

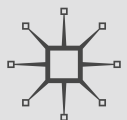
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# VALUING CUSTOMER ENGAGEMENT

Strategies to Measure and  
Maximize Profitability



V. Kumar



Palgrave Executive Essentials

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V. Kumar

# Valuing Customer Engagement

Strategies to Measure and Maximize Profitability

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V. Kumar  
Professor of Marketing,  
and the Goodman Academic-Industry  
Partnership Professor, Goodman School  
of Business  
Brock University  
St. Catharines, ON, Canada

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*“A book is a powerful tool for change but the inspiration behind it is what makes you take the first step. This change is not always the easiest, but some people show their undying support and relentless motivation to make you believe that you can create this change.”*

*—With that, I dedicate this book to*

*My Family, My Mentors, My Doctoral Students, and My Coauthors*

## FOREWORD BY DAVID J. REIBSTEIN

Many companies spend millions of dollars in an effort to attract customers, as no business can survive without customers. But, to attract customers and not keep them is an absolute road to failure. The key to any successful business is customer retention. BASES, a marketing research firm that has a long history of new product testing, discovered years ago that repeat purchase was the number one metric indicative of success. Yet, the majority of marketing spending remains focused on customer acquisition.

Dr. V. Kumar (VK) has spent a rich career focused on understanding profitable customer engagement. He has led a stream of research all around understanding the mechanisms that drive customer engagement that leads to having a profitable customer base. He shares his years of research and working with companies with us in this powerful book, *Valuing Customer Engagement*. It starts with presenting the theoretical principles behind customer valuation and then carefully selecting the “right” customers—those that are profitable. This requires not simply looking at who has been profitable for the firm, but those, if handled correctly, have the potential to stay or become profitable customers. It then is followed by an understanding of what engages the customer so they are happy with the product/service and are very likely to become repeat customers. But his latest insights are in understanding the greater value of customers beyond their purchases—how they influence others to engage with our products and services as well. This book clearly extends into today’s world of social media with plenty of depth to allow us to quantify what few others have been able to do, the impact of social media. He also shows us to realize some customers bring additional value by the feedback they provide allowing us to improve our offerings, not just for that customer, but for numerous others. The five basic tenants of *Valuing Customer Engagement* center on (1) customer lifetime value, (2) customer referral value, (3) customer influence value, (4) customer knowledge value, and (5) customer brand value.

Customer lifetime value is directly linked to the firm's profits, while the other three are linked, but indirectly. These principal components of customer engagement are not merely concepts, but can be measured and tracked. The book has separate chapters on each of these pillars and details how to measure and use these concepts to enhance overall profitability. This is very well illustrated with a rich set of examples. Dr V. Kumar then illuminates for us how each of these measures directly contributes to profitability and return on investment (ROI).

One of the key components of the book is how each of these measures is on an individual level. Each customer has his/her own customer lifetime value, customer influence value, etc. With the emergence of BIG DATA we now have the opportunity to start tracking which of our customers are offering what value and how this can be enhanced by focusing on the key component of customer engagement. Some customers may not be profitable today, but with the right stimulus directed to the critical component, their value can be increased. The roadmap to doing this is extremely clear throughout the book.

Dr V. Kumar has based his work on rigorous research, but the book is not only based on these findings, but riddled with scores of engaging examples that we can all identify. You cannot read this book without coming away with a deep understanding of how to engage your customers.

David J. Reibstein  
Past Chairman of the American  
Marketing Association, and The  
William S. Woodside Professor,  
and Professor of Marketing at The  
Wharton School  
University of Pennsylvania  
Philadelphia, PA, USA



## FOREWORD BY J. PATRICK BEWLEY

One decade ago, in my foreword to a previously published version based on this book, I was excitedly watching the emerging transformation of the field of marketing from an artform to that of a science. There were many parallels to the changes that the manufacturing disciplines within businesses went through in the 80s and 90s. In my work as both a CEO and business leader of some of the world's most sophisticated data and analytics companies, I have been on the front lines applying VK's methods. Back then, I was focused on the potential of reducing hundreds of billions of dollars spent on wasted advertising by helping companies improve their technology, data, and analytic methods. At that time, VK's work in *Valuing Customer Engagement* offered a first of its kind method for integrating the ways in which customers can contribute value to a firm based on the value they assign to the brands offered by the firm. From their lifetime value, referrals, influence, and knowledge—it was clear that customers contribute to the future value of a firm in many ways and that business decisions should consider this holistically.

