

A CONCEPTUAL FRAMEWORK FOR CUSTOMER VALUE WITHIN A DISTRIBUTION SYSTEM

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Abstract: This paper reviews the concept of customer value and applies it to distribution strategy. There is a difficulty in defining customer value due to its subjectivity yet it is imperative for long term productivity and profitability. Marketers thus, must make maximizing customer value an explicit and measured business goal. Stemming from value chain analyses, distributions' objective is to determine appropriate customer service levels, and to manage effectively the cost/service tradeoffs. Distribution decisions are more enduring than the other marketing mix variables. Management needs to search for distribution economics in inventory control, warehouse locations, and transportation modes. The paper conceptualizes customer value in a distribution system as the interactions among customer service, order cycle time, inventory, warehouses, transport and customer complaints. Requisite hypotheses are proposed based on the conceptual framework and a study proposed to empirically investigate the robustness of the hypotheses. The conceptual framework is a tool that can focus managers in designing distribution strategies within value-bases domains. The model can guide management thinking in configuring customer value in a distribution system.

Key words: customer value; distribution system; customer service; order cycle time; inventory; warehouses; customer complaints.

INTRODUCTION

Many authors acknowledge the difficulties involved in defining customer value (Piercy & Morgan, 1997; Woodruff, 1997). These difficulties stem from the subjectivity and ambiguity of value, which is compounded by the fact that customer value being a dynamic concept, evolves over time (Jaworski & Kohli, 1993; Naumann, 1995). There is general agreement that customer value is determined by customers' perception not by suppliers' assumptions or intentions (Belasco & Stayer, 1993; Anderson & Narus, 1998; Woodruff & Gardial, 1996; Zeithaml, 1988). Value is

defined by the customer in the marketplace not by the supplier in the factory (Webster, 1994); it is “not what the producer puts in, but what the customer gets out” (Doyle, 1989). The role of customers in generating ideas has already been recognized by many authors (e.g., Möller, 2006; Yakhlef, 2005; Gibbert, Leibold & Probst, 2002). It is a widely accepted fact that in knowledge economies, customers are not simply passive audiences but they are active knowledge partners (Leibold, et al., 2005). Gibbert, et al. (2002) point out that customers’ input about their contexts and perception of services are substantial and valuable to organizations; and yet only a few organizations actually manage well “their perhaps most precious resource: their clients’ knowledge.”

Definitions of customer value can be grouped into three categories, with some variations within each category. These include value component models, utilitarian or benefits/cost ratio models, and means-ends models. According to Evans (2002) customer value management (CVM) aims to improve the productivity of marketing activity and the profitability of business by identifying the value of different customer segments and aligning marketing strategies, plans and resourcing accordingly. Customer value management is the next buzz word for marketers after concepts like relationship marketing have gained solid footing in enterprises. Loyal customers are both a scarce resource and a source of value. How can business managers nurture this crucial asset? For a start, companies must make maximizing customer value an explicit and measured business goal. This is no mean task for many brick and mortar companies. Customer value is highly intangible and has no specific pointer to its execution. Customer value management (CVM) may be seen as managing each customer relationship with the goal of achieving maximum lifetime profit from the entire customer base. CVM enables companies to take full advantage of the economics of loyalty by increasing retention, reducing risk, and amortizing acquisition costs over a longer and more profitable period of engagement. It shifts the focus of the enterprise from managing products or marketing campaigns to managing the profitability of each individual customer over the entire life of the relationship (Gebert et al, 2003). It is customers that have the business and not the programs we so often are keen to manage. An understanding of this unique concept will definitely alter our perception of the business processes and the kind of training offered to prospective managers.

