Eleven misconceptions about customer relationship management

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Higher buying rates and lower service costs make long-term customers more profitable and firms increasingly focus their marketing efforts on customer relationship management (CRM). However, they are often disappointed by the performance of CRM projects. These disappointing results are caused by managerial misconceptions about CRM and customer behaviour. This article focuses on 11 of these misconceptions to help managers make well-considered CRM-related decisions and raise the success rate of CRM projects.

Though marketing managers have traditionally been trained to acquire new customers with established marketing instruments such as price, promotions and mass advertising, they are now shifting their attention to customer retention and customer relationship development. The aim is to maximise customer lifetime value instead of maximising profits from discrete transactions with customers. In order to do this they have turned to customer relationship management.

CRM is not a totally new concept in marketing. It is based on three aspects of marketing management: customer orientation; relationship marketing; and database marketing (see Figure 1, overleaf). CRM is a managerial process that focuses on the development and maintenance of relationships with individual customers in such a way that value is created for both the customer and the firm using customer databases, statistical decision-support tools and interactive communication techniques.

Despite its roots in marketing, CRM is often associated with the use of software. Survey results show 65 per cent of large companies in the US and Europe are aware of CRM technology, 28 per cent are developing it and 12 per cent are now using CRM applications. Despite the increasing use of CRM software, however, there is an on-going debate about the effectiveness of CRM. The success rate of CRM projects reportedly varies between 30 per cent and 70 per cent. Not surprisingly, a majority of managers are dissatisfied with their CRM performance.

Much of this dissatisfaction is in fact the result of managerial misconceptions about the use of CRM software, the premises underlying CRM and customer behaviour.

Misconception 1

**CRM software alone will enhance business performance**

CRM is often equated with the implementation of software programs and many managers believe that
using such software will directly improve their marketing performance. There are three reasons why this belief is often not fulfilled.

First, CRM is about much more than installing and using software. CRM starts with an acknowledgement throughout the organisation that creating value for customers is the driving business philosophy. This requires a real commitment from top management. Moreover, it requires an organisation structured around customers with a customer-oriented culture in which different departments and employees jointly focus on creating superior value for customers. CRM software, without consideration of the cultural and organisational aspects of CRM, will at best decrease operating costs and improve the efficiency of marketing operations.

Another reason CRM does not always live up to the expectations is that the successful use of CRM software and decision-support tools is affected by the interplay of information technology, analytical capabilities, marketing data and marketing. This interplay implies that analytical tools will only perform well if the marketing data used as input is of high quality. A good fit between the CRM support system and the rest of the marketing environment is critical for successful CRM systems. For example, in some CRM software, new statistical techniques such as genetic algorithms and neural networks are used. Many marketing managers do not understand these techniques. As a consequence they are reluctant to use them, although they can probably outperform more traditional techniques.

Third, adopting CRM software can also disappoint because, despite CRM's emphasis on building long-term relationships with customers, most CRM software focuses on optimising the short-run response of customers. Applying these models implies that only customers with the highest response probability are targeted. As a result, the same customers are selected repeatedly and bombarded with emails, phone calls and/or direct mailings. At the same time, these attractive (ie high-income) customers also receive offers from competitors using the same models and techniques. As a result they may well become irritated and inclined to switch towards less obtrusive suppliers. Most leading firms now have rules on the maximum number of mailings a customer receives in a given time period. Another solution to this problem might be permission marketing, in which the customer directs the content of the offer, the timing and type of direct communication method used.

**Misconception 2**

**Firms should only focus on customer relationship development**

A focus on managing customer relationships might lead firms to pay little attention (devote few resources) to customer acquisition. The underlying assumption is that it is more expensive to acquire new customers than to keep current ones. However, does this mean that firms should concentrate their marketing efforts solely on managing relationships with current customers? This is problematic for two reasons.

First, despite every effort to retain customer loyalty there will always be some that drop out of the customer base. Therefore, every firm needs to acquire new customers if only to replenish this outflow. Otherwise the customer base will shrink with damaging consequences for a firm’s long-term competitive position.

Second, in markets with relatively low retention rates a focus on relationship development can cause a firm’s downfall. In such markets, focusing on maintaining relationships with customers is often hardly worth the trouble since the gains from building such relationships are very limited. Some consumer durables, for example vacuum cleaners and refrigerators, have purchase cycles of 10 to 15 years. Retention rates in these markets are affected by a number of uncontrollable factors and the buying processes for these goods are often very elaborate. Therefore, most consumer durables manufacturers do not strive to build strong
relationships with customers but concentrate their marketing efforts on customer acquisition.

