

Management of Enterprise Based on Matrix of Profitability and Customer Loyalty

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Abstract: The article discusses how customer-strategic hallmark of modern enterprise management. Unlike traditional marketing related to market share and sales, customer orientation assumes the account of customer profitability and the cost of its attraction and retention. It is defined as the interrelation between customer loyalty and their profitability. The article presents an example of management of modern enterprise, based on original methodology of assessing customer profitability of customers according to their loyalty and value for the company.

Key words: Customer orientation • Lifelong customer profitability • Customer profitability • Customer loyalty • Customer matrix • The index of consumer satisfaction • Customer retention rate • Loyalty index

INTRODUCTION

With traditional management, key indicators are sales (product profitability) and market share. As a rule, some attention goes to customer satisfaction and customer loyalty, but in most cases the increase in the number of unsatisfied customers is compensated by attracting new ones. Although it allows you to keep certain profitability in the short term, in the long term increase in the cost of attracting new customers entails falling profitability of the company and an even greater increase in costs on their retention. In this case, the key indicators are, as considered by S.Gupta and D. Lemann, loyalty and customer profitability [1].

The main problems of customer directed business are connected, firstly, with the change of understanding of the value of the client (customer) for the company and secondly, with change in understanding the value of marketing to the business itself [2]. This approach requires considering the costs of working with customers as investments. Customers are represented as company's assets and studies show that expenses for customer retention have stronger impact on the financial value of the company than the actual financial instruments (such as the cost of capital) [3].

However, customer orientation calls for development of new indicators of efficiency of company's activity – namely, profitability management and customer loyalty. Existing instruments are not tested sufficiently here and they depend much on the specific application, which is well shown in many studies [4, 5, 6].

This paper suggests a method of management of correlation between customers based on assessment of their profitability and loyalty by building a special Matrix of customers.

Methodology of Evaluation the Profitability and Customer Loyalty: The essence of the proposed technique is to separate consumers according to their value (profit) for the company. Usually it is used to take a number of indicators characterizing the income received from the customer and the costs, which the company bears for its attraction and retention.

To solve this problem it is necessary to classify the customers in terms of profitability and loyalty. Profitability directly characterizes benefit from working with a customer, the loyalty degree correlates with the cost of the company to «conquer» the customer. Some customers can be loyal and profitable, more profitable but disloyal,

some loyal but not profitable and the others – neither profitable nor loyal. The purpose of classification is to identify those customers who have a high level of loyalty and profitability.

Usually as index featuring «yield» of the customer, we take a known parameter of customer lifetime value (CLV), which reflects the present value of all current and future revenues received from the customer during the period of his collaboration with the company [7]. However, really value of the consumer can not always be determined by the above parameter. In our case, it took a special assessment of the profitability of various customer groups on the basis of accumulated statistics on the relationship with them and the specific conditions of contracting. Therefore, as indicator, a usual income parameter from the transaction has been chosen (CP) [8].

As indicator characterizing the costs, which the company bears to attract and retain customer, we take consumer loyalty index (CLI). The higher the score the more loyal are customers, which means they cost «cheaper» for the company. Consumer loyalty index has been determined by the formula:

$$CLI = ICS \times \text{Retention of the customers} \times \text{Recommendations of the customers}$$

where *ICS* – is index of customer satisfaction, measured by a standard methodology for assessing customer satisfaction by survey. All clients of the company are divided into groups according to the degree of satisfaction and each group has a standard weight (0 – group of unsatisfied customers, up to 100 – the group of absolutely satisfied customers) [9].

Since value of customers for the company, can greatly differ among different groups, specifically the definition of a combination of loyalty and customer profitability for the company in the long run allows you to mark out the so-called «golden» customers. And vice versa – to identify such customers, to maximize the satisfaction of who is not necessary because their yield is low for the company [10]. For segmentation of these four

types of customers matrix is made, the axes of which are indicators of CP (high and low «yield» of the customers) and customer loyalty index (high and low loyalty CLI) [11].

The purpose of the methodology lies in the construction of such Matrix of customers, which is the basis of long-term strategic management of relationships with different groups of consumers.

