Chapter 1
CHAPTER- 1

INTRODUCTION

In the early 20th century in the United States, demand outpaced supply to the extent that companies concentrated on selling as many products as possible. Suppliers focused on product development, manufacturing capacity, and securing distribution outlets, without regard to their consumers. They did not pay much attention to who bought their products or what their customers needed. They used classic marketing tactics, i.e., mass marketing – primarily print and broadcast advertising, mass mailings, and billboards.

By the middle of the 20th century, however, the economy had matured to a point where consumers had the power of choice because supply had outstripped demand. The era of the passive consumer was coming to an end. Companies began to find out who their customers were, what they wanted, and how they could be satisfied. They analyzed data about their customers and segmented them based on their demographics, such as age, gender, and other personal information. Then they promoted their product or service to a specific subset of customers and prospects.

This was called “target marketing.” Each company thought seriously about the “four P’s” (price, promotion, product, and placement), the basic concept of modern marketing, which was first suggested by the expert in the field, Jerome McCarthy, in 1960.
Goods manufacturers are competing in a severe business environment, and target marketing (product, price, place, and promotion, the 4 Ps) alone is perceived to be insufficient.

As a result, Relationship Management is recommended for establishing unique relationships with customers and for generating more value to goods and services than what is possible through traditional target marketing.

Traditional target marketing was not so gratifying under circumstances in which it was so difficult to cultivate new customers that this tactic could not sustain cost efficiency. At this point, the idea of “relationship marketing” gained the confidence of the business sector.

Changing of the needs of the customers, continues product upgradation, changing in technology, changing market trends and high competition in the market which force the marketers to change their strategy from mass marketing to interactive marketing then to relationship marketing.

1.1 Relationship Marketing

Relationships are as old as mankind. It has been studied by sociologists, social psychologists, anthropologists, philosophers, theologians and many other people. For that matter even the traders and businessmen of yesteryears relied on relationships for their success. However the modern marketers started taking a fancy to the same only recently.

In the early 90s the concept of relationship marketing was formally introduced into the field of services marketing.
Financial service institutions, airlines and other service providers found it profitable to retain and reward the existing customers than running after new customers. It was established that building closer relationship with customers resulted in better returns to companies through the following means by Reichheld:\(^1\):

- Increased use of company services by loyal customers
- Charging of price premiums for customized services
- Referrals by satisfied customers that brought new customers

Grnnroos\(^2\) states that relationship marketing is to establish, maintain, enhance and commercialize customer relationships (often but not necessarily always long term relationships) so that the objectives of the parties involved are met. This is done by a mutual exchange and fulfillment of promises.

Grnnroos puts the main arguments behind relationship building as:

1. Offer more security.
2. Feeling of control
3. Sense of trust
4. Minimized risks

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5. Reduced costs of being a customer

Shani and Chalasani\(^3\) offer a similar definition. They define relationship marketing as an integrated effort to identify, maintain, and build up a network with individual consumers and to continuously strengthen the network for the mutual benefit of both sides, through interactive, individualized and value-added contacts over a long period of time.

Although the two definitions differ somewhat, they both indicate that relationship marketing focuses on the individual customer-seller relationship, that both parties in the relationship benefit, and that the relationship is longitudinal in nature. Further, they both imply that the focus of relationship marketing is on retaining customers. Although such a view is common, it has led some authors, such as Bickert\(^4\), to define relationship marketing as being synonymous with database marketing. Such a definition, however, leads to an error of omission because marketing activities that legitimately fall under the purview of relationship marketing are being excluded.

This concept was aimed at building long-term relationships with customers and placed a great deal of value on the


retention of existing customers rather than the acquisition of new ones.\textsuperscript{5}

1.2 Retention and Acquisition

Marketing operations consist of two activities: acquisition and retention of customers. In the world of mass and target marketing, the focus was on the acquisition side. On the other hand, in the world of relationship marketing, attention shifted to retention.

This happened mainly because of the cost involved. In general, it is believed that “it is five to 10 times more expensive to acquire a new customer than obtain repeat business from an existing customer.”\textsuperscript{6}

As the needs of customers became diversified, conventional promotions became less efficient and drove up costs.