Today, in VK's most recent expansion of this vital work through the development of the Theory of Customer Valuation, one can begin to see the glimpse of how the domain of marketing ascends from the role of a business function to an underpinning part of economic value-creation. Economics is defined as the branch of knowledge concerned with the production, consumption, and transfer of wealth<sup>1</sup>. This raises obvious and fundamental questions. Who consumes? Who transfers wealth? Is it not the customers of a business? Is the value of the business not more than the historical value of the customers? Should a customer's future value not be considered? What ways can a customer contribute value to a firm?

What is perhaps my most profound realization about the transformation of marketing, is that these simple questions don't find their home in the

<sup>1</sup> Oxford English Dictionary

vaunted halls of economic theory. As I have watched the last decade unfold, the challenges that I see today in front of marketing practitioners are amazingly the same. Only the medium has changed. As we have moved from direct marketing to e-commerce and now more recently to social media influencers, generations of marketers repeat similar trends and mistakes. It takes time for the data and analytic methods to mature. We marketers like to chase shiny objects. We have short memories. It takes us time to bring discipline to new methods of reaching customers. As this process happens, the pendulum seems to swing from art to science and then slowly back again to art. But isn't this true of everything? Not just marketing? Isn't this central to the innovation process?

The mediums through which we attract the attention, intent, and ultimately the purchase transaction from customers will continue to evolve. New methods of attracting customers will continually emerge. Old methods will fade away. As this cycle continues, practitioners will experiment. They will throw money at the problem. As we begin to understand the new mediums, data and analytic methods will emerge and voila! All of a sudden, we are marketing scientists yet again.

This expanded work has parallels in Deming. Marketing will continue to mature and resemble the operations arm of businesses. Slowly, over time the methods outlined in VK's work will guide our approach to the integration of new mediums and shape the vision and strategy of many of the world's best brands. The discussion of the implementation of the value-creation process in both large multinationals as well as small to medium businesses showcases the broad applicability of the theory, concepts, metrics, and strategies suggested in VK's framework. Once again, VK sits above the fray, calmly bringing order to the chaos.

J. Patrick Bewley  
Innovator and Entrepreneur,  
Atlanta, GA, USA  
[jpbewley@post.harvard.edu](mailto:jpbewley@post.harvard.edu)

## PREFACE

The business world is constantly and rapidly changing. Technological advancements, globalization, changing customer expectations, and volatile market conditions have created a highly volatile and competitive landscape. Businesses face the challenge of adapting to and remaining relevant in an ever-changing environment. Several factors drive the constant change in the business world and hold important implications for organizations. Technology is one such factor that is serving as an instrument of change. The digital revolution has transformed how businesses operate, communicate, and deliver goods and services. Data-driven analytics, digitalization, and new-age technologies have all been disruptive to traditional business models and processes. Companies must embrace and leverage these technologies in order to remain competitive, streamline operations, and meet the changing demands of digitally savvy customers.

Of particular note is the changing dynamics in customer expectations and behaviors. Consumers today are more knowledgeable, connected, and demanding than ever before. They are looking for personalized experiences, immediate gratification, and seamless interactions across multiple channels. Businesses must anticipate and meet changing customer expectations by providing exceptional customer experiences, embracing omnichannel strategies, and leveraging data-driven insights to understand and cater to individual customer needs. To stay ahead, businesses must cultivate an innovative culture, embrace experimentation, and constantly adapt their strategies and offerings. The ability to respond quickly to market dynamics, identify emerging trends, and capitalize on opportunities is critical for long-term success. Most importantly, it is critical for businesses to stay connected with their audiences and continue to be relevant. This leads to the all-important question; how can businesses engage with their customers in a value-creating manner that will be beneficial for all parties?