Construction of Customer Matrix: We are going to consider an example to evaluate management of relationships with the customers based on an assessment of their yield for the effective management of one of the Perm companies. The company N operates in the market of service for production equipment Perm (B2B market). It is a diversified enterprise seeking to complex maintenance of industrial facilities. Market where this company operates is under active development with a high level of competition. In this market, the role of long-term mutually beneficial partnerships with clients is high, which allows companies to provide for future profitability and reduce risks for the quit of client companies. Share of the customers in this market is rather narrow and with tenders, the preference goes to the company with the lowest price to provide the relevant services. In the near future an increase of competition is expected, mainly due to enhancement of service companies and increasing their number. Therefore, the Company today has a challenge: setting-up trustful and long-term relations with customers.

To solve this problem we had their classification in terms of loyalty and profitability and built several Matrixes of the customers.

To measure the level of loyalty we used results of the questionnaire of the company's customers.

Questionnaire had only 2 questions:

- How would you evaluate the level of satisfaction by your company's when working with the Company?

Group of customers	Absolutely dissatisfied	Partially dissatisfied	Neither satisfied nor dissatisfied	Partially satisfied	Absolutely satisfied
All	20	40	60	80	100

- What is the probability that you will recommend the company to other companies?

Possible answers:

Table 1: The results of the questionnaire

Group of customers	Absolutely dissatisfied	Partially dissatisfied	Neither satisfied nor dissatisfied	Partially satisfied	Absolutely satisfied
% of total number	0 %	0 %	19 %	37 %	44 %

Table 2: Indicators for building Matrix of customers

No	Name of client's company	Profit form client	ICS	N – the term of collaboration	KS	Probability of recommendations	CLI
1	2	3	4	5	6	7	8
1.	A	228	0,7	4	0,8	0,4	0,21
2.	B	5441	0,84	5	0,8	0,7	0,47
3.	C	74929	0,72	10	0,9	0,88	0,57
4.	D	150	0,9	2	0,5	0,2	0,09
5.	E	143	0,88	3	0,7	0,08	0,05
6.	F	1570	0,58	3	0,7	0,3	0,12
7.	G	2747	0,77	5	0,8	0,35	0,22
8.	H	168	0,65	2	0,5	0,5	0,16
9.	I	1703	0,9	4	0,8	0,8	0,54
10.	J	77,5	0,98	4	0,8	0,35	0,26
11.	K	5110	0,45	3	0,7	0,28	0,08
12.	L	426	0,95	1	0,0	0,6	0,00
13.	M	405	0,87	2	0,5	0,5	0,22
14.	N	35	0,7	1	0,0	0,01	0,00
15.	O	2277	0,6	5	0,8	0,72	0,35
16.	P	154	0,68	3	0,7	0,2	0,09

0.0 – will not recommend

1.0 – will recommend at every opportunity.

Scale with increments of 0.1:

0.0 0.1 0.2 0.3 0.4 0.5 0.6 0.7 0.8 0.9 1.0

Profile offered to the specialists from the client companies dealing with pricing, the company management and customer relationship. Totally representatives of 16 organizations have been interviewed.

Following results have been obtained after the first question in the questionnaire about the company's customer satisfaction (Table 1).

The first step according to this methodology is the calculation of consumer satisfaction index (Table 2).

As the second step coefficient of customer retention has been calculated by the formula [12]:

$$\text{Customer retention} = 1 - 1 / N,$$

where N – the period of cooperation of client with company.

Customer retention rate (CRR) is presented in column # 6 (Table 2).

The third step determined the probability of Recommendations. To do this, customers were asked: «What is the probability that you will recommend the company to other companies?», Respondents indicated

the probability of the recommendations of the Company according to the scale from 0.0 – will not recommend to 1.0 – will recommend at every opportunity. The results of the answers to this question are also presented in Table 2.

The fourth step was to calculate the index of consumer loyalty, which was produced by multiplying the index variables of customer satisfaction, customer retention and customer referrals, according to the above formula. The results are also shown in Table 2.

The fifth step is to calculate customer profitability need of profit for the period of cooperation with the client company to deduct the costs for its attraction and retention. The authors here are faced with a typical situation for most companies – the cost of customer attraction and retention in the Company are not considered, except for entertainment expenses. Therefore, in this situation, the client's profitability will be calculated as the sum of profit received during the period of cooperation with the client (Table 2).

Once all the necessary indicators were calculated, a few matrixes were built for loyalty management and customer profitability. This was related to the fact that the volume of transactions of customers varied greatly. Therefore, for correct separation clients in quadrants we will divide customers into 3 groups on the basis of profitability: Group A – 0 rubles. up to 500 thousand rubles., Group B from 500 thousand rubles. Up to 5 million rubles. and Group C – more than 5 million rubles.

