Creating Customer Life Time Value through Effective CRM in Financial Services Industry

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Abstract

Customer Relationship Management (CRM) has its origin in the basic paradigm of marketing i.e. to satisfy customers with the best possible alternative in the market through a relational exchange process. Customer relationship management goes beyond the transactional exchange and enables the marketer to estimate the customer's sentiments and buying intentions so that the customer cab be provided with products and services before he starts demanding about it.

This is possible through the integration of four important components i.e. people, process, technology and data. Customer data management gives us leads about the probability of customer demand and the technology helps us in tracking the characteristics and categorization of customers depending on his past behavior. The process reorients the traditional business models to suit to the integrative approach of customer relationship management by putting emphasis on customer life time value than a products life time value. The simple strategy making through a product life cycle approach is now obsolete and it gives path to customer life time value. The concept of customer life time value helps the marketer to analyze the cost of acquiring serving and retaining a certain set of customers in the market.

This research paper throws insight in to some of these issues in financial services industry. The financial services industry today is facing an upheaval task of reorienting itself with changing technology and varying customer demand. The literature survey highlights the earlier research references in the area of customer relationship management to augment the body of knowledge for this study. The concepts of creating customer life time value are analyzed with the examples of a credit management strategy and billing system for a financial services industry.

Key Words: ***Customer Relationship Management, Relationship Marketing, Financial Services Marketing, Customer Life Time Value, Credit Risk Management, Billing System Management.***

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Customer Relationship Management (CRM) is a term for methodologies, technologies and ecommerce capabilities used by companies to manage customer relationships. The traditional database marketing captures customer information including demographic and psychographic data that helps the marketer to develop suitable target marketing strategy, to forecast demand, to determine type and quality of service required by customers and to build strategy for market entry, diversification and expansion. This macro marketing view has led to look at database for building strategic links for the benefit of the organization and customer in the face of rising costs and competition. In 1960s, Theodre Levitt suggested that the purpose of every business is to create and keep customers. He suggested that today's corporations should view the entire business process as consisting of closely held integrated effort to discover, create, arouse and satisfy customer needs.

Customer Relationship Management is now actively considered by organizations across the globe as an integration of database marketing with technology enables strategy. Recent survey be Forrester suggest that the CRM software market is likely to grow by 700% in four years period of time and estimate to generate revenue of $3 billion by the year 2004.The basis proposition of a CRM strategy is based on the age old idea that knowing, understanding, and serving the customer is the best method of developing a sustainable competitive advantage. But building a sustainable and successful relationship with a large customer base is not the easiest thing to do and carries a direct impact on many core operational processes from development of new products to faster debt recovery in financial services industry.

It is not a tactical decision of software implementation but interaction of the entire business with customers through an integrated interface. The modern information technology allows larger organizations to individualize their products and services as per the varying needs of

the customers. This research focuses on the customer relationship management issues in financial services area.

Customer Relationship Management is the establishment, development, maintenance and optimization of long term mutually valuable relationships between consumers and the organizations. Successful customer relationship management focuses on understanding the needs and desires of the customers and is achieved by placing these needs at the heart of the business by integrating them with the organization's strategy, people, technology and business processes (Fox, Stead, 2001).

At the heart of a perfect CRM strategy is the creation of mutual value for all the parties involved in the business process. It is about creating a sustainable competitive advantage by being the best at understanding, communicating, and delivering and developing existing customer relationships in addition to creating and keeping new customers. So the concept of product life cycle is giving way to the concept of customer life cycle focusing on the development of products and services that anticipate the future need of the existing customers and creating additional services that extend existing customer relationships beyond transactions. The customer life cycle paradigm looks at lengthening the life span of the customer with the organization rather than the endurance of a particular product or brand. A good customer relationship management program addresses to the changing need of the customers by developing products and services that continuously seek to satisfy the lifestyle and need patterns of individual customers. Organizations tend to acquire a structure around customer segments and not on the basis of product lines to deliver customer satisfaction

Literature Survey

Berry (1983) formally introduced the term customer relationship management in to the literature but several ideas of relationship marketing have emerged much before. McGarry (1950, 1951, 1953 and 1958) included six activities in the formal list of marketing functions: contractual

function, propaganda function, merchandising function, physical distribution function, pricing function and termination function.