This book is targeted at top/mid-level management of small, medium, and large business-to-consumer (B2C) and business-to-business (B2B) enterprises. Particularly, this book provides in-depth knowledge about the various customer strategies that a firm can undertake to gain maximum profitability from each of its customers while ensuring their continued engagement. Is there a way to monetize customer engagement? Indeed, there is. This book proposes several *concepts* and methodologies to measure customer engagement by developing a framework that includes the multi-dimensional aspects of customer engagement. Methodologies to monetize these components are proposed, tested, and validated in real-world scenarios in order to maximize the profitability of the customers.

The book starts with a basic understanding of customer engagement and then delves deeper into each of the components in the subsequent chapters. Here, readers are introduced to the customer valuation theory (CVT) that forms the bedrock of the customer engagement journey of businesses. This theory was developed with input from presentations at many universities including the Stockholm School of Economics, Sweden and Cambridge University, U.K. Subsequently, the book advances the customer engagement value (CEV) framework that captures the essence of valuing customer engagement. In this regard, this book identifies dollar *metrics* and one attitudinal metric that can help manage customer engagement. The dollar metrics include—customer lifetime value (CLV), customer referral value (CRV), customer influence value (CIV), and customer knowledge value (CKV). Customer brand value (CBV) is the attitudinal metric. Each chapter is broadly designed in the following manner: defining the concept, describing the way to measure it, and then providing several *strategies* to maximize it. It is extremely important to understand that each of these concepts can be inter-related and together they help manage customer engagement as a whole. The book concludes with strategies to identify the relevance of the different metrics and the need to maximize them, based on the company objectives. Thus, this book is a source of knowledge for all courses that focus on how to extract value from customers and how to provide value to the customers. Creating value alignment will result in a sustainable competitive advantage.

The uniqueness of the book lies in the fact that each of these concepts has been implemented by many companies that have reported success. These concepts have passed the test of rigor and relevance and these studies have been published in several top scientific journals. The book illustrates the concepts through many global examples for the comprehension of readers from all around the world. This book is a synthesis of my ongoing research investigations in the area of customer engagement and has been made possible by working with my past and current doctoral students, and several coauthors from all over the world.

## ACKNOWLEDGMENTS

I express my sincere thanks for the support and encouragement offered by all the academic institutions I have worked in for keeping me engaged productively.

I thank Bharath Rajan for his assistance in all the stages of the preparation of this manuscript. I would like to particularly thank Renu for copyediting the manuscript. I also thank my coauthors in each of the studies referenced in this book for their contribution. I am deeply indebted to the editorial team at Palgrave Macmillan for their patience and consistent encouragement, and for accepting this manuscript for publication.

I am grateful to all my well-wishers who kept encouraging me to do more. I am also thankful to many companies worldwide for implementing our strategic framework.

Last, but not least, I owe immense gratitude to my parents (Mr. Viswanathan and Mrs. Pattammal Viswanathan), my uncle (Mr. N. Kannan), my wife (Renu), my daughters (Anita and Prita) and their family, my sister's family (Mr. Prasad and Mrs. Shanti Prasad), my spiritual guru (Mr. M. Karthikeyan), and parents-in-law (Mr. Ramamurthy and Dr. Lalitha Ramamurthy) for their constant support and encouragement till date and I feel truly blessed to have them in my life.

## PRAISE FOR *Valuing Customer Engagement*

“Proactively engaging customers is the answer to creating and leveraging loyal customers. VK describes how to do just that with clear, authoritative logic. A must read for executives facing dynamic marketplaces, fast-moving competitors, and the realities of a digital communications and communities. The five metrics will become classic tools of future executives and students of management.”

—Dave Aaker, *Vice-Chairman of Prophet Brand Strategy, Professor Emeritus at UC Berkeley*

“Engaging the customer is the holy grail in today’s paradigm shifting, big datafied, socially networked, exponential rate of change environment. With this book, VK has presented an invaluable construct to the increasingly complicated, but never more important role of CRM to organizations of all stripes. He has done a remarkable job of explicating the distinct components of customer engagement, while presenting a set of analytical tools that bring each into clear focus for actionable, marketing programs that will optimize customer lifetime value. It’s a must read!”

