



# How to grow a brand: Retain or acquire customers? ☆



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## ARTICLE INFO

### Article history:

Received 24 November 2010

Received in revised form 19 September 2011

Accepted 10 December 2011

Available online 28 August 2013

### Keywords:

Acquisition

Defection

Hendry model

Banking

Pharmaceuticals

## ABSTRACT

While customer acquisition is clearly important for new brands, mature brands are often said to rely on defection management for maintenance and growth. Yet the theory to support this approach has been subject to very little empirical investigation. How do brands actually increase the size of their customer base? Through superior acquisition or by reducing customer defection? Or some mixture of both? Conversely, do brands decline through deficient acquisition or excessive defection? This work analyzes changes in 'first brand loyal' customers to answer these questions, using a combination of panel data on the prescribing behavior of doctors and a cross-sectional tracking survey for residential finance. This study is the first research to compare defection and acquisition against stochastic benchmarks for customer churn under stationary conditions. The results are surprising: for both growth and decline, unusual acquisition plays a much stronger role than unusual defection. This finding demonstrates that acquisition has been under-rated in the past, and implies that prospect management is at least as important as defection reduction. A simulation shows that unusual acquisition also accounts for far more improvement in profit than does unusual defection.

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## 1. Introduction

This research empirically examines the effect of acquisition and defection on the size of the customer base. The size of a brand's customer base is closely linked to market share (Anschuetz, 2002; Baldinger, Blair, & Echambadi, 2002), while the make-up of the loyal customer base is, as shown by Gupta, Lehmann, and Stuart (2004), a key determinant of firm value. Logically, increasing the size of the customer base can only be achieved by reducing customer defection, increasing customer acquisition, or by doing both. Conversely, the customer base will only decline through excessive defection or inferior acquisition or both. The relative emphasis to place on defection reduction and acquisition is a key management decision. Intuitively both should be effective tools for brand maintenance and growth, yet this study demonstrates, empirically, that acquisition explains far more of any change in the customer base than does retention.

This finding presents a challenge to a long line of marketing thinking. The work of Reichheld (Reichheld & Sasser, 1990; Reichheld & Teal, 1996) encourages managers in a range of categories to shift their focus from prospective customers (acquisition) to maintenance of existing customers (defection reduction) through Customer Relationship

Management (CRM) systems. Philip Kotler, among others, champions this cause by admonishing marketers for spending too much time and effort on customer acquisition and far too little on customer retention and capturing customers' lifetime value (Kotler, 1992). The main exception to this prescription seems to be in relation to brands that are growing, where customer acquisition clearly plays a vital role (Gupta et al., 2004); however, even here, retention is still the recommended focus for management efforts. Recent work does value acquisition of customers with high prospective lifetime value, and seeks to identify the customers that managers should acquire or retain, and alternatively those whom managers should avoid, 'sack' or deselect (Gupta et al., 2004; Reinartz & Kumar, 2002; Rust, Lemon, & Zeithaml, 2004). But again, the role of acquisition is but a minor adjunct to a CRM model, where the real focus for brand success remains on reducing defection of the *right* kind of customers; that is, the profitable ones (Cao & Gruca, 2005; Reinartz, Krafft, & Hoyer, 2004).

This existing literature does not suggest that acquisition and retention are unrelated; however, the implications are that managers are unlikely to focus evenly and simultaneously on both, and that retention programs are more profitable than acquisition programs (Reinartz, Thomas, & Kumar, 2005). Retained customers are thought to become cheaper to service with tenure (Thomas, Blattberg, & Fox, 2004) and therefore, to be a greater source of profits for the business than newly acquired customers (Gupta et al., 2004). They are also thought to be more likely to cross-buy (Reichheld & Teal, 1996) and less likely to be price sensitive (Dawes, 2009). While Reinartz and Kumar (2002) find little empirical support for these claims (at least in non-contractual

☆ The authors are indebted to both ISIS research (now part of Synovate) and The Nielsen Company for the provision of the data used in this study.

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settings), such claimed benefits are nonetheless the impetus for encouraging managers to focus on improving retention, in preference to a brand equity or acquisition strategy.

Yet, existing research suggests that variations in retention are more constrained than variations in acquisition. Studies in consumer and business banking show that a considerable portion of switching is for reasons that cannot be controlled or avoided (Bogomolova & Romaniuk, 2009). Similarly, Colombo and Morrison's (1989) two-segment model of loyalists and switchers implies that defection is constrained while acquisition is unconstrained. Consequently, and contrary to the conclusions in much of the literature, unusual defection may be harder to achieve than unusual acquisition (Sharp, 2010).

Little research examines the role acquisition efforts play, particularly compared to retention gains, in a successful brand's market share performance (see Verhoef, 2003). The only study that compares the relative impact of acquisition and retention on market share, rather than profitability, is Blattberg, Getz, and Thomas (2001) who acknowledge that all brands lose some customers; however, acquisition is seen as a requirement to compensate for a lack of retention, rather than a strategy to deliver brand growth in its own right.