The contractual function falling within the main task of marketing reflects McGarry's relational orientation and his emphasis on developing cooperation and mutual interdependence among marketing actors. McGarry's work has not been widely publicized, and his relational ideas did not lead to the same flurry of interest caused by Wroe Alderson (1965)'s focus on inter- and intra-channel cooperation. Two influential writings in the 1960s and 1970s provided impetus to relationship marketing thinking, particularly in business to business context. Adler (1966) observed the symbiotic relationships between firms that were not linked by traditional marketer – intermediary relationship. Vardarajan (1986) and Vardarajan and Rajaratnam (1986) examined other manifestation of symbiotic relationships in marketing.

The second impetus was provided by John Arndt (1979), who noted the tendency of firms engaged in business-to-business marketing in developing long-lasting relationships with their key customers and their key suppliers rather than focusing on discrete exchange and termed this phenomenon as "domesticated markets". The impact of these works spread across two continents. In the United States, several scholars began examining long-term inter-organizational relationships in business-to-business markets and the Industrial Marketing and Purchasing (IMP) Group in Europe laid emphasis on business relationships and networks (Anderson, Hakanson and Johnson (1994); Dwyar et al (1987), Hakanson (1982), Hallen, Johnson and Seyed-Mohamed (1991), Jackson (1985)).

In recent years customer relationship management is being enlarged to include an integrated perspective on marketing, sales, customer service, channel management, logistics and technology for engaging in customer satisfaction. Practitioners are calling it customer relationship management (CRM) and are interested in all aspects of interactions with customers to maintain a long-term profitable relationship with them. They are very keen on learning about the programs,

strategies, processes and technologies that would be applicable for effective customer relationship management in the new millennium.

While undertaking a study on the field of customer retention and corporate profitability, Reichheld and Sasser (1990) stated that role of customers is essential for corporate performance, so that when relationships with customers endure, profits rise up. In addition, Sheth and Parvatiyar (1995) showed that the cost of retaining current clients is frequently much lower than cost of acquiring new ones. In the same way, Reichheld (1993) concluded that economic benefits of high loyalty are important, and in many industries they explain the cost-effectiveness differences among companies. Furthermore, there are two ways by which these improvements can take place i.e. customer retention entails an improvement of corporate performance by means of repeated purchases and references; enhanced organizational performances enable the company to invest more resources on motivating and improving the relationship with its employees, and this will affect again customer retention.

Today's businesses are facing fierce and too aggressive competition while operating in both domestic and global market. This diverse and uncertain environment has forced organizations to restructure themselves in order to enhance their chances of survival and growth. The restructuring efforts have included, among others, the emergence of the "new paradigm" which is commonly referred to as relationship marketing (Berry(1983), Ford(1990), Håkansson(1982), Dwyer et al(1987), Zineldin et al.(1997), Grönroos(1994), Gummesson(1995), McKenna(1991), Morgan and Hunt (1994). Relationship marketing is coined to reflect a variety of relational marketing activities.

The term customer relationship management has become a buzzword, with the concept being used to reflect a number of differing themes or perspectives and becomes a "catch-all" phrase (Brodie et al. (1997)). Ongoing relationships between businesses and their customers are receiving renewed interest in marketing (Berry (1995), Sheth and Parvatiyar(1995)). Indeed, the building of strong customer relationships has been suggested as a means for gaining competitive

advantage (Mckenna(1991), Reichheld (1993), Vavra (1992)). However, these definitions of relationship marketing provide the basis for the new paradigm argument that views marketing as an integrative activity involving personnel from across the organizations, with emphasis on building and maintaining relationships over time. Personal relationships, interactions, and social exchange are the core elements of relationship marketing.