—Alan Beychok, *Former CEO, Benchmark Brands/FootSmart, USA*

“As customer touchpoints continue to proliferate, marketers must continue to learn the depth and value of their engagement with their best customers. In this revision of his landmark book VK adds more depth and insight to the management of each facet of an engagement. A noteworthy advance is the emphasis on the customer asset value created during the customer’s journey.”

—George Day, *Geoffrey T. Boisi Professor; Professor of Marketing, Co-Director, Mack Center for Technological Innovation, Director, Emerging Technologies Management Research Program*

To be successful a firm must engage and satisfy its customers profitably. VK provides the frameworks and metrics for firms to be successful in customer engagement. He provides compelling examples to illustrate substantial gains in profits from successful implementation. Whether you are building a brand, maintaining your brand, or managing for profitability, this book provides you with the tools that you need.”

—John R. Hauser, *Kirin Professor of Marketing, MIT Sloan School of Management*

“This book is destined to be a classic from a real Legend in Marketing!!! It is a MUST READ for managers in ALL for-profit industries!!! Why? Based on years of research, Dr V. Kumar (VK) details the processes a firm can follow to become profitable using an innovative and impressive set of metrics. Furthermore, VK demonstrates the value of implementing these metrics. This is the ONLY book in the market that can provide valuable information for every firm regardless of industry. As such, this book is unparalleled. Most business pundits propose a ‘silver bullet’ that is demonstrated via case studies to work in a small number of firms. Unfortunately, most managers discover that these ‘silver bullets’ miss the mark for their businesses. Instead, VK shows that there is more than one way for a firm to profitably engage with its customers. Each way is based on sound theoretical principles, carefully defined, measured, managed, and shown as a blueprint that managers can follow to achieve sustainable profits. Moreover, this book is loaded with case studies and implementation stories. As a result, VK offers convincing evidence that this is no magic bullet—it is a tried and true guide to long-term business success.”

—Timothy Keiningham, *J. Donald Kennedy Endowed Chair in E-Commerce, St. John’s University, NY and Chief Strategy and Client Officer, Rockbridge Associates*

“Companies that want to be winners have to go beyond just making and selling more products. They need to deepen their engagement with their customers and have ways to measure the engagement level of their individual customers. VK has done the best theoretical and empirical work that I know in this field. This book will be an ‘eye opener’ for most companies.”

—Philip Kotler, *S.C. Johnson Distinguished Professor of International Marketing, Kellogg School of Management, Northwestern University (Emeritus)*

“Dr V. Kumar has once again identified a timely and critical way to maintain a competitive advantage and drive continued profitability at a time when many companies are focusing on cost-cutting strategies rather than their customer base. This book shows in a clear and straightforward manner multiple ways a company can identify profitable customers and more important, keep those customers loyal and profitable to your brand by engaging them in a manner that in some ways makes them co-producers of what they are

purchasing. Driven by theoretical support and metrics developed through rigorous research involving both large and small companies, Dr Kumar suggests a number of new engagement strategies that are certain to lead to guaranteed profits. These strategies are described in a clear manner and illustrated by various real-world case studies. This book is a must read for both C-level executives and customer-facing employees.”

—Robert P. Leone, *J. Vaughn and Evelyne H. Wilson Chair and Professor of Marketing, M.J. Neeley School of Business, Texas Christian University*

“While firms generally recognize that their customers are the source of their growth and profitability, most fall far short of optimizing their customer engagement process. As V. Kumar shows in this important new book, customer engagement optimization goes far beyond the direct, economic profitability of individual customers. Customers provide positive (or negative) profit contributions through their social networks, their referrals, and their knowledge or knowhow. Drawing on decades of research, VK provides the theoretical basis, conceptual framework, the measurement processes and the marketing strategies firms need to optimize the customer engagement process. This book provides a blueprint for increased profitability through improved customer engagement and is destined to become a classic.”

—Gary L. Lilien, *Distinguished Research Professor of Management Science, Penn State and Research Director, Institute for the Study of Business Markets*

“This is the best book that incorporates Theory of Customer Valuation and Measuring Customer Engagement value, period! It is very comprehensive, highly readable, and simply engrossing. It is also conceptually rich, scientifically rigorous, and managerially relevant.”