Economic value to the customer is the fundamental premise underlying value-based strategies. As such, it is the starting point for a careful analysis of customer value. Marketers need to evaluate all of the customers’ costs related to buying a product or service. The selling price of the vendor’s product then is compared to that of a reference product offered by competitors. Through a comparison of the incremental value of both products, the marketer can establish a price that reflects the relative value of the product to the customer. A product whose relative value is higher than the reference product will occupy a larger and probably more important section in the customer’s mind. The converse is true for products whose relative value seem lower than the reference product. Such goods are seen to be inferior in the eyes of the customer. It is important to note that the customer is a strategic element in a company’s downstream supply chain (Xu, Kaye, & Duan, 2003). She is in the layer closest to the organization’s task environment that has direct transaction with it. Changes in the type of customers, behavior and patterns of customers have direct impact on the firm’s future strategy and prosperity (Xu & Walton, 2005). Satisfying customers is pre-eminent in differentiating a company’s product from its competitors’ and probably the central role of marketing. Indeed it is the basis for advocating for the marketing concept and must not escape the eye of any keen marketing strategist. A clear understanding of the concept of value becomes essential for the success of the value-based strategies (Woodruff, 1997).

Customers are value maximizers within the bounds of search costs, limited knowledge, mobility and income (Lilien, Kotler, & Moorthy, 2003). They form an expectation of value and act on it. A workable tactic here is to aid the customer in forming this expectation through a careful study of the market and aptly communicating those items in the product offering that point to that value. Customers will buy from the firm that they perceive offers the highest customer delivered value. This analysis may be executed speedily especially when the customer is highly involved purchase situation or over long periods of time when there is no time pressure. Marketers must be weary of what messages target customers are consuming long before their offering is in place for attention and action. Customer value is a ratio between what the customer gets and what she gives. She gets benefits and assumes costs. The benefits include both functional and emotional benefits. Functional benefits are attributable to the product in question whereas emotional benefits, hedonic value, are largely dependent on the customer. The costs include monetary costs, time costs, energy costs and psychic costs. Thus customer value is a combination of quality, service and price (Kotler & Armstrong, 1994). Reichheld and Sasser (1990) showed that, on average, a five percentage point’s increase in customer retention leads to between 40-50 percent increase in the net present value profits. Reichheld (1994) found that customers who describe themselves as satisfied are not necessarily loyal. He reported that 60-80 percent defecting customers reported they had been “satisfied” or “very satisfied” on the last satisfaction

survey prior to their defection. Reichheld & Sasser (1990) reported that Xerox found that its completely satisfied customers were six times more likely to repurchase a Xerox product or service than its merely satisfied customers. The literature shows that loyalty and profits are strongly linked to value created to customers (Khalifa, 2004).

CUSTOMER VALUE IN A DISTRIBUTION SYSTEM

Porter (1985) proposed the value chain analysis as a tool for identifying ways to create more customer value. He asserted that every firm is a collection of activities that are performed to design, produce, market, deliver, and support its products. He contended that successful firms needed to look for competitive advantages beyond their own operations, into the value chains of their suppliers, distributors and customers. And if his analysis was true, many companies have partnered with specific suppliers and distributors to create superior value-delivery networks (Kotler, 2001). Customer value is becoming increasingly used in strategy and marketing literature in recent years. Needless to say, it is considered central to competitive advantage and long-term success of business organizations (Khalifa, 2004). Consequently, a great importance is attached to this concept by both practitioners and theorists.

The notion of 'value-based business strategy' has become a central feature of strategy and economics as taught in business schools (Saloner, Shepard & Podolny, 2001; Besanko, Dranove, Shanley & Schaefer, 2004; Gans, MacDonald & Ryall, 2005). It is a term coined in a highly influential paper by Brandenburger and Stuart (1996) and popularized by Brandenburger and Nalebuff (1996). Brandenburger and Stuart (1996) offer an exact definition of the value that can be created by firms transacting with suppliers and buyers. This naturally leads to the notion of 'added value,' a measure of a firm's contribution to the aggregate value produced in a given market. As Brandenburger and Stuart (1996) argue, a firm's added value imposes an upper bound on the value it can appropriate.