Customer relationship management is to identify, establish, maintain, enhance and when necessary also to terminate relationships with customers and stakeholder, at a profit, so that the objective of both parties are met, and that this is done by mutual exchange and fulfillment of promises (Michel (1999)).An extensive review of literature reveals ten different but interrelated forms of relationship marketing as mentioned below:

1. The partnering involved in relational exchanges between manufacturers and their external goods' suppliers (Frazier et al. 1988)
2. Relational exchange involving service providers, as between advertising or marketing research agencies and their respective clients(Frazier et al. 1988)
3. Strategic alliances between firms and their competitors, as in technology alliances (Nueno and Oosterveld (1988), Bucklin and Sengupta (1993), (Ohmae 1989))
4. Alliance between a firm and nonprofit organizations, as in public-purpose partnership (Steckel and Simons (1992)).
5. Partnerships for joint research and development, as between firms and local, state, or national governments(Comer et al.(1980), (Berry 1983))
6. Long term exchanges between firms and ultimate customers as particularly recommended in the service marketing area (Berry 1983)
7. Relational exchanges of working partnership, as in channels of Distribution (Anderson and Narus (1990).
8. Exchange involving functional departments within the firm (Ruckert and Walker (1987)

9. Exchanges between a firm and its employees, as in internal marketing (Arndt (1983), Berry and Persuraman (1991)
10. Within-firm relational exchanges involving such business units as subsidiaries, divisions or strategic –business units (Porter (1987)).

Customer Relationship Management in Service Industries

Globalization and deregulation, combined with advances in information technology, have radically changed the managerial context of service industries. Though the origin of customer relationship management was initially in the industrial context, the service industry is also focused on maintaining and enhancing customer relationships. Services are produced and delivered by the same institutions. Success of a service provider is dependent on long term relationships that develop between the provider and customer of the service. A greater emotional bond and trust between the service provider and service user develops a need of maintaining and enhancing relationship.

Berry (1983) defines customer relationship management as attracting, maintaining and enhancing customer relationships in multi service organizations. Berry and Persuraman (1991) propose that customer relationship management concerns attracting, developing and retaining customer relationships. Berry stressed that the attraction of new customers should be viewed only as intermediate step in the marketing process. Solidifying the relationship, transforming indifferent customers into loyal ones and serving customers as clients should also be considered as marketing. He outlined five strategy elements for practicing customer relationship management: developing a core service around which to build a customer relationship, customizing the relationship to the individual customer, augmenting the core service with extra benefits, pricing services to encourage customer loyalty and marketing to employees so that they, in turn, will perform well for customers.

It is a consensus that the relationship between the firm and its customers is critical to their firm's survival and success. The management of customer relationships is critical in services marketing for three reasons.

Lovesick (1983) points out that many services by their very nature require on going membership (e.g. insurance, banking etc). Even when membership is not required, customers may seek on –going relationships with service providers to reduce perceived risk in evaluating service characterized by intangibility and credence properties. Customers are more likely to form relationships with individuals and with the organizations they represent than with goods (Berry, 1995). Services are performances where the employees play a major role in shaping the service experience (Bitner, 1995). The service setting is especially conducive to customers forming relationships with individual service providers.

Relational Benefits to Services Industries

Inseparability is widely cited as one of the distinctive features of services. The fact that services typically are produced and consumed simultaneously means that it is common for customers to have a direct input to service provision. For service businesses, strong customer relationships are important because of their inherently interpersonal focus and relative lack of objective measures for evaluating service quality (Czepiel 1990). Previous empirical research has focused on the benefits of customer loyalty as viewed from the perspective of the firm, typically in business-to-business contexts (Crosby, Evans and Cowles (1990); Peterson (1995). Loyal customers can lead to increased revenue (Reichheld (1993); Schlesinger and Heskett (1991), result in predictable sales and profit streams (Aaker (1992), are more likely to purchase additional goods and services (Clark and Payne (1994); Reichheld (1996), typically lead to low customer turnover(Reichheld and Sassar (1990) and often generate new business for a firm via word-of-mouth recommendation(Reichheld (1996); Reichheld and Sassar (1990); Schlesinger and Heskett (1991); Zeithamal, Berry and Persuraman (1996). In addition, a loyal customer base can lead to

decreased costs (Jarvis and Wilcox (1977);   O' Boyle (1983); Reichheld (1993). Loyal and satisfied customers are likely to cost less to service (Reichheld (1996), sales, marketing and setup costs can be amortized over a longer customer lifetime (Clark and Payne (1994).