Firms introducing new products or selling existing products in underdeveloped markets should initially also pay more attention to customer acquisition than to CRM. A good example is the marketing strategy of mobile phone service operators. In the early phases of the market life-cycle operators invested millions of dollars in customer acquisition by giving away mobile phones to sell network subscriptions. Now that the market has matured customer retention has become the buzzword. Thus, firms should carefully spread their efforts over customer acquisition and customer relationship development.

**Misconception 3**

**Customer acquisition and CRM are two unrelated activities**

Customer acquisition and CRM are often considered as separate activities. This is reflected by the existence of separate functions or departments for customer acquisition and CRM. However, considering the two as separate activities severely reduces the effectiveness of CRM strategies. They need to be managed simultaneously because customer acquisition strategy impacts customer relationship development.

For example, the insurance industry commonly uses price discounts to attract new customers. Once a prospect has become a customer, companies apply various cross-selling instruments, such as loyalty programmes and direct mailings, to develop the relationship. However, this strategy may not always be successful since offering discounts often attracts price-sensitive customers who are more inclined to switch, less liable to buy additional higher-priced products and are thus less profitable. Another example relates to the marketing channels used to attract new customers. Different channels may attract customers with different profitability levels. Again within the insurance industry, customers attracted via direct-response advertisements in newspapers were more inclined to switch after one year than customers acquired through other marketing channels.

In general it holds that with more selective acquisition strategies the lifetime value of individual customers can be maximised. However, being too selective will hamper customer acquisition and lead to lower profitability levels. Although this trade-off is difficult to manage it becomes easier when customer acquisition and CRM activities are looked upon as two interrelated activities that must be carried out in harmony and close co-operation.

**Misconception 4**

**Customers want to have relationships with companies**

From an economic perspective, customer relationships are often defined as a series of repeated transactions between a customer and a supplier. From a social perspective, customer relationships also include repeated social interactions between a customer and a supplier. As early as the 1960s firms acknowledged the importance of repeated transactions with customers but it was only from the 1980s onwards that they accepted the social dimension of such relationships. Social interaction is considered important because it shapes customers’ commitment to the relationship. As a result, firms use marketing instruments that focus on the social dimension of customer relationships. For example, insurance companies send customers magazines with general information about healthy and pleasant aspects of life. Another example is the Dutch retailer Albert Heijn, which uses a magazine called *Allerhande* to enhance the shopping experience in its stores.

However, the effect of all this is negligible in most consumer markets because social interactions do not add much value to the product or service that is delivered. This is because in most instances customers do not want a personal or one-to-one relationship with a supplier. This is especially true for low-involvement products and utilitarian goods and services. With these products repeat purchase is often based on inertia and/or switching costs.

For high-involvement and/or hedonistic products, on the other hand, relationships might provide customers with highly valued social benefits. For example, the marketing and community programmes of brands such as Jeep, Harley Davidson and Manchester United provide important benefits for both the customer and the firm. Social aspects in customer relationships might also be important in face-to-face contacts in small, often specialised neighbourhood stores and service providers.
In other words, depending on the type of product and their shopping behaviour, customers may well not want to have a relationship with suppliers. Knowing this beforehand saves marketing resources and prevents customers from perceiving suppliers as obtrusive and aggressive.

**Misconception 5**

**Long-lasting relationships with customers are always more profitable**

Another assumption underlying the focus on building long-term relationships with customers is the idea that long-life customers are more profitable. The arguments underlying this claim are that: customers with long-lasting relationships are less price sensitive and therefore price premiums can be asked; the costs of servicing these customers are lower; the revenues per customer are higher; and loyal customers generate customer referrals.

Although there is some anecdotal evidence for this claim, empirical research has shown that it is a gross simplification to equate loyal customers with higher profits. An explanation might be that the assumptions underlying the positive association between relationship length and customer profitability are wrong. The assumption that customers with long-lasting relationships are willing to pay a price premium is not true. These customers have more experience with the company and a better understanding of the value that it provides. Therefore, long-tenure customers are often more price sensitive.

The empirical evidence of lower operating costs for long-lasting customers is also rather scarce because no substantial differences have been found between customers with long and short tenure concerning their promotion costs. Empirical research has, however, found that customers with long-tenure relationships are less inclined to switch.

In summary, it seems that solely focusing on higher retention rates is not a good marketing strategy. Managers should instead try to exploit cross-selling and up-selling possibilities. CRM should focus more on relationship development rather than relationship continuance.

