On some models of customer loyalty

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Abstract: *Business databases are sources of information that a company can use together with analyses of business statistics for acquiring knowledge of its own customers. Such large availability of information allows companies to devise new models of market segmentation, customer satisfaction and customer loyalty, which require great amount of data. We investigate the possibility of defining new types of customer loyalty by using strategies of market segmentation and statistical indexes of customer satisfaction.*

Keywords: Market segmentation, customer satisfaction, customer loyalty

1. Introduction

Market segmentation is a main goal of commercial companies and is developed through different marketing activities. It can be said that the process of segmentation requires as a preliminary step, the knowledge of the characteristics of its own customers in order to check if they are coherent with the corporate objectives. In fact, customers may differ in many aspects, e.g. their purchasing power and their specific needs. Therefore, a company needs to identify and address their different expectations in order to develop strategies that increase their satisfaction and value.

Segmentation starts from the selection of variables that measure those customers' characteristics that are considered appropriate for classifying clients in homogeneous groups or clusters. There exist two main approaches to segmentation, the *top-down method* and the *bottom-up method*. According to the former, the management selects ex ante the variables to be used for the cluster analysis. As for the bottom-up method, the process of segmentation defines the clusters through correlation coefficients that are calculated on the basis of all the available information on customers, information that is typically collected via data mining.

The selection of these segmentation variables is highly strategic; it can involve variables largely known in the marketing literature, such as socio-demographic variables which lead to the so called *geo-demographic segmentation*, or individual-specific variables, such as *purchasing power*, *purchase frequency*, frequently *purchased goods* and average expenditure. A third class of variables is given by variables that describe the life and consumption styles of a customer, giving rise to a *psychographic segmentation*.

Segmentation can also be based on variables of customer loyalty and customer satisfaction, although they may be measured in many different ways according to the existing marketing literature. For example, consider the bottom-up method and support it with data analysis techniques. Then, it is possible to associate socio-demographic and behavioral variables, including indexes of customer satisfaction and customer loyalty.

The paper is organized as follows. We first review different models of market segmentation, some of them associated with models of customer satisfaction. Then, we consider different types of loyalty, and, finally, we show how market segmentation models commonly used in the literature (which use different variables for clustering) may generate different types of loyalty.

2. On market segmentation models

In 1956, W. Smith defined: "Market segmentation involves viewing a heterogeneous market as a number of smaller homogeneous markets, in response to differing preferences, attributable to the desires of customers for more precise satisfactions of their varying wants". Market segmentation models have emerged as a strategic activity of management: they aim at formulating different alternatives, ranging from mass marketing to one-to-one marketing. The recent availability of transnational corporate data has promoted a frenetic activity of market segmentation, moving from simple socio-demographic variables to more complex variables generated from the customer behavioral styles. Consequently, market segmentation has become an important part of business for firms that have customer loyalty as their main goal.

Segmentation models have the role of simplifying a complex situation by dividing the clients in groups so as to address specific strategies of product and service marketing to each one of them. However, it is worth noting that market segments are not real entities but theoretical concepts that are necessary when it has to be decided which strategies to implement for detecting customers' needs and increasing the profit.

If one agrees that markets segments are determined by the need of simplifying a given market and by the strategic view of the management, then different segmentation models should produce different kinds of customer loyalty.

Many recent papers analyze how market segmentation has changed because of the globalization of markets observed in the last decades: they all agree that globalization causes a profound reconsideration of marketing strategies towards the definition of international market segments of customers. To name a few, Steenkamp and Hofstede (2002) consider the interesting phenomenon of international market segmentation, while Brangule-Vlagsma et al. (2002) analyze the change in the system of values, trying to understand the change in customer attitudes and the consequent changes in market segmentation. Finally, Boone (2002) proposes neural networks as an alternative method for market segmentation and makes a comparison with other existing methods.

3. On generation of different kinds of loyalty

The notion of loyalty has received an increasing attention in the marketing literature in the last forty years. There exist two different points of view, a deterministic approach, focusing on loyalty from an attitudinal perspective, and a stochastic approach, which considers loyalty from a behavioral perspective.

Day G.S. (1969) was the first to advance the idea that loyalty is a two-dimensional concept involving *attitudinal loyalty* and *behavioral loyalty*. In the last years, a multidimensional view of loyalty has emerged making the concept of loyalty more complex and engaging for researchers. Let us focus now on the recent marketing literature. We may start from the loyalty models considered by Augustin and Singh (2005). They consider the curvilinear effects of customer loyalty on relational exchanges: on the basis of the theories on needs, reasons and social exchanges, they examine the curvilinear effects of loyalty caused by transnational satisfaction, loyalty and value in relational exchanges. Their main contributions to the study of loyalty are of three different types: a) the theoretical proposal of the nature and the shape of the influence of different loyalty determinants; b) the consideration of simultaneous and differential effects of multiple determinants; c) the study of the implications of these effects for theory and management practice.