—Jagdish N. Sheth, *Charles H. Kellstadt Professor of Marketing, Goizueta Business School, Emory University*

“In today’s globally competitive environment, differential advantage is shifting from product-related advantages which can be easily copied to the ways that companies engage with their customers. In this book, internationally renowned Professor V. Kumar develops a highly useful and innovative 5-component model for how companies can value customers, design and implement such engagement strategies profitably. Backed by sound and rigorous academic research as well as numerous illustrations, Professor Kumar’s recipe for competitive advantage should be studied and utilized by any company that wishes to survive and be profitable in the marketplace today.”

—Russ Winer, *William H. Joyce Professor of Marketing Chair and Marketing Department Academic Director of Stern Center for Measurable Marketing, New York University*



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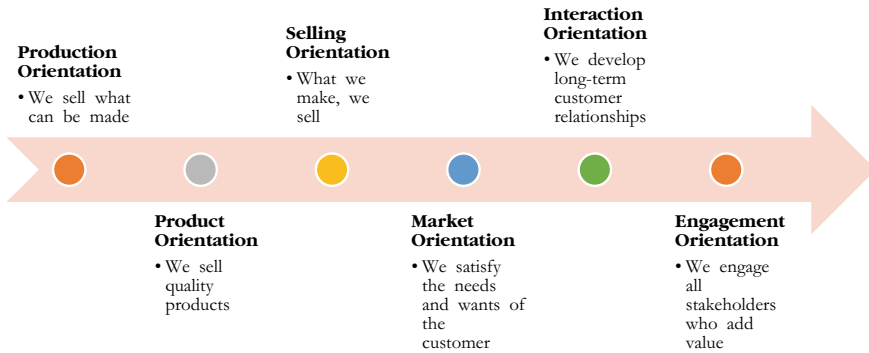
# Overview of Customer Engagement

## Learning Objectives

- Gain an understanding of what is customer engagement.
- Learn how customer engagement helps businesses.
- Know the importance of valuing customer engagement.

Companies are constantly in the pursuit towards success at the marketplace. To achieve this, companies have adopted various marketplace orientations over the years. Tracing the evolution, we can see that organizations have adopted approaches such as “we sell what can be made,” “we sell quality products,” “what we make, we sell,” “we satisfy the needs and wants of the customer,” “we develop long-term relationships with customers,” and “we engage all stakeholders who add value to the collaborative marketing effort.” Fig. 1.1 traces the evolution in marketing orientations.

Figure 1.1 presents a gradual evolution of how organizations have been practicing marketing. At the outset of the twentieth century, companies adopted a *production orientation* wherein they focused on selling whatever can be made. Here, concepts such as production efficiencies, cost minimization, and mass distribution became popular and widely practiced. Such an approach indicated a market dominated by sellers where customers remained in the background, and all communication was from companies to customers and without a feedback loop.



**Fig. 1.1** Evolution of marketing orientations

In the late 1940s and early 1950s, the focus gradually shifted toward a focus on product quality. Influenced by the resource constraints brought on by the Second World War, the *product orientation* adopted the view that consumers will favor products that are of high quality. Such a change saw concerted efforts by companies on continuous improvements to quality and performance. The development of quality management through the efforts of Edwards Deming and Joseph Juran is a noteworthy development during this phase. By focusing on high-quality offerings, companies believed that the products would sell themselves, without any marketing interventions.

With subsequent changes in the economic environment and improvements in technology, companies moved to a *selling orientation* wherein aggressive sales and advertising methods propelled consumers to buy more. Such a shift also marked the emergence of a buyers' market. Here, rather than recognizing the needs and wants of the consumers, the need to convince consumers to buy the offerings became the priority for companies.

Then came *market orientation*, where the organizational focus extended beyond their customers to include all functional departments. That is, all units of the organization were involved in the generation and dissemination of market intelligence, in addition to initiating responses to marketplace changes.<sup>1</sup> Generally, a focus on marketplace developments assumed critical importance for organizations to devise their strategies.