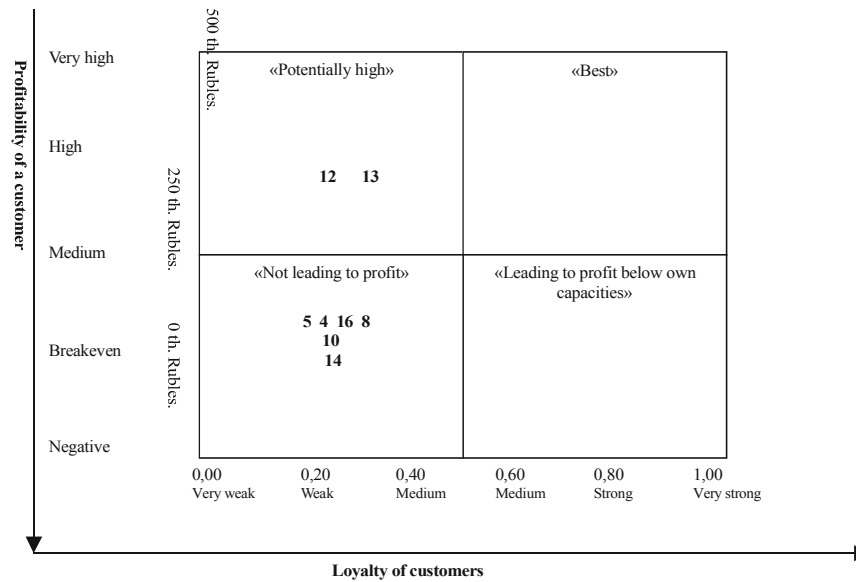


Fig. 1: Matrix of customers with profitability from 0 to 500 thousand rubles

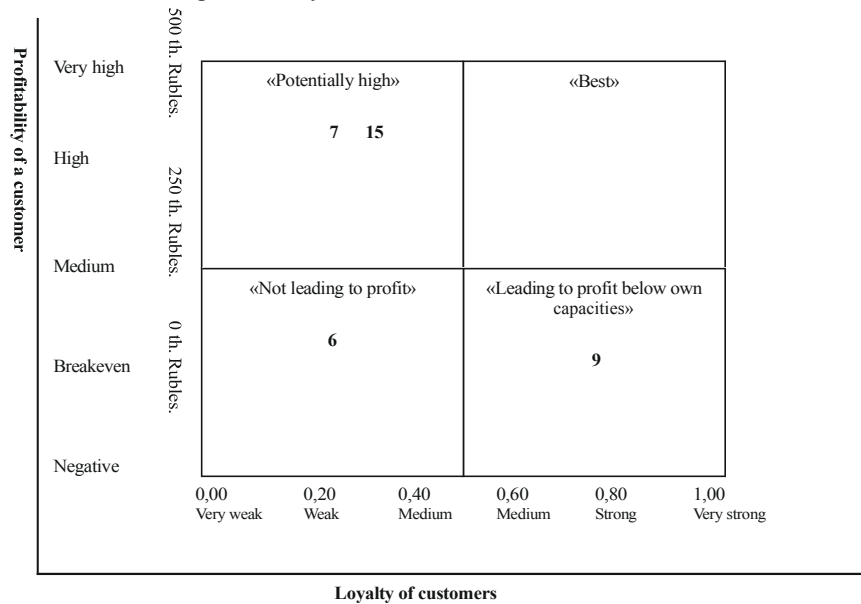


Fig. 2: Matrix of customers with profitability from 500 thousand rubles up to 500 million rubles

Let's analyze the available results. As can be seen from Table 1, there is a group of customers, the level of profitability for the Company is significantly different from other clients.

Group A – Profit up to 500 Thousand Rubles: Matrix with a profit of 500 thousand rubles (Fig. 1) has got 8 companies out of the total number of customers.

Most of these companies occupy quadrant «unprofitable»: 4, 5, 8, 10 and 14.

With companies in this category, who are in quadrant «unprofitable» company should proceed as follows:

separate potentially profitable customers from unprofitable «defectors» and concentrate efforts on potentially profitable customers. Many of the companies located in this quadrant relatively recently started its cooperation with the company and in the near future may become highly profitable customers and loyal customers.