**Misconception 6**

**Satisfied customers are always more loyal**

Having satisfied customers is one of the main objectives of customer-driven organisations. Satisfied customers are assumed to be more loyal. Drawing on this assumption, many firms have invested heavily in total quality programmes to improve customer satisfaction. Despite these investments, managers frequently report that it is hard to find a positive link between customer satisfaction and loyalty.

A second problem with customer satisfaction is that it measures today’s status quo. It does not capture unfulfilled needs. That is why many academics advocate focusing on the creation of superior value for customers instead of customer satisfaction.

Instead of a cross-sectional measurement of customer satisfaction, firms should therefore monitor the satisfaction level of their individual customers over time. This is more informative than monitoring the absolute satisfaction level of all customers at one point in time.

A third reason why managers often do not see any link between satisfaction and loyalty is because of customer heterogeneity. The loyalty of some customers is primarily driven by satisfaction while for others it is switching costs, habitual buying behaviour or variety-seeking behaviour.

Managers should: focus on delighting customers; adopt a more dynamic view of customer satisfaction; and implement programmes to improve customer satisfaction only in customer segments in which loyalty is indeed affected by customer satisfaction. In other words, the assumption that improving customer satisfaction always enhances customer loyalty is too simple.

**Misconception 7**

**Firms should focus their marketing efforts on their most profitable customers**

It is a rule of thumb that approximately 20 per cent of customers are responsible for approximately 80 per cent of turnover or profits. These customers are often identified via the customer pyramid (see Figure 2). Losing top customers has a strong negative effect on a firm’s profitability. Therefore, a key-recommendation is that firms should aim their marketing efforts on their most loyal and profitable...
customers and hence allocate a substantial part of their marketing budget towards these customers.

However, the question is whether these investments are really needed to prevent these customers from switching to competitors.

Empirical research shows that customer loyalty is often primarily driven by inertia, which is independent of any loyalty programme. This means that the majority of loyal customers will remain loyal in the future. Thus additional investments in the loyalty of profitable customers are a waste of marketing resources. Allocating a large part of the marketing budget to the most profitable customers also implies that less resources are available to up-sell potentially very profitable customers in lower tiers of the pyramid. Thus focusing marketing efforts solely on the most profitable customers harms the long-term profitability of a firm. Companies should therefore focus exclusively on their most profitable customers but also on customers who have a high future potential value.

**Misconception 8**

*The customer pyramid is a good segmentation scheme*

One of the key analytical tools within CRM is the customer pyramid. This pyramid classifies customers into different tiers according to their profitability. Despite the attractiveness and often-reported usefulness of this segmentation, the customer pyramid has some inherent limitations beyond the exclusive allocation of marketing resources to the most profitable customers.

An important problem with the customer pyramid is that it is often difficult to calculate customer profitability. This is usually calculated by summing the contribution margins of the products and/or services sold to individual customers. These profitability measures are only customer-specific with respect to purchase behaviour. Customer-specific costs are often not included. For example, customers with high service costs (many phone calls, personal service needs and so on) are valued equally with customers with little or no service costs. Equally, the customer pyramid does not consider non-purchase-related behaviours such as customer referrals. Moreover, the contribution margins considered in the pyramid can be sensitive to the number of products and/or services sold because the margins often increase when the number of products and/or services sold increases. This is especially true when fixed costs are a substantial part of the costs allocated to a product or service.

Another drawback of using the customer pyramid as a segmentation scheme is that it only considers customers’ monetary value. For example, mutual-fund giant Fidelity classifies its customers into segments

![Gold Silver Lead](image)

Figure 2

*The customer pyramid*

![Gold Silver Lead](image)

Figure 3

*From customer profitability segmentation to customer profitability and customer need segmentation*
based on profitability and then uses that information to tailor its offering to the various segments. As a result, managers may be inclined to focus solely on the monetary results of customers’ behaviour, thereby forgetting latent customer needs. It is therefore not surprising that many firms find it hard to build relationships with customers. In order to overcome this problem firms should aim to capture customer needs in their customer pyramid (see Figure 3).

