

THE NOT-SO-STRAIGHT-FORWARD RELATIONSHIP BETWEEN CUSTOMER SATISFACTION, LOYALTY AND PROFITABILITY

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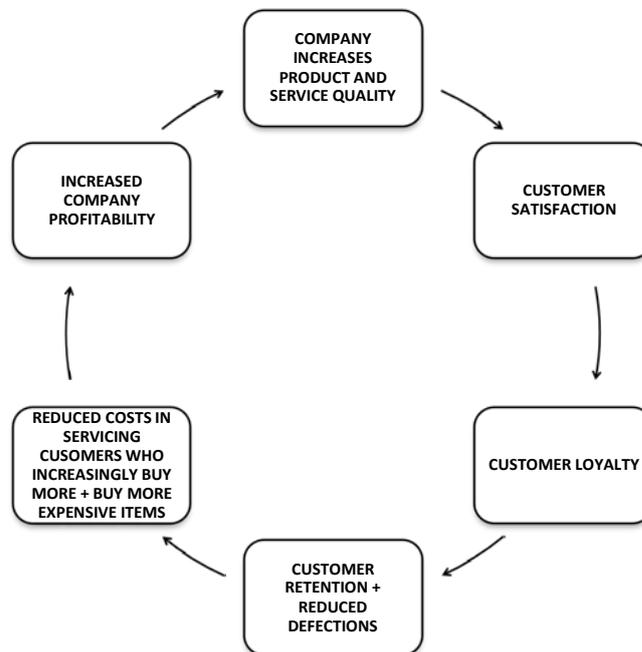
ABSTRACT

Check out of your hotel and you'll soon be sent an electronic questionnaire asking for your satisfaction ratings of the hotel's various services. While having a meal at a restaurant you'll often see a card-questionnaire on the table asking for your satisfaction with the meal and service. Call up the telephone company regarding a telephone issue and you'll be asked to stay on the line an extra minute to respond to several questions regarding your satisfaction with the service. Visit a doctor and, before you leave, there are some questions they'd like to get your responses to regarding your satisfaction with the visit. Most companies recognize that in order to maintain high levels of customer satisfaction they must maintain and deliver high-quality products and services. But will providing high levels of measurable satisfaction ensure that companies create a coterie of loyal customers, and will this in turn increase company profitability? This paper investigates the links in the Customer-Company Profit Chain beginning with the construct of "satisfaction," a construct that has become a feature of everyone's daily life.

SATISFACTION

Less than 20 years ago, service marketing was recognized as a unique branch of marketing with its own issues and theories separate and distinct from tangible-goods marketing. A stream of service marketing research was generated, resulting in contributions in the areas of service development, implementation, and assessment. The measurement of customer satisfaction became prominent as a means of assessing users' attitudes toward the quality of companies' service delivery. Restaurants, banks, airlines, hospitals, hotels, car rental agencies, insurance companies, and universities, among others, queried their diners, account holders, passengers, patients, guests, customers and students about the quality of their service. This was the "Golden Age" of customer satisfaction studies. No effort was spared to ensure that customers were receiving the highest quality service possible. The reasonable assumption is satisfaction makes a difference in developing and maintaining customer relationships, and through better service comes higher profits. The Customer-Company Profit Chain (See Figure 1) posits that increasing service quality increases customer satisfaction which will lead to retention and loyalty. Such customers cost less to serve, will increasingly buy more, trade-up to more expensive offerings and increase company profitability. This article investigates whether this is really the case.

FIGURE 1: THE CUSTOMER-COMPANY PROFIT CHAIN



Organizations believe that satisfied customers will provide positive word of mouth, buy a greater variety of products and services and trade-up, which will, in turn, increase profits and improve company value. But will providing high levels of satisfaction ensure that companies create a coterie of loyal customers who will spend more and increase company profitability? Understanding the relationship between satisfaction, loyalty, and profitability is critical to our developing better marketing strategies and is the topic of this paper.