Distribution objectives seek to determine appropriate customer service levels, and to manage effectively the cost/service tradeoffs (Bookbinder & Lynch, 1997). The importance of superior customer value is acknowledged in most business strategy models (Cravens et al., 1997). Walters and Lancaster (1999) explored the notion of what is meant by customer value and summarized in terms of its involvement in delivering the product/service attributes, considered necessary to create customer satisfaction. They suggested that value delivery comprises all those activities involved in delivering the product-service attributes that are considered to be necessary to create customer satisfaction and maintain an ongoing, long-term relationship with customers and in so doing build a competitive advantage.

Distribution decisions are more enduring than the other marketing mix variables. Management needs to search for distribution economics in inventory control, warehouse locations, and transportation modes (Kotler, 2001). Senge (1990) described a situation in which a strong sales surge causes the company to fall behind in meeting delivery dates. Management needs to identify the real bottlenecks and invest in more production and distribution capacity. Stimulating channel members to top performance must start with understanding their needs and wants. Producers vary in skill in managing distributors. This is a clear opportunity for differentiation. Producers can draw either coercive, reward, legitimate, expert or referent power to elicit cooperation. Intermediaries can aim for a relationship based on cooperation, partnership, or distributor programming (Kotler, 2001; Rosenbloom, 1995).

Narus and Anderson (1987) identified four ways distributors strengthened their relationships with manufacturers. These included obtaining a clear agreement with their manufacturers about their expected functions in the marketing channel; gaining insight into the manufacturers' requirements by visiting their plants and attending manufacturer association conventions and trade shows; fulfilling their commitments to the manufacturer by meeting the volume targets, paying bills promptly, and feeding back customer information to their manufacturers; and identifying and offering value-added services to help their suppliers.

Casado, Sellers and Más (2004) offer two propositions on customer loyalty. Firstly, less customer loyalty implies a lower probability of continuing to purchase from the same provider (Fornell, 1992), which will be reflected by lower company returns, as less loyalty jeopardizes a steady stream of future cash flow (Reichheld & Sasser, 1990; Rust & Zahorik, 1993; Rust, Zahorik, & Keiningham, 1994, 1995). Secondly, lower customer retention should increase a company's future transaction costs as it will no longer benefit from the purchase of other goods and services

(offered by the firm) by satisfied customers, or the price premiums which satisfied customers are willing to pay (Reichheld & Sasser, 1990). Moreover, the company needs to spend heavily (advertising, promotions and sales costs) to gain new customers (Zeithaml, 1988). Additionally, dissatisfied customers are most likely to engage in negative word-of-mouth (Reichheld & Sasser, 1990), which could reduce the effectiveness of advertising and the attractiveness of warranties (Anderson, Fornell, & Lehman, 1994).

THE RELATIONSHIPS BETWEEN CUSTOMER VALUE AND DISTRIBUTION

We can conceptualize customer value in a distribution system as the interactions among customer service, order cycle time, inventory, warehouses, transport and customer complaints (Aila, 2007). The interactions are depicted in Figure 1 below. A linear relationship is proposed to interact between the respective variables. We thereafter discuss each of the variables.