Customers who have developed a relationship with a service business expert expect to receive satisfactory delivery of core service. There exist different types of relational benefits through effective customer relationship management. Customers derive social benefits from long-term relationships with service firms (Barlow 1992; Czepiel 1990; Jackson 1993). In addition to the benefits received from core service, a kind of friendship often occurs between customer and service providers. A second set of relational benefits reported by respondents can be described as psychological benefits. Customers realize that there is often a comfort or feeling of security in having developed a relationship with a provider.

This feeling of reduced anxiety, trust, and confidence in the provider appear to develop over time and only after a relationship has been established between customer and the service providing organization. The economic benefits relate to discounts or price breaks for those customers who have developed a relationship with an organization.. In addition to monetary benefits, a non-monetary benefit is also identified many atimes by the customer. The economic benefits customers may receive for engaging in relational exchanges, both monetary and in the form of time saving, are consistent with what scholars have argued is the primary motivation for developing relationships with businesses (Peterson 1995). For their regular customers many service providers may tailor their service to meet particular needs. In some cases this may be perceived by customers as preferential or special treatment. Special treatment in marketing exchange relationships has been briefly mentioned in the literature (Barlow 1992; Hakansson 1982).

The Case of Financial Services Industry

In today's deregulated world, members of financial services industry are continuously forced to seek new ways to gain on their competitors and to outdo one another in terms of effectively reaching to retail customers demands for increasing sophisticated financial products and services. As they have moved away from traditional broad based marketing to retail relationship service provision to attract and hold customers, to cross-sell products and most importantly to turn customers to avail multi products and services, customer relationship management is of utmost importance to financial services industry for survival and growth. To keep customers in today's competitive environment, financial institutions are increasing the depth of relationship through implementation of customer relationship management programs.

A successful customer relationship management program in financial services addresses four key areas of business: strategy, people, technology and process. The processes in the organizations are the drivers of change that give direction to the organization. The strategic direction moves the two enablers people and technology and their systematic interaction leads to a successful customer relationship management program.

Knowledge focused organizations collect data on their customers to provide them with a framework to build an understanding of their market. Innovations in technology has played the role of an enabler in capturing customer data, in developing an ability to store, share, analyze and transfer vast amount of data at low costs. Growth in the use of sophisticated databases, data warehouses and data mining software applications make it possible for organizations to analyze customer behavioral patterns, individual levels of profitability and life time value of their customers.

In a financial services industry it is untypical to find website interactions in one database, lease agreements in an administration system, call center history in another and payment history in accounting system. Though difficult to do but integrating such a huge information system can

provide valuable insight in to financial customer's behavioral pattern, preferences and signals for intended behaviors. Advanced data analysis models can provide valuable information on customer behavior and can help in projecting behavior in more accurate way about the likelihood of purchase of specific products and services, the best next offer information and the probability of defection to the competitor brands. These models are customized to that organization's business domain and customer behavior and are not based on any behavioral or non behavioral correlates but are purely based on actual interactions of customers with financial institutions.

Customer relationship management delivers value to the business organizations. Finding out the type and nature of customers, their buying patterns and delivering a product of their choice increases the return on investment and makes the marketing strategy more scientific and goal driven. The paradigm is based over assumption that creating satisfied customer always serves as a sustainable competitive advantage for the organization. Analysis of customer interaction history by using database helps in figuring out customer's apparent need.

This allows the marketing planner to target groups of customers that have demonstrated interest in the products and services promoted by a financial service provider and subsequently to identify groups of prospects who appear similar to the first target group and might respond to the financial services positively when offered. Intelligent analysis of customer data provides the mechanism for managing meaningful relationships with customers. Data analysis can direct the strategic marketing communication, the standardization of service quality delivery, establish a basis for meaningful interaction through either personal or web based dialogues, the development of quality financial products and a large number of outcomes that can be translated in to long term profitable relationships with the sustainable source of revenue
i.e. Payments by customers.