If satisfaction is the key to maintaining and enhancing customer relationships which, in turn, lead to greater profitability, then measurements of marketing strategy effectiveness can be based on the rich array of satisfaction measures that already exist. Marketing strategies should be developed that focus on increasing customer satisfaction. However, if satisfaction does not prove to be intimately related to customer loyalty and profitability, then we should determine why, and search for other marketing effectiveness measures.

Quality of service is what the customer, not the company, says it is. A recent study showed that while 80 percent of the 362 companies surveyed felt they provided a superior-quality service, only 8 percent of customers felt they did (Anderson, Fornell and Lehmann 1994). While it is generally agreed that the concepts of service quality and service satisfaction are related, some feel that there is confusion regarding exactly how the two variables relate to one another (Brown, Fisk and Bitner 1994). Some have suggested that customer satisfaction is transaction specific (an immediate post-purchase evaluation) and therefore somewhat

variable. Others feel that since consumer satisfaction is an evaluation based on the total purchase and consumption experience with a good or service over time (cumulative satisfaction), it is an enduring attitude toward an organization's service quality (Evans 2011).

It is possible that a customer may experience low transaction-specific satisfaction but still have high cumulative satisfaction with a company. For example, a business traveler waiting a long time to check into their hotel room and then being told their reservation can't be found is bound to experience low satisfaction with the hotel for this particular transaction. They may have stayed at this hotel for a number of years without incident, however, so their overall cumulative satisfaction with the hotel is still high. Transaction-specific satisfaction measures are more useful in determining the effectiveness of training or other quality improvement efforts. Cumulative satisfaction measures are more useful in determining the effectiveness of customer retention efforts.

One conclusion that seems to characterize the many diverse studies with respect to customer satisfaction is that while satisfied customers may not remain loyal, dissatisfied customers certainly won't (if they have a choice). The vast majority of dissatisfied customers, reported to be as high as 90 percent in some studies, will not have further dealings with such companies (Knauer 1992). Further, nearly all research has shown that dissatisfied customers tell more people about their bad experiences than satisfied customers with good experiences. Negative word-of-mouth (mouse) is spread more quickly, to more people, than positive word-of-mouth (mouse) and it has more impact on their future behavior. Satisfaction is, therefore, said to have an asymmetric impact on variables such as loyalty and profits. Leaving a customer dissatisfied damages a company in two ways: loss of business from that customer and negative word of mouth leading to the loss of business from many others.

It behooves a company to try to recognize dissatisfied customers and reverse a bad situation. Unfortunately, numerous studies have shown that only a small percentage of dissatisfied customers complain—usually less than 10 percent. T. Peters reported that 26 of 27 customers failed to report a bad experience (Peters 1987). Why? Perhaps because they felt that the time and effort involved was greater than the potential return they would accrue from the company satisfactorily handling their complaint.

Handling customers' complaints satisfactorily is impossible if customers do not report them. Companies must establish systems, procedures, and an underlying culture that views customer complaints as an opportunity rather than a threat. Tony Tuor, the late, Swiss-born executive manager of the Dusit Thani Hotel in Bangkok, could be seen every day talking with hotel guests in one or more of his hotel's restaurants, soliciting their feedback regarding lapses in his hotel's service. Tuor once said: "I love when customers complain because that gives me the opportunity to solve their problem, provide a solution that exceeds their expectation, and cement the relationship. These previously dissatisfied customers will become more loyal to our hotel than if they didn't experience a lapse in service quality in the first place."

Dissatisfied customers have dire consequences for a company's business, but let us now turn our attention to the benefits of having satisfied customers. Here, the matter becomes less straightforward. The following are two definitions of what it means to be a satisfied customer (Lemon, White and Winer 2002):

Satisfaction can be broadly characterized as a post-purchase evaluation of product quality given pre-purchase expectations (Anderson and Sullivan 1993).

Satisfaction is the consumer's response to and evaluation of the perceived discrepancy between prior expectations (or some other norm of performance) and the actual performance of the product as perceived after its consumption (Tse and Wilton 1988).