According to the well-known empirical “Pareto principle,” it is assumed that 20 percent of a company’s customers generate 80 percent of its profits.\textsuperscript{7}

\begin{footnotesize}
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\item\textsuperscript{5} Satoshi Ueno “The impact of Customer Relationship Management” Program on U.S.-Japan Relations Harvard University 2006.
\item\textsuperscript{6} Paul Gray and Jongbok Byun, “Customer Relationship Management” March 2001: 10.
\item\textsuperscript{7} The Pareto principle (also known as the 80-20 rule, the law of the vital few, and the principle of factor sparsity) states that for many phenomena, 80 percent of the consequences stem from 20 percent of the causes. 21 June 2006 http://en.wikipedia.org/wiki/Pareto_principle Wikipedia: The Free Encyclopedia.
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1.2.1 The Pareto Principle

The Pareto Principle was propounded by Vilfredo Pareto (1848-1923) when he observed that 20 percent of the people of Italy owned 80 percent of the wealth. This concept of disproportion often holds in many areas. The exact values of 20 and 80 are not significant; they could actually be 10 percent and 60 percent. What is important is that there is a considerable disproportion. The values of 20 and 80 just have a simple symmetry.

This principle of concentration, inequality, or inverse proportion can be seen from the following diagram, where the smaller first part increases to the larger second part as shown in gray. In other words; retention of a large customer base is a major issue.

Other such situations follow; there are many in real life:

- 20% of the time expended produces 80% of the results.
- 80% of your phone calls go to 20% of the names on your list.
- 20% of the streets handle 80% of the traffic.
- 80% of the meals in a restaurant come from 20% of the menu.
- 20% of the paper has 80% of the news.
- 80% of the news is in the first 20% of the article.
- 20% of a home collects 20 percent of the dust.
- 20% of the people cause 80% of the problems.
- 20% of the features of an application are used 80% of the time.

These Pareto-type observations are not necessarily bad, or good. For example, if only 20% of the roads in a town handle 80% of the traffic, then that could be good for a maintenance crew who can concentrate mainly on the fewer roads; but it could be bad for commuters who take the busy roads. Such Pareto observations could lead to strategies; road crews could try to move commuters off of the busy roads, or commuters could move off on their own.

Therefore, many businesses have an easy access to dramatic improvements in profitability by focusing on the most effective areas and eliminating, ignoring, automating, delegating or retraining the rest, as appropriate.

The important thing is to notice any such disproportions, and then possibly act on such observations.

Relationship marketing is emerging as the core marketing activity for business operation. On an average it cost 10 times as much to acquire a new customer then to retain an existing one, 50 percent of the company customers will do business with their competitors and 25 percent of their very satisfied customers will do business with competitors and 20 percent of the company’s loyal customers account for almost 75 percent of their profits.
1.3 The Changing of Market Environment

Marketing is an activity which all organization doing it in a daily basis, till the recent time marketers focused on traditional modes of marketing to segment and to acquire few customers from the targeted segment using tools, software and techniques developed for mass marketing in the industrial era.

The increasing in the growth rate, intensifying competition and technological business development induced to reduced costs and improve their effectiveness. Business process re-engineering, automation and downsizing reduced the manpower costs. Production and operation costs have been reduced through Total Quality Management (TQM), Just in Time (JIT) inventory, Flexible Manufacturing System (FMS) and efficient Supply Chain Management (SCM).

However, reduction in cost alone is no longer enough or is necessarily an effective strategy.

In facing competitive threat as new entrant, pricing pressures, technology along with the related cost including the time lags in procuring, maintaining and strengthening one’s market, more and more organization are releasing that traditional marketing model is no longer effective. Therefore they start thinking to maintain relation with their customer to have a long term relation with them.

After the introduction by Levitt in 1983 Relationship Management was rapidly accepted among marketers. The popularity however soon fell as it was found that the
information needed to work with Relationship Management was mostly missing as corporations were still much aimed at product and segmented marketing (Peelen, 2005).

Interest was however rekindled during the 1990’s when organizations realized that customer relations were something that had to be given a more holistic view. It was found that customers do not solely interact with the marketing department, but instead all parts of the organization. In both B2C and B2B the entire organization needed to be aimed at pleasing customers, not just marketing. Many organizations that had previously been built around factories tried refocusing their attention on customers, aiming more on finding the right” customers and creating relations in which both parties profited. However, the excitement about relationship marketing soon disappeared once again as it was proving difficult to achieve good short term results with it. The strategies and systems used to try to keep these customer databases also proved very expensive and tedious to maintain (Xu, Yen, et al, 2002). In several companies this might have been the end of Relationship Management, but with the introduction of more advanced Information Technologies it has come back with a new name, Customer Relationship Management (Peelen, 2005).