Chapter 4
Building a model to capture the dynamic concept of Relationship Quality

Literature Study	**Internet Services** **The Marketing of Services** **Relationship Marketing** **Interrelationships between constructs**
Methodology	Survey and Analysis
Qualitative Findings	Visualisation of Internet Service provision Service breakpoints (Fail Points)
Quantitative Findings	SERVQUAL Interrelationships between constructs
Recommendations	Defining a portfolio of projects
	Academic recommendations

The framework proposed for investigation in Chapter 1 incorporate the basic sequence: service quality leads to customer satisfaction, which leads to relationship strength, which leads to relationship longevity, which leads to customer relationship profitability. In this chapter each of these links between the constructs discussed in previous chapters will be discussed in more detail. Some of the interesting dynamics discussed in literature will also be highlighted in the section to combat a simplistic view of this framework.

The chapter will thus cover the following:

(1) The first link deals with the relation between service quality and customer satisfaction.
(2) The second link deals with the relation between customer satisfaction and relationship strength.
(3) The third link deals with the relation between relationship strength and relationship longevity.
(4) The final link deals with how relationship longevity is connected to customer relationship profitability (Rust *et al.*, 1993:1-23).

This model firstly adds the dynamic perspective of service quality, which has been called for by service quality and customer satisfaction researchers for some time now. Secondly, it ties service management and its notion of perceived service quality to relationship marketing. This is an important step, because as successful relationship marketing to a large extent depends on the capability of the firms of adding value, through various types of services to the core solutions offered to customers and clients, a relationship marketing strategy cannot be implemented without a thorough understanding of service management. Without an understanding of how to manage the quality of services in customer relationships on a long-term dynamic basis, the company will not be able to make full use of the competitive advantage opportunities offered by a relationship marketing strategy (Storbacka *et al.*, 1994:21-38; Ennew and Binks, 1996:219-230).

4.1. Link 1: The relation between service quality and customer satisfaction

The following theoretical conclusions can be found regarding the relation between satisfaction and quality:

Firstly, satisfaction is understood as an antecedent of service quality. According to this interpretation, quality is equated with the customer's appraisal of a concrete product or service experience. Consequently, it does not include expectational aspects, whereas satisfaction is based on the disconfirmation of expectations associated with the service or product experience. However, this interpretation involves a number of problems, because it ignores the higher stability of the customer's quality perceptions and the different affective–cognitive structure of both constructs. Moreover, the problematic assumption of a quasi-objective understanding of the quality construct implicitly underlying this interpretation of the relation between satisfaction and quality raises questions. The latter is clearly illustrated when Strandvik and Liljander, as proponents of this interpretation, explain the state of being dissatisfied despite high quality by arguing that the product or service 'does not fit the customer's preferences'.

Secondly, both constructs are treated as one and the same. According to this approach, no significant theoretical difference between satisfaction and quality exists. As with the first interpretation, the aforementioned divergences concerning the higher stability of quality perception and the emotional dominance of satisfaction are ignored by this approach.

The third is found where customer satisfaction is modelled as an antecedent of quality. Following this interpretation, the product and/or service-related quality perception is seen as the higher-order and more stable variable, which is built mainly on previous experience of (dis)satisfaction related to discrete transactional episodes. Thus, satisfaction is regarded as a short-term emotional state that results from an intrapersonal comparison of the customer's expectations with the evaluation of a single product or service encounter. This emotional state of satisfaction leads to an overall, global attitude concerning service quality, which is implicitly based on some kind of internal expectation standard. Because quality is a dynamic construct, additional consumption experiences influence and modify the existing quality perception. In other words, multiple satisfaction evaluations contribute to an overall quality evaluation.

Underlying dynamics:
There has been some confusion regarding the difference between service quality and customer satisfaction.

Suggestions have been made that perceived service quality could be seen as an outsider perspective, a cognitive judgement of service. It need not even be experienced, it can be based on knowledge about a service provider through word of mouth or advertising. It is, however, usually also based on experiences with the service (Storbacka *et al.*, 1994:21-38).