Notice the similarity in these definitions of satisfaction: the comparison of prior service expectations with the actual service level received. This is referred to as the expectancy confirmation/disconfirmation model of satisfaction, wherein satisfaction is the difference between expectations and current experiences. If service rendered exceeds what was expected, the consumer is satisfied. If service rendered is below what was expected, the consumer is dissatisfied. An important strategic outcome of this is that there are serious ramifications in store for those companies that promise more than they can deliver. On the other hand, if a company keeps expectations relatively low (Carnival Cruise Lines) customers leave satisfied when they find their expectations have been exceeded.

From the mid-1980s until 2000, service firms and academics worked diligently to establish the best ways to measure customer satisfaction because of the belief in the relationship between customer satisfaction and loyalty and, further, the belief that long-term relationships were more profitable than short-term relationships. As research results accumulated, however, some concluded that satisfied customers may not necessarily develop into loyal customers. For example, while Carnival Cruise Lines has 95% satisfaction, less than 20% of their customers return more than once!

SATISFACTION, TRUST, COMMITMENT AND LOYALTY

To many researchers of relationship marketing, satisfaction appears to be too weak a construct to describe the strength and depth of a relationship, so other variables were investigated as predictors of future behavior. Since relationships are studied in many fields including social psychology, industrial marketing, services marketing, marriage and family, and even religion, it is not surprising that a vast array of variables were considered. Several constructs more essential than satisfaction were hypothesized to underlie relationship-strength including: caring, support, loyalty, honesty, communication, respect, affection, helpfulness, trust, understanding, liking, reciprocation, trustworthiness, commitment, placing priority on the other's interests, maintaining privacy, desire to maintain a long-term relationship, interacting over time, benefits accruing to both parties, not criticizing publicly, working through disagreements, and keeping confidence.

While many elements such as these underlie relationships, the research literature singles out trust and commitment between both parties as being critical. R. M. Morgan and S. D. Hunt, in their theory of relationship marketing, state that trust and commitment are essential because they encourage partners to:

1. Preserve the relationship through cooperation
2. Resist attractive short-term alternatives in lieu of expected long-term benefits
3. Take risks since they are confident their partner will not act opportunistically (Morgan and Hunt 1994)

With trust, one partner will rely on another because they have confidence in their integrity, durability, and ability to work out problems they will face in the marketplace. Commitment refers to both parties' understanding that they are in the market together for the long run. They are willing to make sacrifices for their partner because they are mutually dependent upon one another in their quest to achieve long-term returns on their psychological and financial investments.

The importance of trust and commitment was further emphasized by B. B. Jackson who identified three types of relationships that a company can have with its customers—that of being an acquaintance, friend or partner. She states that acquaintance relationships, based on satisfaction, are the weakest (Jackson 1985). An **acquaintance relationship** exists when a customer is satisfied with the product or service a company provides because it is on par with what they could get elsewhere. This implies that satisfaction, in and of itself, cannot be expected to be a precursor to loyalty since competitors' offerings are comparable with the selected offering, and any number of situation-specific variables could lead the consumer to switch to an alternate. A **friendly relationship** exists when the customer trusts that a company provides differentiated value. And a **partner relationship** exists when the customer is committed to the company because it provides customized value.

When there is commitment, both parties will do whatever is necessary to maintain the relationship. As such, partner relationships are more likely to occur in the business-to-business (B2B) sector (for example, between franchisor and franchisees) although they do occur in the business-to-consumer (B2C) sector as well (for example between Harley-Davidson and Harley Owners Group (HOG) members). Since the strength of a relationship moves from satisfaction to trust to commitment, satisfaction alone cannot be expected to lead to loyalty since it indicates only a weak bond between customer and company. Organizations may want to determine what type of relationship—acquaintance, friend, or partner—characterizes ongoing customer–company bonds in their company and industry, and then decide whether measures of satisfaction, trust, or commitment are most appropriate.