Management of customer value in financial services industry is a cyclical process which starts with definition of customer actions. Understanding of customer base by analyzing existing

customer data can provide information about various segments either on the basis of customer usage rate or customer choice, behavioral characteristics, profitability and customer attrition rates.

Customer expectations are difficult to manage but are often cause of dissonance those results in loss of existing customer base. So understanding of customer expectations with regard to service delivery levels and product quality is essential if a long term and symbiotic value relationships are to be established. It is also important to design customer value model. The combined understanding of customer's behavior, needs and wants, the customer value model will seek to deliver the value in the most cost effective manner. Defining the customer's expected life cycle, performance measurement mechanism and corresponding service mix offering are crucial for success of a financial service provider. Implementing the integration of systems, processes, service providers, business technology and infrastructure in addition to the creation of measurement system to monitor the progress augments the customer value model. This integrated approach can help in calculating **customer life time value (CLV)** by calculating and analyzing all relevant costs of customer acquisition and retention and corresponding revenues generated from each customer categories. Customer life time value creation consists of a process of ad hoc segmentation and data analysis for data base marketing, a process of automation of decisions against customer requests, targeted retention activities and decisions to ensure retention effort is aligned to customer life time value, identification of customer categories for cross selling and up selling of financial services, development of service and product portfolios aligned to the concept of customer life time value, alignment of customers to appropriate channels by customer life time value.

Many organizations are still not aware about the impact of customer relationship management strategy across the organizations and are unable to know the gaps for developing further customer centric organization. This is because customer relationship management is always seen as a technical development than strategic development. An integrated customer relationship management program covers product development, channel management, marketing

planning, sales automation, customer acquisition, customer fulfillment, inventory management, customer service, customer billing and invoicing, payment management, credit management and prevention against fraud and customer retention.

While developing a debt management strategy to offset the foreseen credit risk of future legislative changes, the financial services organization are asked to restructure the business model and processes to become more customers centric. The approach is to challenge the prevalent utility thinking by proposing to move from a reactive debt recovery approach to a proactive credit management model. The former approach allows debt to arise with only minor attempts to align risk to payment terms up front. The customer's previous debt recovery history is used to increase the severity of further recovery actions. The latter approach uses both internal and external information to segment the customer base and to determine the customer's credit rating, based on the characteristics of the customer profile group to which they belong.

This data is not only used to determine the appropriate payment terms up front but also to tune subsequent debt recovery activity. Payment performance is used as a feedback mechanism to update the risk represented by the profile group, realign the payment terms to reflect changes to a customer's perceived risk and to refine the over all debt recovery strategy. A key feature of the credit management strategy is that the customer information is held centrally, independent of any billing or credit management system, in order that it may constitute part of enterprise wide customer knowledge architecture capable of supporting customer relationship management.

Similarly financial service providers can also reorient themselves from a traditional service provider to organizations with product offerings. This is possible by packaging the base service in to a product tailor made for specific customer segments. Characteristics that can be used for product definition for a financial service firm (credit card firms in particular) include bill frequency, bill media, user rate, payment method and payment frequency.

Selecting appropriate settings for each of these parameters can enable the products to be tailored that will reflect both a cost to serve and risk category. Subsequent alignment of these

characteristics to customer groups can help in reducing credit risk, maximize profitability and support greater customer retention. By combining credit facility on shopping, short term and long term loan offerings in to a product and assigning an appropriate discount to reflect the reduced costs to serve one bill, one payment, one contact, cross selling and up selling can be maximized. So application of customer relationship management principles in financial services industry can help in generating higher customer value and also reducing the business risk. The cost of serving to a certain set of customers can be approximated through a risk return trade balance for financial services providers.

Conclusion

Financial services providers are most probably the industry category that is facing rapid modernization and inflated competition in today's world. The fight has begun for getting a larger share of the customer pie with the lowest possible cost to serve the customers. Since profits are drying up in the face of increased competition and customers are moving very fast from one firm to another on service and complete solution provision dimension, it becomes important to have an integrated customer relationship management strategy across the whole organization for generating higher customer life time value. Without this awareness and constant attention to varying customer needs a financial service provider can not be competitive in today's world. Integration of process, people, technology and information will offer a greater value to the customers.

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