A good example is the approach of Robeco Direct, a capital investment company. It has segmented its customer base into 10 different customer groups based on their attitude towards money, which Robeco identified through questions on life objectives, preferences with respect to financial situation and the actual financial situation. Two examples of these customer groups are the “safety seekers” and the “self-made man”. This need segmentation is subsequently combined with a profitability segmentation. For each need/profitability segment Robeco has developed different customised marketing programmes and service systems. Both customers’ needs and their expected monetary value direct the content of these programmes and systems. An additional implication of the customer pyramid is that it encourages marketers to drop less profitable customers. Having fewer customers and lower turnover might, however, reduce the contribution margin of each product and/or service sold due to the dependence between the contribution margin and the number of products or services sold. This implies that customers that are currently profitable might become unprofitable when other customers are dropped and they themselves are then subsequently also dropped. This self-fulfilling prophecy is called the customer profitability trap. Dropping customers might also have other negative consequences, in particular when the size of the customer base is an important quality signal for potential customers.

Finally, when using the customer pyramid as a segmentation scheme firms should be aware of how customers perceive differentiated treatment of the various tiers of the pyramid. In markets in which equality is an important social value, a differentiated treatment of customers may harm a firm’s reputation.

**Misconception 9**

**Loyalty programmes always improve customer loyalty**

A loyalty programme is the marketing instrument most closely associated with CRM. Although simple loyalty programmes have been around for years, technological developments have enhanced the use of these programmes. The objective of loyalty programmes, often using loyalty cards, is to improve retention rates and to enhance cross-selling.

The implementation of such loyalty programmes is costly. Moreover, once a loyalty programme has been implemented most firms are very reluctant to stop it because of the negative responses from customers. For example, in the 1980s Shell ended its loyalty programme in the Netherlands, followed by a large group of customers boycotting the company. This caused a lot of negative publicity and forced Shell to restart the programme, incurring high costs and unfavourable word-of-mouth publicity.

There is little empirical evidence about the positive effect of loyalty programmes because most firms are unwilling to share data. The evidence that is available reveals that in many established, competitive markets purchasing patterns are so well established that it is difficult to increase customer loyalty above the market norm with an easy-to-replicate loyalty programme.

Firms should therefore be very careful before implementing a loyalty programme and make a thorough cost-benefit analysis before making a final decision. Note that the benefits considered should also encompass non-monetary gains resulting from increased customer loyalty. For example, the implementation of a loyalty programme may provide retailers with valuable customer information, which can be used to target promotions, forecast sales and negotiate with manufacturers.

**Misconception 10**

**The lifetime value of individual customers is predictable**

Customer lifetime value (CLV) is one of the most important performance measures within CRM. (CLV is best described as the net present value of all future earnings from an individual customer). If a firm knows
a customer’s net present value all marketing efforts can be focused on those customers with the highest expected value. To accurately forecast the lifetime value of each individual customer, managers need information on individual retention and cross-buying probabilities.

Despite the availability of large databases, many firms compare the prediction of CLV with the search for the Holy Grail. Another problem is that CLV is affected by a number of other factors, such as customer satisfaction, competitive actions and legislation, which are often not stored in the database. This makes it difficult accurately to predict CLV.

Despite the difficulties associated with the estimating CLV, it is still a useful concept for two reasons.

First, using CLV as a performance measure forces managers to adopt a long-term view in their marketing decision making. Instead of focusing on short-term measures, such as market share and sales, they are forced to focus on their future earnings. Second, there are good and relatively simple models available that can be used to predict CLV at the aggregate or group level. The resulting forecast can be used to allocate a budget to customer acquisition and customer development strategies for specific market segments. For example, if the expected value of a newly acquired customer is $200, the maximum customer acquisition costs per customer should be $200.

Misconception 11

The Internet is the most suitable tool to enhance customer loyalty

Although the Internet hype is over, it is still believed that the Internet is the ultimate channel to build customer relationships, especially because of the customisation opportunities it offers. The truth might be different, however, because an important consequence of the Internet is that the cost transparency of the market increases. The Internet allows customers to compare prices, for example by means of price comparison sites, and easily switch to other suppliers because traditional switching barriers, such as distance to a store, are not present. Thus the loyalty of customers is likely to decrease on the Internet.

The objective of firms operating on the Internet should therefore be to lock-in customers through the provision of customised services. These customised services do not have to be limited to the Internet. For example, home delivery of food products can be adjusted to a customer’s personal wishes and constraints using customer profiles built on Internet shopping behaviour data.

In brief, the Internet is only a suitable tool to enhance customer loyalty when customers voluntarily switch towards the new channel and customers can be locked in through customised offerings.

If managers keep these 11 misconceptions in mind they will have more realistic expectations of what CRM has to offer. Moreover, they will be more careful and selective before investing in CRM projects because they are aware of the fact that successful adoption of CRM requires them to formulate and implement a comprehensive customer-driven CRM strategy.

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Resources