While satisfaction as a measure of the bond between customer and company may be a somewhat weaker construct than loyalty, a few research studies have shown that a positive relationship exists between satisfaction and financial performance even though the relationship may not be direct. One study showed that for every 1 percent, or 1 point, increase

in satisfaction, a firm's market value increased by \$35 million (Anderson, Fornell and Mazvancheryl 2004, Ittner and Larcker 2000). Other research has shown that the satisfaction–profit link is asymmetric and nonlinear with a 1 percent increase in satisfaction increasing return on investment (ROI) by 2.4 percent, but a 1 percent drop in satisfaction decreasing ROI by 5.1 percent (Gupta 2006). The findings cannot be generalized, however, since the satisfaction-profit link varies by industry.

With respect to the construct of loyalty, researchers have still not developed a definition of loyalty acceptable to everyone. At least four definitions exist:

1. **Behavioral or Spurious loyalty** simply looks at the brand(s) purchased without consideration of the feelings toward the brand. For example, a consumer purchasing Minute Maid orange juice every week for 10 years would exhibit behavioral loyalty if they purchased it because it was the only brand available even though they didn't like it.
2. **Affect or True loyalty:** "Affects "are the feeling components of an attitude and include "liking" and "preference." Proponents of this approach state that loyalty is determined not simply by looking at what is purchased but also by looking at a person's "liking" and "preference" of the brand. Many feel that for true loyalty to exist there must be affect loyalty; that is, a strong commitment to a brand.
3. **Situation-specific loyalty:** Proponents of this approach state that the relationship between attitudes and behavior is moderated by other variables such as an individual's economic circumstances, personality, and the buying situation (on-the-shelf availability, low price, point-of-purchase displays, sales promotion, etc.). With this model, it is possible that a consumer may forgo purchasing a brand they like and prefer because of another brand's promotion or availability. A consumer exhibits situation-specific loyalty if they purchase a Honda motorcycle because of a \$2,500 cash-back offer even though they prefer Harley-Davidson.
4. **Latent loyalty:** Latent loyalty exists when a consumer loves a brand but can't buy it because of price or other restrictions.

When there is no feeling toward brands within a particular product category and the consumer purchases whichever brand the store sells (coffee filters, vegetable oil, sugar), there may be no loyalty at all. "Convenience" goods are characterized by such brand indifference.

RETENTION

Reichheld, Markey and Hopton were not keen on measuring customer satisfaction since they claimed it was not related to retention. Instead, they stated that companies should carefully track repurchase loyalty as the "truer measure of how they stack up versus the competition." They stated that Lexus uses repurchase loyalty as their key satisfaction indicator (Reichheld, Markey and Hopton 2000). Reichheld was one of the first to propose that companies needed to focus more on customer retention as opposed to acquisition. Along with Sasser, he made a strong case that customer retention is the major driver of company profits. They made the following points regarding the importance of retention:

- Customers defect at the alarming rate of 10–30 percent per year. In fact, the annual

defection rate for newspaper subscriptions is 66%.

- A 5 percent increase in customer retention consistently resulted in 25–100 percent profit swings, over time, across all industries studied.
- Companies can boost profits by almost 100 percent by retaining just 5 percent more of their customers. For one auto-service firm the expected profit from a fourth-year customer was more than triple the profit the same customer generated in the first year.
- Reducing defections by just 5 percent generated 85 percent more profits in one bank's branch system.
- Companies with loyal customers can financially outperform competitors with lower unit costs and higher market share but high customer churn. In the credit card business, for example, a 10 percent reduction in unit costs was financially equivalent to a 2 percent decrease in defection rate (Reichheld and Sasser 1990).

FACTORS INTERVENING BETWEEN SATISFACTION AND LOYALTY

“Loyal customers, high in repeat purchase behavior and strong in attitude, are, theoretically, the most desirable customers...loyalty indicates a commitment to the support of a relationship.” W. G. Zikmund, R. McLeod, Jr., and F. W. Gilbert, *Customer Relationship Management* (New York, NY: Wiley & Sons, 2003).