According to this suggestion, satisfaction refer to an insider perspective, the customer's own experiences of a service where the outcome has been evaluated in terms of what value was received, in other words what the customer had to give to get something. A customer could, therefore, respond on a questionnaire that a particular bank is of high quality even if this did not mean that this customer was satisfied using the bank.

Service quality can be judged low but the customer is satisfied. This might be the case when the service fits the customer's budget or is priced according to low quality. Low satisfaction but high perceived service quality is also a possible outcome. The customer judges the service to be of high quality but is not satisfied because what was given (price) is not perceived to correspond to the received quality. Satisfaction is thus related to perceived value (Storbacka *et al.*, 1994:21-38).

A conceptual model has been presented by Henning-thurau and Klee (1997) that postulates that the relationship between satisfaction and customer retention is moderated by the relationship quality construct and must be interpreted as non-linear.

Furthermore, the conducted analysis suggests that the traditional understanding of the customer's product- or service-related perception must be broadened for three aspects:

(1) A competition-related perspective must be added.
(2) The customer's level of involvement must be considered.
(3) The quality construct has to be differentiated on the basis of changes of the customer's internal expectation standard (Henning-thurau and Klee, 1997:737-764).

4.2. Link 2: Customer satisfaction association to relationship strength/relationship quality

One way to achieve strong relationships and, thus, long relationships is to ensure that customers are satisfied. The proposition is that dissatisfied customers will defect; the relationship ends. Customers seem to have a zone of tolerance, which can be defined as the difference between adequate and a desired level of service. Customers are "prepared to absorb some unfavourable evaluations before expressing them in terms of net dissatisfaction". In retail banking this would suggest that customers may be dissatisfied with a service episode and still be satisfied with the relationship. (Storbacka *et al.*, 1994:21-38).

Underlying dynamics:
There are aspects of relationship strength other than customer satisfaction. These include the existence of bonds between the customer and the provider. These bonds function as switching barriers beside customer satisfaction. Another dimension relates to the customer's (and the provider's) commitment to the relationship. Commitment might be based on customer's intentions and plans for the future.

Ten different bond types can be identified in the consumer market: legal, economic, technological, geographical, time, knowledge, and social, cultural, ideological and psychological. The first five bonds constitute effective exit barriers for the consumer. They can be seen as contextual factors that can not easily be influenced by the customer but can be observed and managed by the service firm. They are more likely to be perceived in a negative sense than the other five bonds. These bonds can prevent the customer from switching even when the service given is of low quality.

Dissatisfied customers may remain loyal due to high switching costs. Establishing a new relationship represents some sort of investment of effort, time and money which constitutes a significant barrier to the customer's taking action when dissatisfied with a distinct interaction during a relationship.

The other five bonds; knowledge, social, cultural, ideological and psychological bonds, represent perceptual factors, which are difficult to measure and manage by the firm. The consequence of bonds is that the customer might accept lower levels of service quality, compared with other service companies, without breaking the relationship.

An additionally interesting perspective on how relationship strength is achieved is the commitment of customers (Storbacka *et al.*, 1994:21-38).

Commitment and loyalty are related concepts, although they relate from different research traditions. Loyalty is usually defined as observed purchase behaviour. This is consistent with the transactional perspective used within traditional consumer marketing. Commitment has been used within the interaction approach of industrial marketing. It refers to adaptation processes, which are the result of the parties' intentions to act and positive attitudes towards each other. Loyalty is defined as only repeat purchase behaviour within a relationship. Commitment is defined as the parties' intentions to act and their attitudes towards interacting with each other.

Loyalty can occur with three different types of commitment, positive, negative or no commitment. A negatively committed customer shows a negative attitude but might still buy repeatedly because of bonds. This also means that customer loyalty is not always based on positive attitude, and long-term relationships do not necessarily require positive commitment from the customers. This distinction is important as it challenges the idea that customer satisfaction (the attitude) leads to long-lasting relationships (the behaviour).