Two companies were in the upper left quadrant «high potential»: 12, 13. Profits from this group of clients are not so significant – up to 500 thousand rubles. Despite the fact that companies 12 and 13 fall into the category of «high-margin» customers. Such clients are easy prey for the competitors, since their loyalty is low. Therefore it is

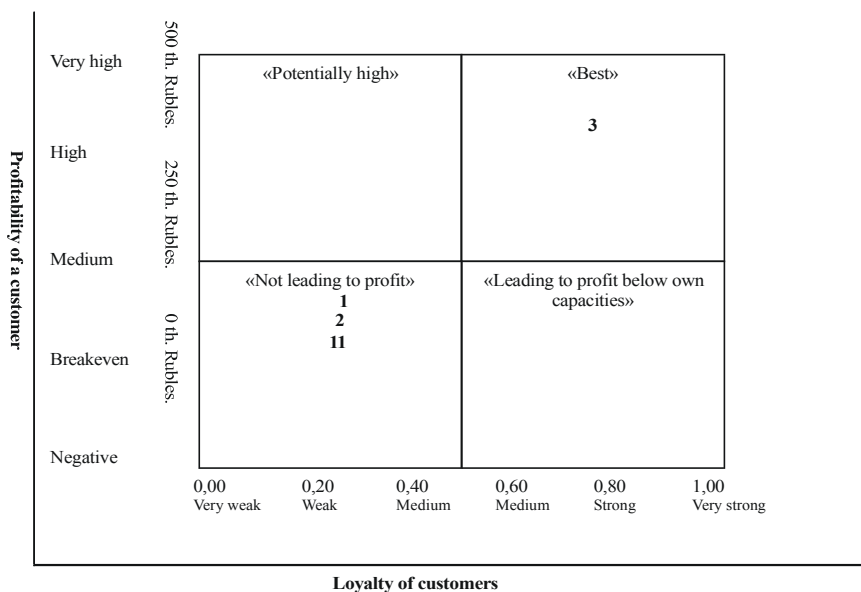


Fig. 3: Matrix of customers with profitability over 5 million rubles

necessary to selectively invest into relationships with such customers need to be very selective, i.e. with a personal touch.

Group B – Profit from 500 Rubles up to 5 Million Rubles: Matrix with profitability from 500 to 5,000 rubles has got four companies. Two of them are located in the quadrant «high potential» 7 and 15 (Fig. 2).

In this case, the strategy of working with clients is slightly different from a similar strategy in Group A – «The profitability of up to 500 thousand rubles. «The company's actions in this case should be directed to invest to form loyalty of these buyers with the help of specially prepared proposals, enhancing their customer satisfaction and desire to stay.

Customers 6 and 9, respectively, are located in quadrants «unprofitable» and «Profit Gains underachieved» respectively. For company 9, which has fallen into the quadrant «Profit profits below their capacity», it is needed to create opportunities to increase consumer revenue and margin, as well as to invest in maintaining customer loyalty. Working with the company 6 in the near future should be denied.

Group C – Profit over 5 Million Rubles: In the Matrix with profitability over 5 million rubles were only 4 companies. Three of them took quadrant «unprofitable»: 1, 2 and 11 (Fig. 3).

Although the data of the companies 11, 2 and 1 got in quadrant «unprofitable», but in fact they are the major customers in Group C – «Profit from 5 million rubles»,

conceding only to the company number 3. Definitely, we need to invest into improving loyalty primarily clients 11 and 2 and then client 1, as they are potentially «highly profitable».

Limitations to Apply the Methodology: This assessment methodology does not just allow customers to rate their profitability and loyalty to the company. But, as we see, based on these indicators this allows to work out strategy of relationships with each customer group, to set up an individual approach to build «highly profitable» customers, on the one hand and to consider the need to work with the « low-income» customers, on the other. In other words, this technique meets the requirements of modern management and marketing relationships with customers [13, 14].

However, it should be noted that this study accounted only the profitability into, but not yet the yield, i.e. no marketing costs and costs to attract and keep customers have been considered. This slightly reduces the accuracy of the estimate because the marketing costs can not be excluded from the efficiency analysis of the company [15].

CONCLUSIONS

Key findings of the survey are as follows:

- There is a need for special focus thinking on key executives of the company profitability and customer loyalty performance indicators,

- Methodology to evaluate the profitability and customer loyalty is a simple tool for managing strategic relationships with clients,
- Application of the method in practice requires an assessment not only of cash flow from customers, but also the cost of their service.

On the basis of this methodology one can build a targeted system of relationships with clients within the framework of strategic management of the enterprise. That is what was done afterwards by the company management.

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