Will maintaining high levels of satisfaction lead to customer loyalty? Most companies believe it will. Following, however, is a comprehensive view of intervening factors that may decrease, or even negate, the relationship between satisfaction and loyalty:

- The sheer numbers of competitive offerings that are on par with the company's offerings make it easy for satisfied customers to switch allegiance without any negative effects. For example, a consumer may love his Mercedes-Benz auto but when it comes time to purchase a new car he may decide among other high-quality luxury autos such as Lexus, BMW, Audi and Infiniti. Conversely, if few or no competitive offerings are available (telephone service, for example), a dissatisfied customer may, in fact, continue to purchase a product or frequent an enterprise toward which they are dissatisfied.
- Novelty-seeking behavior: while a consumer loved his last three Volvos he switches to an Audi just to experience something different
- Lack of personal attachment to a brand with which they are satisfied: a consumer may be very satisfied with Duracell batteries but purchase Eveready the next time he needs batteries. Consumers in general do not become emotionally attached to brands of convenience goods; e.g., brands of coffee filters, flashlight batteries or tooth-brushes. Even if highly satisfied, consumers buy what is available.
- Lack of consistency in performance: A season ticket holder loved 5 of the 6 operas at the Civic Opera House but decides not to repurchase season tickets because of the one opera she disliked.
- New competitors offer better value: the consumer loved his Mercedes but purchased a Lexus because of the automatic park-itself feature.
- New competitors provide a greater variety of ancillary services that lead a satisfied customer to switch. Such ancillary services could include financing, guarantees, training, delivery, formulation, servicing, packaging, etc.
- With respect to customer retention, high expectations of future use may override low levels

of satisfaction, and low expectations of future use may override high levels of satisfaction (Anderson and Sullivan 1993): For example, a consumer may not like Avis but since the company expects him to use Avis he has a long-term relationship with the brand.

- Customers may be very satisfied with a company's service and yet not want a long-term relationship with the firm. For example, a consumer cannot wait to stop doing business with a major credit card company even though its service is superb.

All of these examples point to the "disconnect" between satisfaction and loyalty and should give companies pause in their use of satisfaction measures to predict the direction of future sales.

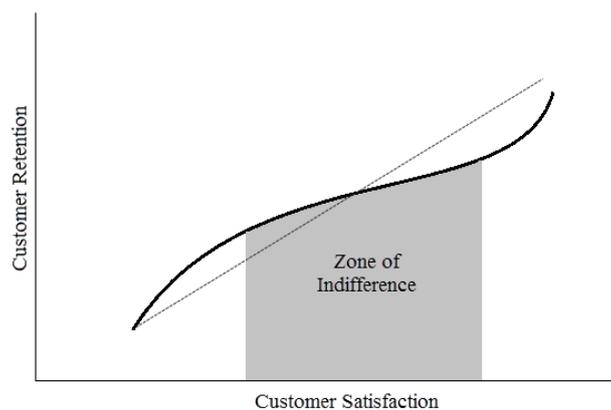
RESEARCH FINDINGS REGARDING THE RELATIONSHIP BETWEEN SATISFACTION AND LOYALTY

Even though customers may have high satisfaction scores but defect anyway, there is a lot of academic and commercial support for the satisfaction/loyalty/repurchase model; and companies continue to invest in attitudinal satisfaction studies. Why do some researchers stress that satisfaction is intimately related to retention but others caution that one should never relate satisfaction levels to retention (Rust and Zahorik 1993, Reichheld 1993)?

There appear to be five reasons for such disagreement:

1. Some research indicates that there is a relationship between satisfaction and loyalty, but it is not a simple linear relationship (See Figure 2). V. Kumar and W. J. Reinartz claim that the link between satisfaction and retention is asymmetric (dissatisfaction has a greater impact on retention than satisfaction) and nonlinear (the impact of satisfaction on retention is greater at the extremes, with the flat part of the curve in the middle called the zone of indifference) (Kumar and Reinartz 2005).

