed campaigns; 3) defined resources for the successful performance of the business in the long term.

Key words: customer equity; customer lifetime value

INTRODUCTION

The key role of customers for business development is determined by the revenue they generate through their purchases. For this reason, modern consumer-oriented organizations focus on maintenance of effective long-term relationships with customers in order to guarantee a successful market performance. The establishment and maintenance of these relationships are grounded in the concept of *Customer Equity* (CE), developed by Blattberg in 1996. This concept is considered as an innovative approach to acquisition and retention of customers, as well as an approach to management of their value for the company. This, in turn, leads to gaining competitive advantages for the organization, expanding its market presence, and enhancing its market value.

The concept of *Customer Equity* (CE) reflects a newly emerging paradigm that defines customers as the main source of current and future revenues, represented by the measure "Customer Lifetime Value." The management of CE is a dynamic, integrated marketing system that uses information about

consumer behavior and techniques for its financial assessment. Thus, CE aims to obtain the highest benefits from customers during their relationship with the company.

In line with Villanueva and Hanssens (1), this paper suggests that research on Customer Equity and Customer Lifetime Value is particularly promising because it can help management practice in the following areas: 1) allocating marketing spending for long-term profitability; 2) understanding the connection between marketing spending, marketing metrics and financial performance; 3) providing a customer focused approach for measuring firm value; 4) providing much needed frameworks, tools and metrics for enhancing the productivity of Customer Relationship Management (or CRM) platforms.

Put differently, managers who do not embrace a CE view of the firm, are at risk in several ways: 1) allocating resources to marketing actions that produce larger shortterm gains at the expense of long-term performance; 2) spending on actions or monitoring metrics that do not meaningfully impact customers' behavioral change; 3) investing in firms that may seem attractive from a standard financial perspective, but whose customer metrics (such as the monthly evolution of acquisition costs, new

*Correspondence to: Darina Pavlova, Industrial Business, University of Economics – Varna, Bulgaria, 9000, Varna, Hristo Popovich 29, darina.pavlova@abv.bg, 0886 641 392

customers, retention rates, margins per customer) tell a different story, and 4) investing in expensive CRM platforms without careful consideration of how these platforms will be used to grow CE.

The purpose of this publication is to introduce the CE concept and discuss the possibilities for successful business performance by Customer Equity Management.

EXPOSÉ

1. DEFINITION OF CE APPROACH

The CE approach to marketing management is grounded in several overlapping key research streams including direct marketing, service quality, relationships marketing, and brand equity (Hogan et al. (2). Integrating the strengths of these streams, the concept draws attention to the following main aspects:

- assessing the relationship with customers;
- choosing strategies for long-term relationships with customers;
- maximizing the value of the cash flows from customers;
- increasing the market value of the company (Gupta et al. (3).

A literature overview on the topic can show that the positions of different authors do not differ substantially. The basic definition of CE can be summarized as the total combined customer lifetime values of all of the company's customers. Depending on the scope of the clients, however, there are two main nuances in the above definition, which form two different approaches while defining CE. The first defines CE as the discounted lifetime values summed over all of the company's customers (Blattberg, et al. (4), while the second considers both the current and the prospective customers of the company (Rust (5), Gupta, Zeithaml (6), Leone (7), Vogel, Evanschitzky, Ramaseshan (8), Blattberg, Getz, Thomas (4).

Thus, the main focus of these definitions is placed on the customer relationship with the organization. The main difference, on the other hand, is found in the scope of the concept. CE is presented as the result of the relationship between a company and its current and future customers. These definitions allow for the following conclusion: the CE definition has a static and a dynamic form depending of the elements included in its interpretation.

The *Static Customer Equity* (SCE) metric comprises only the current customers and is

appropriate for researching the company's customer base or a particular group of customers. Its application is suitable for tracing consumer behavior for a particular period. This metric is measured by the following:

- individual customer lifetime value;
- average customer lifetime value for group of customers.

The *Dynamic Customer Equity* (DCE) is a metric that includes both current and future customers of a company. This metric is a good proxy of the company's market value because it accounts for both current and future relationships (Gupta et al.).

Referring to submitted definitions outlined the strengths and weaknesses of static and dynamic form of the CE:

- SCE allows for studying the company's current customers, including their characteristics and specific consumer behavior. In addition, the value of the customer base of the firm can be calculated easily by using the analytical model, suggested by Blattberg and Deighton. The ignoring of the future customers value, however, appear to be one of the main weakness. This, in turn, leads to an underestimation of the CE value. Also, SCE does not analyze relationships among the customers which creates insignificant benefits for the company;
- A positive side of the dynamic metric of CE is that it overcomes the above drawbacks, includes the value of the future customers, and analyzes the benefits of relationships between customers. On the other hand, its application is difficult because of a complicated analytical mechanism for calculation of its value and the prognostic character of this metric, given the frequent changes in the market environment.