Despite the benefits of market orientation, studies have shown that as more firms become market-oriented the benefit of being an early adopter of market orientation decreases over time. Further, considering the finding that firms adopting market orientation did not have a competitive advantage in the long run, the need for a sustainable advantage resulted in the development of the interaction orientation.<sup>2</sup> The concept of *interaction orientation* reflects the firm's ability to interact with the customers and to take advantage of information obtained from them through successive interactions, to achieve profitable customer relationships.<sup>3</sup> Specifically, this approach (a)

pursues marketing activities at the customer level, (b) views customers both as a source of business and as a business resource for the firm, (c) values the strategic importance of customer-to-customer linkages, and (d) recognizes the importance of customer networks and effectively manages it. However, given the focus of this approach is on customers, the other stakeholders of the company are not considered. This has created a clear need to incorporate all stakeholders of an organization in the quest towards building true engagement.

Now, companies are looking at engagement as the next evolutionary point in their marketing activities through the *engagement orientation*. This evolution through the various orientations has often led companies along the path of introspection regarding value-creation potential to and from customers. Further, such introspection among companies has also yielded critical questions such as:

- Who are our most profitable customers?
- How can we manage, and reward customers based on their profitability?
- How do we identify the “right” products/services to sell to the “right” customers and at what time?
- How do we optimally allocate marketing resources to maximize profitability?
- How do we hold on to our profitable customers?
- How can we encourage customers to contribute value to us through direct and indirect means?

These questions continue to dominate the agendas of marketing managers and the C-level executives in the boardroom.

An important outcome of creating value to and from customers revolves around measuring and maximizing customer profitability. Companies are consciously moving away from a product- and sales-centric philosophy to a customer engagement philosophy. The underlying principle of a product-centric philosophy is to sell products to whoever is willing to buy. In such organizations, the aim of all business functions will be to solve the needs and problems of customers by developing appropriate product solutions. Typically, managers of companies with this type of orientation would focus on: (a) How many customers can we sell this product to? (b) How can we strengthen our product development and increase our market share? (c) What type of new product features should we introduce and how do we highlight their advantages? (d) How can we improve product profitability and market share so that the firm’s performance is enhanced? While such an approach may be worthwhile in some situations, the pitfall of such a focus is that companies tend to ignore customer-specific needs that are crucial in determining their relationship with the firm. When companies do not factor in customer relationship needs, customers are likely to defect to competition.

On the contrary, the customer engagement philosophy advocates developing a portfolio of customers (a specific set of valuable customers) and nurturing relationships with these customers. Under such an approach, companies typically focus on: (a) How many products can we sell to this customer? (b) How can we highlight the product benefits that align with customer needs? (c) Which customer segments can we focus on and how should we develop relationships with these customers? (d) What customer metrics should we use to measure firm performance? Several firms that have moved away from a product-centric to a customer engagement philosophy have reported huge gains in profits. For example, while casinos such as MGM Grand and Caesar's Palace focus on attracting as many customers as possible for profit, Harrah's success results from its ability to identify and pursue serious gamers.<sup>4</sup>

An important element of the customer engagement philosophy is the management of profitable and unprofitable customers. When companies compute customer profitability and identify the unprofitable customer segments, they are immediately inclined toward "firing" such customers. Though this instinctive decision of firing unprofitable customers at times helps businesses stay profitable, it has been proven wrong many times too.

Consider the following instances:

- In Fall 2021, U.K.-based household electric company, Omni Energy, moved the accounts of thousands of unprofitable customers to rival companies without express consent from the customers, to manage the company's financial losses.<sup>5</sup>
- Amazon is known to ban customers from making purchases on their website for practices such as returning too many items. The company has been adopting this practice since 2014 when they banned a customer from buying on Amazon's website for returning 37 out of 343 items purchased.<sup>6</sup>
- Nike recently took a hard stand against individual resellers by announcing that it can deny access to Nike products to any customer that appears to be purchasing products with the intent to resell. Such a decision is expected to prevent people and/or bots from resorting to sneaker reselling (at a premium price).<sup>7</sup>

The above examples are just a sample of corporate actions in dealing with users who can create loss-making situations for the companies. However, they do raise some important issues on profitable customer management techniques. Did these companies have a clear idea about the "future" profitability of the customers, as against how profitable the customers were at the time of firing? In this regard, it is important to use a metric that computes the "future" profitability of a customer, and not rely only on historical profit contribution. That is, had these companies computed the future profitability of customers,