No prior studies use actual market data to evaluate the relative contributions of customer retention and acquisition to dynamic change in market performance. Therefore, rather than add to the theoretical literature on defection, this work makes substantive empirical contribution. The research shows whether changes in defection or acquisition are more frequently associated with changes in brand share (i.e. the relative size of the customer base). The focus is on variations from stationary market benchmarks for acquisition and defection, and how these relate to increases or decreases in brand share.

This approach breaks new ground in several respects. Previous work comparing acquisition and defection is restricted to estimating elasticities for an assumed model. In contrast, this work makes minimal assumptions and simply observes empirical regularities in the association of acquisition (and defection) with brand share growth (and decline). The study extends the understanding of retention and acquisition to an environment in which multiple brands are regularly bought (or prescribed), using the established construct of *first brand loyalty* as a measure of the customer base over time (East, Harris, Lomax, & Wilson, 1997; Hammond, East, & Ehrenberg, 1996). The research presents an early application of recently developed stochastic benchmarks for the normal defection and acquisition rates for a brand of a specific size, in a specific market. The findings complement the work of Reinartz et al. (2005), who consider the *profitability* of retention or acquisition efforts, by examining the relative *frequency* of unusual defection and acquisition during brand growth and decline.

The research makes three primary contributions:

1. Quantifying the relative frequency of unusual acquisition and defection.
2. Quantifying the relative contribution of unusual acquisition and defection to changes in brand shares.
3. Following Reinartz et al. (2005), extending the analysis to profitability through simulation.

The context of the investigation is pharmaceutical prescribing and retail financial services. While very different industries, pharmaceuticals and financial services both have a long history of using CRM and selling efforts to both reduce defection and improve acquisition rates. Globally, drug companies place a strong emphasis on developing and maintaining relationships with doctors, often at great cost. The market for prescription medications is often described as 'CRM focused' in its approach to marketing (Blumenthal, 2004). Despite having such a history, little research exists on doctors' prescribing loyalties and how these contribute to brand performance.

Similarly, in financial services and banking, the tracking of outputs from CRM activities and customer lifetime value modeling is

commonplace. Indeed, much of the knowledge about the relative effects of acquisition and retention efforts has come from studies undertaken in financial services markets; see for example, Verhoef (2003).

## 2. Method

This work does face certain methodological challenges, namely: selection of an appropriate customer base or loyalty metric; the decomposition of dynamic market from stationary market effects, and; developing an appropriate simulation to extend the analysis from brand share to profitability. Sub-section 2.1 describes and explains the choice of loyalty metric. Sub-section 2.2 explains the role of stochastic benchmarks in the analysis of acquisition and defection. Sub-section 2.3 describes the data used. Sub-section 2.4 explains how stochastic benchmarks are applied to this data. Finally sub-section 2.5 describes the simulation that evaluates the relative profitability of observed changes in defection and acquisition.

### 2.1. Membership of the customer base

Changes in the customer base are not simple to define in frequent repeat-buying markets. Take the case of prescription medications. Prescription drugs can be considered a business-to-business market, as the doctors who make the purchase decisions are not the consumers of the product. Many transactions are made and a non-contractual arrangement exists between the specifier (doctor) and seller (manufacturer). The prescription drug market is a repertoire market (Sharp, Wright, & Goodhardt, 2002) where doctors prescribe from a limited personal armamentarium of brands. This divided loyalty means that real brand switching is not easily distinguished from everyday shuffling within a doctor's armamentarium. This issue is common to frequently purchased categories: to accurately measure repertoire composition, and subsequent changes therein, is virtually impossible due to the great heterogeneity in consumers' buying behaviors. Some buy often and from many brands, others buy less often and from far fewer brands. Distinguishing between a change in the underlying choice propensities and the display of polygamous loyalty is not possible. For instance if a buyer of the category buys Brand A, then B, then A, does such buying reflect a change in their likelihood of buying these two brands over time, or a consistent and underlying 33% chance of Brand B being bought and a 67% chance of Brand A being purchased? For a detailed discussion of the problems associated with conceptualizing and measuring repertoire composition see Stern and Hammond (2004).

One seemingly obvious measure for operationalizing loyalty in repertoire markets is share of category requirements (SCR). Yet SCR is a volume-based measure that does not distinguish between customers that have different repertoire sizes. SCR can be identical for two very different customers, one who has a large repertoire and is mostly loyal to the focal brand, and a second who has a small repertoire in which the focal brand is the second or third preference. Managers of CRM initiatives often want to differentiate between these two types of customers, focusing retention programs on the former, and aiming development/re-acquisition at the latter. Further, researchers will commonly consider defection away from a brand rather than a more moderate change in SCR (Trubik & Smith, 2000).

The use of *first brand loyalty* as the measure of preference overcomes these problems (Stern & Hammond, 2004). This measure is the proportion of customers who buy the focal brand more often than any other over the time period being analyzed. This measure recognizes that loyalty is not exclusive and that customers buy from a repertoire of brands, while not mistaking mere shuffling within repertoires for loss or acquisition of a customer. Rather, gains or losses occur only where the brand bought most often over 12-month period changes. East and Hammond (1996) and East et al. (1997) use first brand loyalty, as an indicator of repertoire change in studies of customer

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