Y. Liu (2007) develops further this perspective by considering the effects of loyalty programs on long term loyalty. His research examines the long-term impact of a loyalty program on consumers' usage levels and their exclusive loyalty to the firm. Using longitudinal data from a convenience store franchise, the study shows that consumers who were heavy buyers at the beginning of a loyalty program, were most likely to claim their qualified rewards, but the program did not prompt them to change their purchase behavior. In contrast, consumers whose initial patronage levels were low or moderate, gradually purchased more and became more loyal to the firm. Anderson and Srinivasan (2003) study the effect of satisfaction on loyalty in the context of electronic commerce. They show that the relationship between satisfaction and loyalty is moderated by consumers' individual level factors and firms' business level factors. Among consumers' level factors, the effect of satisfaction on loyalty is increased by convenience motivation and purchase size, whereas the effect is reduced by inertia. With respect to firms' level factors, the effect is increased by trust and perceived value. According to Oliver (1999), the relationship between satisfaction and loyalty is asymmetric. He investigates what aspect of the customer satisfaction response has implications for loyalty and what proportion of the loyalty response is due to this satisfaction component. His results show that satisfaction is a necessary step in creating loyalty, but becomes less effective when loyalty begins to set through other mechanisms. Bandyopadhyay and Martell (2007) extend the idea set forth in Dick and Basu (1994) of loyalty as essentially given by a positive attitude towards the brand and repeat purchasing. Bandyopadhyay and Martell propose a market segmentation model on the basis of attitudes that govern the loyalty behavior. Moreover, they propose a behavioral model for a non-user customer to be included along with two known behavioral patterns, single user and multiple user. Chaudhuri and Holbrook (2001) consider two different aspects of brand loyalty, *purchase loyalty* and *attitudinal loyalty*, and develop a model which includes different types of variables inside the process that creates indexes of brand performances from loyalty. Their results suggest that purchase loyalty leads to greater market share and attitudinal loyalty leads to a higher relative price for the brand.

4. On segmentation-loyalty link

On the basis of our previous analysis, we may state that there exist three fundamental instruments of marketing: *market segmentation*, *customer satisfaction* and *customer loyalty*. Customer satisfaction involves the analysis of the level of satisfaction of a consumer through statistical models and refers to attitudes and behaviors of customers. The activities associated to customer satisfaction can be considered short term plans, that is, tactics. More complex business activities oriented to customer loyalty are instead strategic, Montinaro (2007). Customer loyalty needs realization periods that are of medium to long term range, which are linked to the life span of a product and require high costs.

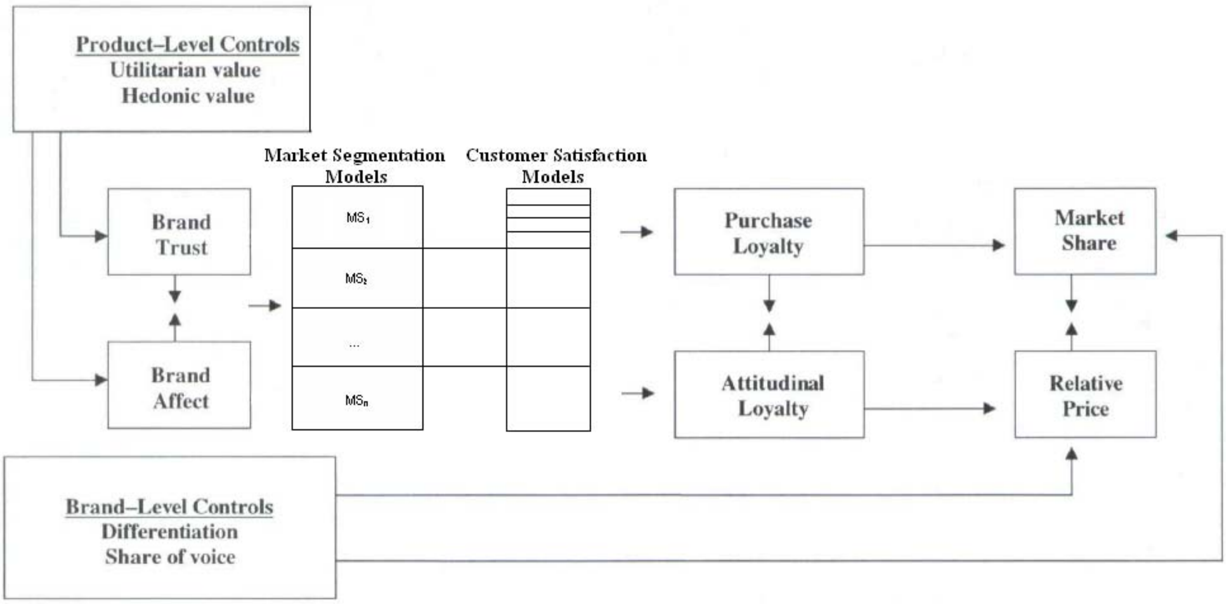

Figure 1: From segmentation models to different types of customer loyalty

In fact, a firm needs to have two important components: *highly qualified human resources* and *advanced technology*. The availability of complex informative sources, such as corporate databases which collect transnational data, makes possible the definition of well-defined market segments through marketing studies that can involve large number of variables and which were unaffordable even few years ago. If we associate to these market segments, those measures of customer satisfactions that describe, on the basis of the analysis of customers' attitudes and behavior, how much a product or a service match clients' expectations, then we get a winning strategy that ends up characterizing the different profiles of customer loyalty. Customer loyalty is a strategic objective for a company since gaining the trust of a customer leads to an increase of profit. We believe that an effective market segmentation represents the right methodological tool for defining the new kinds of customer loyalty required by a global economy. Figure 1 below illustrates the process which begins with a segmentation model and, by associating to each segment a corresponding measure of customer satisfaction, leads to the definition of different types of customer loyalty proposed by Chaudhuri and Holbrook (2001).

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