Based on the presented views on the CE, it could be said that CE is the amount of current customers who generate revenues through their purchases, have the potential to attract new customers, and increase the benefits for the company.

The scope of this definition comprises only the current customers, which the firm has been able to acquire and retain through its performance on the market, since the retention of the customer base is essential for any firm. Customer equity is expressed through revenues from the current customer base, but it also includes their ability to

generate additional intangible benefits for the firm through interpersonal relationships.

According to this definition, this form of equity is characterized by:

- Measurability – it is measured in monetary value
- Manageability – the concept offers mechanisms for increasing the value of the firm's customers for the time of the relationship
- Variable value – consumer behavior and the value of the firm's customers as its result change as result of the influence of a large number of external factors
- Increase – current customers have the opportunity to attract new customers through recommendation and create a positive image of the organization or its product.

2. CUSTOMER EQUITY

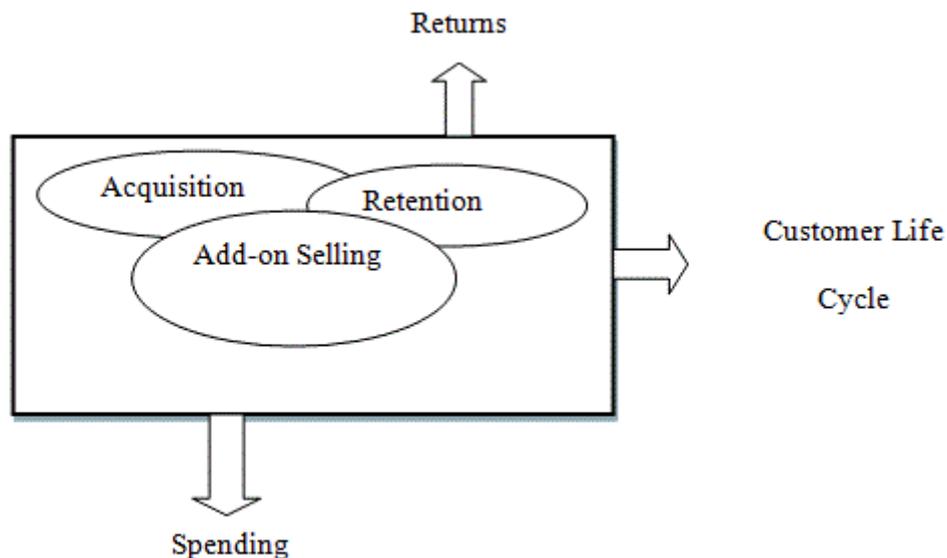


Figure 1. The Customer Equity Model – Blattberg (4-11)

The focus of this approach is to the skills of the organization to implement effective management strategies in terms of customer base. Increasing the value of the resort is directly linked to efforts to optimize the marketing costs and determine the profitability of customers for the company.

Based on the theoretical analysis, can be derived following advantages and disadvantages of the application of this approach to structuring and management of the CE.

Strengths of the approach of Blattberg, Getz and Thomas:

- Items are specific - they are expressed through real measurable value.

MANAGEMENT

The main focus of this paper is placed on developing management capabilities CE through the formative components. In the literature there are two basic approaches in determining the structural components of the CE, which differ in scope and implemented means for the realization of the concept.

The founders of the first approach - Blattberg, Getz and Thomas (4), presented the management of the resort as an integrated system based on three defined process: management of attracting customers, managing customer retention and management of additional sales (**Figure 1**). Accordingly, the value of the resort is derived as a result of the management of these processes and is expressed by the sum of the value of attracted customers, value of detainee customers, and the value of additional sales to customers for the company.

- Detailed processes are described in the management of the three elements.

- The authors have pushed wide methodology for their calculation.

- Outlines the detailed guidelines for concrete actions by the management of the three components.

Weaknesses of the approach of Blattberg, Getz and Thomas:

- Application management processes and calculation of the value of the components, the availability of a database of customers is critical.

- No account external factors that can affect the value of the CE.

- The concept is viewed primarily from the perspective of the company and its management skills and not focusing on the

customer - his perceptions and desires. The main focus is on the financial aspect of the CE.