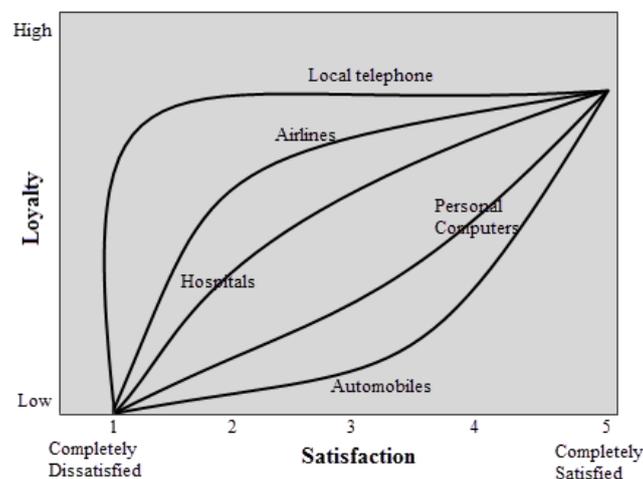
FIGURE 2: THE SATISFACTION-RETENTION CURVE



2. One must make the distinction between spurious loyalty and true loyalty. The former can be generated in industries where competition is scarce, high-switching costs exist, or

loyalty programs engender usage even when service does not warrant it. With local phone service, a convex relationship exists where customers are loyal (falsely loyal), even at high dissatisfaction levels (See Figure 3). On the other hand, where numerous high-quality competitors exist—e.g., the auto industry--a concave relationship exists where even a slight drop from complete satisfaction causes a tremendous drop in loyalty. Note, again, that there is not a simple linear relationship between satisfaction and loyalty. Thus, when it comes to measuring the effectiveness of marketing strategy, a researcher must distinguish between true (affect) and false (behavioral) loyalty. As T. O. Jones and W. E. Sasser, Jr. point out, to a much greater extent than previously thought, completely satisfied customers are more loyal than merely satisfied customers (Jones and Sasser 1995).

FIGURE 3: HOW THE COMPETITIVE ENVIRONMENT AFFECTS THE SATISFACTION-LOYALTY RELATIONSHIP



3. Even though Reichheld, Markey, and Hopton provide findings that show customers buy significantly more from companies with which they are completely satisfied, they hold to a more rigorous definition of satisfaction than most. To them, a customer is satisfied only if they are a “5” on a 5-point scale (Reichheld and Sasser 1990). Other satisfaction levels do not show a similar relationship.
4. Many studies investigating the relationship between attitudinal satisfaction and other dependent variables (longevity, profits, positive-recommendations, buying higher margin items, etc.) do not differentiate among first-time, short-term, and long-term customers. We posit that the relationship between satisfaction and indicators of loyalty or profitability will be strongest for long-term customers with positive satisfaction scores and lowest for short-term customers with positive satisfaction scores. The former can be considered in a relationship, while many of the latter may turn out to be transactional buyers. This may result in their having high initial satisfaction scores but low scores on the dependent variables such as retention.
5. Perhaps most importantly, your most loyal customers may also be your competitors’ most loyal customers. Most loyal customers may not, in fact, be exclusively loyal. “Road Warriors” may actually be the best customer segment for numerous airlines, hotels, and

rental car agencies. This group may be highly satisfied with all company interactions, but one slight slip may cause them to defect since there are so many high-quality alternatives. As G. R. Dowling and M. Uncles pointed out:

“There is reliable empirical evidence to suggest that many or most heavy users are multi-brand loyal for a wide range of products and services. That is, a company’s most profitable customers will probably be the competitors’ most profitable customers as well (Dowling and Uncles 1997).

A. S. C. Ehrenberg found empirical proof for a logical corollary; namely, “100 percent loyal buyers tend to be **light** buyers of the product or service” (emphasis added) (Ehrenberg 1988). In other words, in many markets, the high-volume buyers split their purchases across companies, whereas the low-volume buyers are more likely to purchase from a single company. The implications for measuring the effectiveness of marketing efforts is that one must be careful in how loyalty is defined. Customers who are 100 percent loyal should be expected to be most profitable. In actuality, those with divided loyalty may be a firm’s most profitable segment.