Customer satisfaction is only one dimension in increasing relationship strength. Strong relationships can be dependent of perceived or contextual bonds that function as exit barriers. It is, however, important to note that the use of contextual barriers can generate latent dissatisfaction, which emerges as the importance of the contextual bonds (for instance legal bonds) decreases. Some customers may be very committed to the relationship and for these customers the perceived satisfaction with the relationship is very important. Others may find the relationship basically unimportant and for these customers the satisfaction component is not as important.

Rust and Zahorik (1993) prefer to have a repurchase intention measure rather than retention. The categories on the repurchase intention question may vary from company to company, but it may be useful to have more than a yes-no question for repurchase intention. This is because in a very good company the number of 'no's' are small, leading to a loss of explanatory power, and in turn resulting in a very large sample size requirement.

It must also be recognised that the repurchase category may not reflect the true probability of repurchase. These categories must be followed up on samples of respondents, to determine their actual repurchase probabilities. Once this calibration has been done, the repurchase intention may be used directly for some time, without further calibration (Rust and Zahorik, 1993:193-215).

4.3. Link 3: Relationship strength association to relationship longevity

The benefits of quality come in two forms. One effect is the improved ability of the firm to attract new customers, due to word of mouth, as well as the firm's ability to advertise the quality of its offerings. This effect is in many ways analogous to product repositioning, and is part of 'offensive marketing' those actions which seek to attract new customers. Conjoint analysis methods can be used to determine the 'pull' that upgraded quality might have for customers of other brands.

Another result of improved quality is that current customers are more satisfied with the products they buy, and they return. Retaining current customers through higher levels of satisfaction is called 'defensive marketing'.

In the context of relationship marketing, customer satisfaction is often viewed as a central determinant of customer retention. However, the few empirical investigations in this area indicate that a direct relationship between these constructs is weak or even non-existent.

In numerous publications, satisfaction has been treated as the necessary premise for the retention of customers, and therefore has moved to the forefront of relationship marketing approaches. Kotler sums this up when he states: "The key to customer retention is customer satisfaction" (Kotler in Henning-thurau and Klee, 1997:737-764). Consequently, customer satisfaction has developed extensively as a basic construct for monitoring and controlling activities in the relationship-marketing concept.

The link between satisfaction and long-term retention of customers is typically formulated by marketing practitioners and scholars in a rather categorical way, and is therefore treated as the starting point, rather than the core question of the analysis. Consequently, only a few researchers have investigated the nature and extent of the relation between satisfaction and retention itself.

The small number of existing studies in this area can be classified into the following groups:

The first group of researchers use monetary data, such as revenues or profit, as dependent variables. Thus, the individual level of analysis is substituted by an aggregated company-wide level. The validity of such a procedure for the investigation of the satisfaction – retention relation seems to be limited for two reasons. First, the aggregation of data renders any analysis on the individual customer level impossible. Second, profit and revenues are determined by a multitude of variables, which in addition are highly correlated.

A second group of studies on an individual level utilises repurchase intentions of customers to investigate the link between satisfaction and retention. This approach is also accompanied by two primary limitations. Because satisfaction values and intention measures are normally obtained through the same questionnaire the data are inherently correlated. This may lead to an overestimation of the strength of the relationship. Secondly, previous research in the area of customer loyalty shows that the predictive validity of intention measures varies depending on the product, the measurement scale, the time frame, and the nature of the respondents.

Finally, a few studies have used real purchasing data on an individual level to examine the satisfaction–retention relationship. This is the main group of interest here, because it avoids the problems mentioned above. These studies consistently show only a weak (or in some cases non-existent) link between both variables (Henning-thurau and Klee, 1997:737-764).

Customer retention does clearly not contain any attitudinal aspects. In customer retention, the marketer is seen as taking the active role in the marketer–customer dyad, whereas the behavioristic repeat-purchase concept pays no attention to the factors underlying the displayed behaviour. Therefore, customer retention aims at repeat purchase behaviour that is triggered by the marketer's activities, its study focuses on the managerial aspects.
"When investigating the determinants of customer retention, the scientific knowledge gained in the fields of brand-loyalty and especially repeat-purchase behaviour can only be applied when the knowledge does not refer exclusively to repeated patronage of a marketer/supplier that is not related to marketing activities and/or attitudinal aspects" (Henning-thurau and Klee, 1997:737-764).