➤ Although the authors have noted links between the three elements, these links are not addressed in detail. In this sense, risk managers concentrate on only one of the three elements, which can adversely affect other components and affect the ultimate value of the CE.

The second approach for structuring the CE placed in the center of attention of the customer life cycle and the possibilities for its extension. Its founders are Lemon (9), Leone (7) and Rust (10), who study the management of the CE, through the analysis

of consumer behavior and defining the factors that encourage customers to buy from a company both now and in the long term. The deduced structure of the CE is the result of developing the concept of managing relationships with customers. In this connection it is highlighted specific focus of this approach, namely a strongly customer oriented. According to Lemon, Leone Rust (9), the organization can maintain and expand its client base by forming Value equity, Brand equity and Relationship equity for the user (**Figure 2**). Therefore, the value of CE is formed as a result of the action of these three determinants (10).

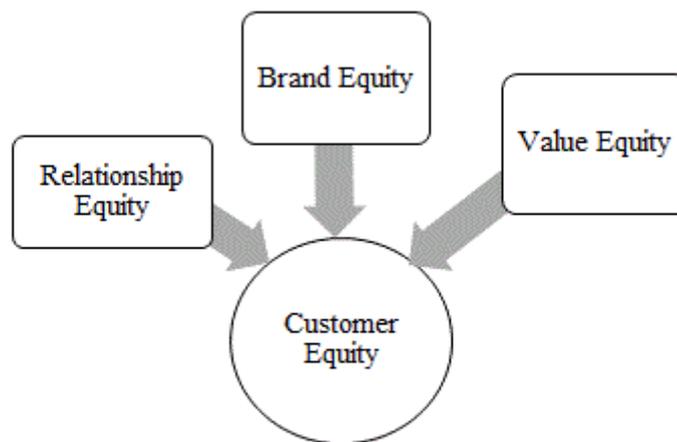


Figure 2. The Customer Equity Model – Rust (10)

The focus of this approach is on customer relationship with the company. It is represented by three stages:

- The First, "attracting customers" - the user has formed their attitudes to the brand and the product before made purchases;
- The Second, "after the purchase" - formed the evaluation of the value of the brand and the value of the product offer for the customer. As a result, of these assessments, the customer continues to purchase from the company;
- The Third, "analysis of the established relationship between the organization and customers" - with the help of specific marketing tools that connection grew into value the relationship with the company for the customer.

In this way, the authors derived the influence of three determinants on long-term customer value for the company.

CE presents the mechanism by which each of the determinants leading to optimal relationship between company and customer.

These three "values" acting individually and together, defining customer value for the duration of its life cycle, and examined their effect on all customers determine the value of the CE.

In summary of the display structure of the CE Lemon, Leone and Rust, one can say that it differentiates CE as a result of the influence of Value Equity, Brand Equity, Relationship Equity on customer behavior. This requires an analysis of the impact of each of the three values and taking strategies to reinforce their importance for the customer. Based on the views are displayed following advantages and disadvantages in the application of this approach, to structuring and management of the CE.

Strengths of the Lemon, Leone and Rust approaches:

- Focus is on consumer behavior and consumer desires of customers.
- These clients are presented as a kind of capital organization whose value is formed under the influence of three components.

Outlines the opportunities for category management through defined components: value equity, brand equity and relationship equity with the company.

- Thoroughly examined the three elements of the CE, as well as possibilities for their formation.
- CE elements are bound to increase "customer lifetime value", which is the basis for the calculation of the CE.
- Outlines the specific marketing strategies and tactics to increase the value of the CE.

Weaknesses of the Lemon, Leone and Rust approaches:

- No methodology for calculating the three elements of the CE - separately. CE is calculated on a "life-time value of the customer".
- Risk of errors in determining the significance of the three elements of consumers, which leading to the adoption of inappropriate strategies.
- This focus does not consider the adequacy of financial investments in marketing tools to influence consumer behavior.

These approaches, in the design of the CE, give different starting points of the business for the management of its value. The first approach is oriented to the optimization of marketing costs to customer value for the company, and the second is aimed at understanding and retention of customers, providing value for the company in the long term.

