

Chapter VIII

The King is Naked: Discovering that Frequent Customers May Not be Your Best Friend

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ABSTRACT

The scope of this work is to explore the transaction profitability of frequent and sporadic buyers in the e-commerce arena. Evidence from relationship marketing literature stressing the impact of purchase frequency on customer profitability, as well as recent academic research challenging this approach and pointing out the importance of sporadic clients, are analyzed and presented. A single case study research methodology was chosen for this article, due to the exploratory facets associated with the subject and the industry under investigation. In order to gather relevant input to carry out this research, one of the largest retailing groups in Brazil was investigated. Conclusions are drawn showing that greater frequency of purchases does not necessarily translate into increased customer transaction profitability. Implications are presented, enabling practitioners and academics to grasp fully the real value of customers—both frequent and sporadic buyers—in order to develop coherent approaches for dealing with them adequately.

INTRODUCTION

Traditional marketing literature suggests that the benefits accrued from long-term relationships between firms and customers are greater than

the returns reaped from short-term relationships. Conceptual evidence on this theory was collated from several researchers who have addressed the importance of retaining customers for corporate profitability (see, for instance: Kenny & Marshall,

2000; Kotler, 1999; McKenna, 1993; Peppers & Rogers, 1997; Reichheld, 2006; Reichheld & Sasser, 1990; Seybold, 1998).

Notwithstanding the perceived importance of frequent buyers, recent research has challenged this conventional approach, highlighting the fact that companies either fail to comprehend or assess correctly the true value associated with their customers, be they frequent or sporadic purchasers. This behavior may lead firms to make strategic mistakes as well as perpetuate managerial errors, such as high spending for retention of unprofitable customers or failing to perceive the importance of a high-value sporadic consumer (Dowling & Uncles, 1997; Reinartz & Kumar, 2000, 2002; Reinartz, Thomas, & Kumar, 2005; Schultz & Hayman, 1999).

The correct understanding of how to manage both frequent and sporadic buyers has assumed a truly important dimension, mainly in the **e-commerce** realm, due to the very high **churn rate** of customers in this arena. Reichheld and Shefter (2000) point out that up to 50% of consumers abandon an **e-retailing** company before the third year of their commercial relationship.

The impact of other issues related to the Internet regarding customer defection and transaction profitability is also relevant. The low **information asymmetry** generated by this technology makes customers far more aware of products and services, readily enabling them to search and locate where the best price can be found, thereby reducing **switching costs** (Smith, Bailey, & Brynjolfsson, 1999). According to Bakos (1997), if the **search cost** is low enough, buyers will tend to look for prices and products among all the available and potential sellers.

The scope of this research is to explore, in an empirical manner, the transaction profitability derived from sporadic and frequent customers in the home appliance **e-retailing** sector. The company analyzed is one of the largest retailing groups on the Brazilian market serving the major and minor appliance industry both through

conventional channels and via its Web site. Due to confidentiality issues, the name of the group was omitted from this chapter.

This study is divided into five sections. The first section identifies literature dealing with the relationship between customer retention and transaction profitability. The second section addresses the Brazilian environment with respect to Internet users and the e-commerce industry, comparing the latter to that of the U.S. The third section presents the research methodology used to gather and analyze data and discusses the criteria applied for categorizing clients according to their value to the company, as well as the inherent limitations of such criteria. In the fourth section, the evidence obtained is analyzed and the propositions about customer transaction profitability are tested. Finally, the last section summarizes and discusses the academic and managerial implications derived from the chapter's findings and also recommends further research tracks.

CUSTOMER RETENTION AND TRANSACTION PROFITABILITY

In relationship marketing literature, several authors have pointed out the beneficial impact of customer retention on corporate profitability. Kotler (1999) claims that the longer a client remains with a supplier, the more profitable this customer becomes. According to the aforementioned author, frequent buyers are more profitable for four main reasons: (a) they purchase more over the course of time; (b) the cost of serving a frequent client decreases with the passing of time; (c) satisfied consumers usually recommend the supplier favorably to others; and (d) frequent customers are less sensitive to price.

Day (1999) suggests that companies achieve higher profitability by building long-term relationships with their clients. Peppers and Rogers (1993) claim that there is only one way a business can guarantee its financial sustainability, namely by

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