The shift towards keeping existing customers is associated with three rules of thumb from service management:

(1) It costs five times more to attract a new customer than to keep an existing one.
(2) It takes 12 positive service experiences to overcome a negative one.
(3) 25 to 50 percent of the operating expense of a company can be attributed to poor service quality–to the cost of not doing it right the first time (Holmlund and Kock, 1996:287-304).

Relationship marketing differs from the traditional marketing mix model as the main emphasis is on maintaining long-term relationships with customers. Furthermore, it is more advantageous and profitable to develop new products for present customers instead of trying to find new customers for present products.

Companies believe that they are marketing-oriented when seeking customer opinion of current products, whereas the customer believes that a firm is market-oriented when their opinions guide the design of products (Holmlund and Kock, 1996:287-304).

Bolton (1998) suggests that customer satisfaction ratings elicited prior to any decision to cancel or stay loyal to the provider are positively related to the duration of the relationship. The strength of the relationship between duration times and satisfaction levels depends on the length of customers' prior experience with the organisation. Customers who have many months' experience with the organisation weigh prior cumulative satisfaction more heavily and new information (relatively) less heavily. Organisations should focus on customers in the early stages of the relationship, if customer's experiences are not satisfactory, the relationship is likely to be very short.

In a study of 276 immunochemistry analysers and test kit customers it was found that the building of service partnerships with customers lead to firms having customers that were more satisfied and loyal. Furthermore, customers perceived a greater level of quality associated with the products of firms who engaged in relationship building activities. In order to build such long-term relationships, companies need to embrace the concept of customer satisfaction. Buying into, or embracing customer satisfaction concepts requires that a firm continuously measure and collect information relating to their customer's level of satisfaction (Conrad, Brown and Harmon, 1997:663-674).

Clarity Connect Inc., of Ithaca N.Y., tries to avoid the cancellation call altogether. Each month the ISP scans call logs and disconnect reports for a drop in individual customer activity or a high amount of disconnects, said Chuck Bartosch, Clarity's president. "Then, before we send a bill we call them and ask if everything is okay. Sometimes they've simply been on vacation, sometimes it's a problem we help them resolve. Either way, they appreciate the attention" (Hulme, 1997).

From literature, one can deduce certain underlying dynamics:

Longevity can originate from relationship extrinsic factors such as the market structure, in which the relationship exist, and the possible geographical limitations (the customer moves to a geographical location in which the provider does not have a presence). Longevity can also originate in relationship intrinsic factors such as the relationship strength and the handling critical episodes during the relationship.

The customer may be loyal to the relationship because of a lack of perceived alternatives, such as thinking that all banks are the same, regardless of relationship strength.

When analysing relationship intrinsic factors we also have to consider how critical episodes are handled. It is important to note that every episode does not carry the same importance or weight in the customer's evaluation of the relationship. Some of the episodes can be labelled routine episodes. A critical episode can be defined as an episode that is of great importance for the relationship. The continuation of the relationship is dependent (both in a negative and positive way) on critical episodes. A successful critical episode can strengthen the relationship so that it may withstand several unsatisfactory routine episodes. On the other hand an unsuccessful critical episode may end the relationship abruptly, although it may have been preceded by years of satisfactory routine episodes even though the relationship has been judged to be strong.

The definition of a critical episode is customer and situation specific. A routine episode can become a critical episode if, according to the customer, the adequate level of performance is not met. The episode then becomes a 'critical incident' which makes the customer very involved and may end the relationship.

It is obvious, based on the above discussion, that relationship longevity is not always a function of relationship strength. There are many random factors that influence the development of a relationship. Most of the relationship extrinsic factors are such that the provider cannot influence them. It is important to note that relationship longevity may be a result of the fact that the episodes in the relationships have all been routine episodes. The customer may feel that the relationship is not very important, or at least not important enough to motivate the investment of time required to end the relationship. As soon as there is a poorly managed critical episode in the relationship, the customer may become involved enough to take the time to choose another provider.