THE RELATIONSHIP BETWEEN CUSTOMER LOYALTY AND COMPANY PROFITABILITY

Companies focus on developing a loyal customer base for the increase in profits this group is expected to generate. It seems intuitive that the longer loyal customers buy from a company, the more profitable they become. Few would argue this in contractual situations; e.g., between health clubs and their members or between phone companies and their subscribers. But these contractual settings should be contrasted with more transactional settings such as exist between retail stores and their customers. Even in transactional settings the relationship between customer loyalty and company profitability has been found to exist. Reichheld and Sasser’s study showed that even a small increase in customer retention rates could have a major impact on profitability (Reichheld, Markey and Hopton 2000). Reichheld and T. Teal showed that profits increase with the length of time a customer remains in a relationship with a company (Reichheld and Teal 1996). R. C. Blattberg and J. Deighton showed that it was much more cost effective for a company to retain their current customers than to acquire new ones (Blattberg and Deighton 1996). R. Best said that retained long-life customers produce higher revenues and margin per customer than lost or newer customers and that total profits should increase over time (Best 2000). These studies reinforced the benefits of what is called **defensive marketing** as opposed to **offensive marketing**.

The increased profits from loyal, long-term customers are said to accrue for a number of reasons:

- They buy more
- They tend to “trade up” (i.e., purchase more expensive items in a company’s product lines)
- They lose their vigilance toward price and become less price-sensitive. The reasoning is that long-term customers, because they understand a company’s procedures and product lines well, can extract more value in terms of convenience and purchase efficiencies and, therefore, are not as price sensitive as newer customers.

- They give word-of-mouth referrals to family and friends
 - They cost less to serve since companies are more efficient in meeting their needs
- All of these factors have increased companies' efforts to retain customers.

Recently, however, results of empirical studies have led to numerous qualifications regarding loyalty–profitability tenets. Uncles and Dowling caution: “In short, the contention that loyal customers are always more profitable is a gross oversimplification (Ehrenberg 1988).” Reinartz and Kumar point out that if the cost of servicing customers is greater than the profit margin generated by customers profits will not increase over time nor will the nature of the lifetime-profitability relationship be positive (Reinartz and Kumar 2000).

Costs of servicing long-time customers can be high. Consider the catalog company that sends ten or more catalogs per year to a household that never buys. Consider the cost to a company that sends out millions of bills each month to customers with a \$0 balance. Consider long-time customers who tie up the contact center personnel with constant complaints or consistently return merchandise. Finally, consider the significant costs associated with loyalty/reward programs. Costs of servicing long-term customers can actually exceed the profit margins they generate.

Does it truly cost less to service long-term customers than short-term customers? Those involved with B2B say “yes” because experience factors play a role in most of these relationships. When the transaction involves learning, long-term customers should cost less because the cost of educating them gradually decreases while transaction efficiencies increase over time. For example, corporate tax accounting firms can service long-term clients more efficiently since they have acquired a deeper knowledge of their business over time and trained the client in time-saving input routines. Those involved with B2C, however, point out costs such as mailing, are unaffected by a customer's tenure.

Reinartz and Kumar empirically tested the relationship between retention and profitability and their findings contradict many of the traditional tenets. They found that:

- In terms of profitability per month, short lifetime but high revenue customers were the most attractive.
- Profits for long-life customers did not increase over time.
- Short-life customers paid higher prices than long-life customers. This supported company managers, who said that long-term customers have a higher value consciousness (i.e., pay lower average prices).
- Some long-life customers may cost the firm more in the long run due to marketing expenses exceeding profits for this group (Reinartz and Kumar 2000).

Their study illustrated the importance of weighing promotional costs against expected profits from varying tenured customer segments.