3. THE APPLICATION OF CE FOR THE SUCCESSFUL PERFORMANCE OF THE COMPANIES

There are many fundamental reasons for companies to move to a customer equity approach. First, several critical new technologies are converging to make customer asset-based management feasible. Second, these same technological capabilities, along with other changes in how markets work in today's turbulent business environment, are making it a requirement to manage marketing to maximize the value of a company's customer assets. The practical business benefits from the application of the concept are outlined in several directions:

First, CE is the basis for management of customer value of the company (Berger (11)); Second, CE is the best basis for analyzing customer behavior to customers (Thomas, Gutsche and Bauer (12). United, both directions displayed CE as an expression of expected future behavior of customers of the organization. This makes the application of the concept key, because with its help can build long-term relationships with customers

to increase their value to the business, thus improving its market performance in the long term;

Third, the high value of the CE is a significant competitive advantage to the company (Pitt (13));

Fourth, CE is presented as the most important determinant of long-term market value of the company. It does not define fully the value of the company (tangible assets, intellectual property, research and development), but the customer base is the most reliable source of future income, thus growing the business can be defined as a matter of retaining and attracting customers.

The researchers highlight the priority use of the CE for the following purposes of the companies (Lemon (9), Blattberg (4), Villanueva, Hanssens (1):

- Optimal planning and allocation of marketing budget;
- Display understandable link between marketing investments, marketing and financial performance indicators of the organization;
- Increasing the return on marketing investments;
- Attract and retain customers;
- Building long-term relationships with customers;
- Ensuring the long-term profitability and benefits for the company;
- Determination and increasing the market value of the company.

CONCLUSION

Dynamic market environment is challenging the ability of companies to find, learn and apply management and marketing approaches that create prerequisites for successful market performance. CE concept is one of the business opportunities for successful performance by forming long-term, profitable customer relationships. Following the reasoning presented on the nature, scope and benefits of CE for businesses, it can be concluded that the concept encompasses two managerial problems.

On the one hand, it directs managers to take specific marketing activities to attract and retain customers, which are consistent with consumer behavior and desires, on the other, it is connected with the economic justification of marketing activities. Thus, CE reveals opportunities for prosperity of the company through:

- analysis of consumer behavior;
- build stable relationships with clients;
- linking marketing actions to the market value of the company;

- optimal allocation of resources to attract and retain customers;
 - maintaining and expanding customer base.
- In conclusion we can say that, all they define the essential contribution of the marketing concept for the successful performance of the business.

ABBREVEATIONS

- CE - Customer Equity
 CRM - Customer Relationship Management
 DCE - Dynamic Customer Equity
 SCE - Static Customer Equity

REFERENCES

1. Villanueva, J., Hanssens, D. Customer Equity: Measurement, Management and Research Opportunities. *Foundations and Trends in Marketing*, 1:3, 2007.
2. Hogan, J.E., Lemon, K.N., Rust, R.T. Customer equity management: charting new directions for the future of marketing. *Journal of Service Research*, 5:4-12, 2002.
3. Gupta, S., Lehman, D., Stuart, J. Valuing customers. *Journal of Marketing Research*, XLI:7-18, 2002.
4. Blattberg, R., Getz, G., Thomas, J., Customer Equity: Building and Managing Relationships as Valuable Assets. Boston, Massachusetts, Harvard Business School Press, 2000, p. 3.
5. Rust, R., Lemon, K., Zeithaml, V. Return on marketing: using customer equity to focus marketing strategy. *Journal of Marketing*, 68:109-127, 2004.
6. Gupta, S., Zeithaml, V. Customer metrics and their impact on financial performance. *Marketing Science*, 25:718-739, 2006.
7. Leone, R., Rao, V., Keller, K., Luo, A., McAlister, L., Srivastava, R. Linking brand equity to customer equity. *Journal of Service Research*, 9:125-138, 2006.
8. Vogel, V., Evanschitzky, H., Ramaseshan, R. Customer equity drivers and future sales. *Journal of Marketing*, 72:98-108, 2008.
9. Lemon, K., Rust, R., Zeithaml, V. What drives customer equity? *Marketing Management*, 10:20-25, 2001.
10. Rust, R.T., Zeithaml, V.A., Lemon, K.N., Driving Customer Equity. New York, The Free Press, USA, 2000.
11. Berger, P., Bolton, R., Bowman, D., Briggs, E., Kumar, V., Parasuraman, A., Terry, C. Marketing Actions and the Value of Customer Assets: A Framework for Customer Asset Management. *Journal of Service Research*, 5:39-54, 2002.
12. Thomas, B., Gutsche, J., Bauer, H. Customer Equity Marketing: Touching the Intangible. *European Management Journal*, 20:213-222, 2002.
13. Pitt, F., Ewing, M., Berthon, P. Turning competitive advantage into customer equity. *Business Horizons*, 43:11-18, 2000.