The importance of critical episodes is evident. Even strong relationships may end because of poorly managed critical episodes. This way of arguing can be related to ideas about the importance of 'service recoveries' (Storbacka *et al.*, 1994:21-38).

4.4. Link 4: Relationship longevity link to customer relationship profitability

According to the US strategy consulting firm Bain and Company. Its recent research showed that a five per cent increase in customer retention leads to a considerable rise in net present value profits: this increase can be as much as 125 percent for a credit card company and 50 percent for an insurance broker. According to Payne (1994), there are five reasons why retaining customers is so profitable:

(1) Sales and marketing and set-up costs are amortised over a longer customer lifetime.
(2) Customer expenditure increases over time.
(3) Repeat customers often cost less to service.
(4) Satisfied customers provide referrals.
(5) Satisfied customers may be prepared to pay a price premium.

The best argument for trying to anticipate the future direction of customer values is that satisfying and retaining loyal customers over several years can dramatically affect a company's profit stream. According to Bradley Gale's study of 2 746 businesses (taken from the PIMS data base of The Strategic Planning Institute), gaining a mere 3% in customer satisfaction can increase annual return on investment (ROI) by at least one percent. In another study of nine industries, it was found that retaining just five percent more customers can boost long-term profits from 25% to 85% depending on the industry (Freid and Freid, 1995:40-41).

The realisation that tiny reductions in the rate of defection to rival brands can have disproportionate effects on profitability has done wonders to concentrate marketers minds, leading them down the now familiar road of customer loyalty, the quest for deeper, longer relationships with customers, and obsession with customer satisfaction (Mitchell, 1998:32-33).

The following underlying dynamics can be identified:

(1) In a study of retail banking, customer satisfaction was higher among the most unprofitable customers in the customer base. Customer satisfaction seemed to be a function of the relationship volume, such as the amount of deposits and lending that the customer had in the bank under consideration. We can speculate whether high volume drives customer satisfaction rather than the opposite.

(2) The proposed value of increased relationship longevity is based on the idea that keeping existing customers is cheaper than acquiring new ones and that the positive cash-flow of customer increases the value of long-lasting customer relationships. Seeking to retain a hopelessly unprofitable customer in industries with continuous customer relationships cannot make business sense. It is important to note that if it is impossible to enhance an unprofitable customer relationship in order to make it profitable, there is no logic to strive towards relationship longevity. It is not self-evident that a provider should aim at long-term relationships with all customers (Payne, 1994:29-31).

(3) There are ways to increase relationship revenue; to raise the prices or to increase the patronage concentration of the customer under consideration. A provider can influence its customers to concentrate their patronage by increasing relationship strength, but certainly there are others to consider, relationship pricing being one of the more important ones. Customers that generate the same relationship revenue may have different episode configurations. Thus the relationship costs and profitability of the relationships will be different.

The ideal situation is that of a customer relationship with high customer relationship profitability that would have a high level of relationship strength. If these customer relationships have a low level of relationship strength, the organisation under consideration is obviously very vulnerable and exposed to competitive action. If customers with negative profitability have a high level of relationship strength, the strength can be used to influence the customer's behaviour. As the relationship is strong it may also be possible to use more persuasive means of influence without endangering relationship longevity (Storbacka *et al.*, 1994:21-38).

Customer retention has a major impact on market share, but it is not the only factor. Market growth rate, market 'churn' (customers entering or leaving the market, even given a stable market size), the competitor's retention rates, and the effectiveness of the companies offensive marketing efforts such as advertising, price and convenience. These factors all play a role in determining market share. Given estimates of these other factors, which are generally available from internal company data, competitive analysis, or customer surveys, the effect of customer retention rate can be calculated on market share (Rust and Zahorik, 1993:193-215).

4.5. Summary of Chapter 4

The body of literature referred to supports the model where service quality leads to customer satisfaction and customer satisfaction to relationship quality, which in turn leads to customer longevity and thus revenue. In the following chapter, the methodology proposed for empirically confirming this model within the Internet Industry will be discussed.