Additional empirical studies across industries will have to be conducted before the many

tenets of the loyalty/profit relationship can be accepted or rejected. What can be recommended now, however, is that each company tests these loyalty/profit tenets using their customer base. Transaction-based service companies, such as restaurants, hotels, and airlines, may have a significantly different loyalty/profit profile than health clubs, telephone companies, and insurers that have contractual service relationships with customers. In addition, companies producing highly identifiable products and services that are strong in psychological benefits and consumer involvement (university degree programs, professional sports teams) may have significantly different loyalty/profit profiles than companies producing products and services that are undifferentiated from their competitors (luxury hotels, airlines).

In one of their landmark articles, W. J. Reinartz and V. Kumar provided an interesting typology of customers based on their profitability and their projected duration with a company (Reinartz and Kumar 2000). (See Figure 4)

The typology is useful because once a company determines which quadrant a customer belongs to, it can determine the amount it should spend on relationship efforts. They suggested that since Butterflies are high-profit/short-term customers, the mistake that most companies make is investing too much money over too long of a time period in relationship marketing. The key with Butterflies is to maximize transactional profit through short-term promotional blitzes and not to attempt a long-term relationship. Because True Friends offer the greatest profit over the longest time period, companies must foster this relationship more than the others but not overwhelm these customers with constant communications. Since Strangers are low-profit/short-term customers, no investment should be made on them. Companies should seek profit on every transaction and never expect that offering them loss-leaders will cause them to trade-up. They are only loyal to low prices and will not change. Barnacles are long-term/low-profit customers. They may be low profit either because their wallets are small or because you have a small share of their wallet. Companies should try to increase profits from this group by cross-selling and trading-up. If this fails, assume their wallets are small and minimize relationship marketing expenses.

FIGURE 4: CUSTOMER LOYALTY AND PROFITABILITY

Profitability	High	Butterflies 	True Friends 
	Low	Strangers 	Barnacles 
		Short-Term	Long-Term
		Customer Loyalty	

Based on a categorization of customers classified on profitability and loyalty, here are the marketing strategies that are recommended (See Figure 5): For high-profit/high-loyalty customers use a CRP strategy: customize, reward, and personalize. For high-profit/low-loyalty customers try and OUTFOX the competition. This group probably divides its purchases among a number of competitors, so companies should try and increase their share by developing effective strategies and tactics; however, this must be done continuously for competitors will match the ones that prove successful. For low-profit high-loyalty customers X-RAY WALLETS: i.e., direct promotions to the entire group for a year to determine which customers are valuable and which aren't. Drop those with thin wallets and keep those with thick wallets. For low-profit low-loyalty customers use the FAT strategy; i.e., "forget about them." You will never recoup your marketing investment in this group.

FIGURE 5: CHOOSING A LOYALTY STRATEGY BASED ON TYPE OF CUSTOMER

Profitability	High	Butterflies Outfox Strategy	True Friends “CRP” Strategy
	Low	Strangers “FAT” Strategy	Barnacles X-Ray Wallet Strategy
		Low	High
		Loyalty	

SUMMARY

The relationships between customer satisfaction, loyalty and profitability are not clear. Increases in satisfaction have been related to increases in company profitability although the relationship does not appear to be linear. In addition, the relationship between satisfaction and profitability appears to be asymmetric. Dissatisfaction will hurt the bottom line more than satisfaction will help it. Most established competitors today produce quality products and render high-quality service, so consumers are highly satisfied with numerous options in each category. That being the case, companies need to strive for something greater than customer satisfaction. Companies need to deliver a marketing mix that customers simply cannot live without. Companies need to bond with their customers through effective relationship marketing strategies and create loyalty, trust and commitment rather than just satisfaction. The difficulty is in not overspending on customer segments that don't want a deep relationship with your organization. It is most probable that the relationships between customer satisfaction, loyalty and profitability are industry specific and are best determined by companies mining and analyzing the data in their customer information bases. The greatest successes will be gained by companies who are able to identify their “steep-skew” customer segments; i.e., those generally small groups of customers spending the most money on high-margin products and services. These are the segments you want to become loyal and you want to retain through relationship marketing efforts.

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