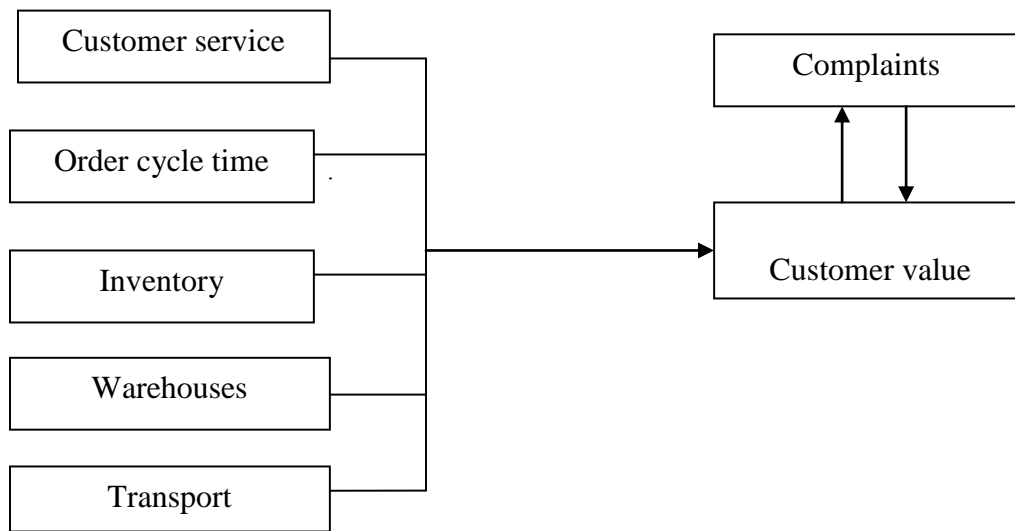


Figure 1: *Conceptual framework for customer value in a distribution system.*

Customer service

Customer service is here conceptualized as the service offered by the producer to his distributors. A firm’s middlemen are downstream customers immediately within its control domain. Distributors include all intermediaries that intervene between the producer and his ultimate customers. The functions that both the producer and distributor perform are altogether regarded as service and are the basis for determining long-term profitability. The quality of services offered impacts on perceived customer value. Service quality is big business (Sylvester, Tate & Johnstone, 2009). It can be a major differentiator between competitors (Davenport et al., 2001; Porter, 1980). Delivering quality service is an essential component of customer retention.

An additional driver comes from customer expectations (Burn & Robins, 2001). Customers now have far greater access to information and demand personalized experiences as opposed to simply acquiring goods and services. A customer driven organization is one that maintains a focus on the needs and expectations of customers both spoken and unspoken in the creation and/or improvement of the product or service provided. Successful firms have recognized that developing customer focus is an absolute necessity (Cavanagh & Livingston 1997; Schoeniger, 2000). Customer service can thus be hypothesized as:

H_1 : *As customer service increases so does customer value.*

H₂ : High service quality leads to high customer service.

H₃ : High customer expectations demands high customer service.

Order cycle time

Order cycle time is time lapsed between placing an order and receipt of delivery. It is critical to the customer. This cycle involves many steps, including order transmission by salesperson, order entry and customer credit check, inventory and production scheduling, order and invoice shipment, and receipt payment. Companies today greatly attempt to shorten this cycle (Kotler, 2001). A long order cycle time often lowers customer's satisfaction. This in turn lowers the company's profit levels. A shorter order cycle time on the contrary is the most envisages and tends to increase customer satisfaction. Increased customer satisfaction is one sure way to increase a firm's profitability level. Time and transportation costs seem to be inversely related (Keh & Teo, 2001). In other words, as the company attempts to meet time demands, the transportation mode chosen for faster delivery will tend to be more expensive than ordinary means of transportation. Consequently, when time is not critical, cheaper means of transportation can be afforded. Companies currently use interventions in computer technologies to speed these processes (Sheridan, 1999).

Other important concepts here include order cycle consistency, which is the extent to which order cycle time varies. Consistency promises predictability and allows exploitation of opportunities (demand) as they arise. Suppliers who deliver products consistently over periods of time are creating an advantage to themselves. Consistency reduces amount of worry for the purchaser and aids timely execution of programs. Order accuracy is the degree to which items shipped meet order specifications. Accuracy is a critical element of the order especially where the distributor amalgamates the consignment for transshipment. Inaccurate orders are seldom accepted and is a recipe for complaints. Order completeness is the extent that items ordered are totally filled when the order is assembled for shipment. And order condition, the damage level at the receipt time (Gross, Banting, Meredith & Ford, 2000). All these five concepts affect the quality of service rendered to the distributors. They either limit or enhance his sales hence profits. Order cycle time can thus be conceptualized as:

H₄ : Order cycle time is inversely related to customer value

H₅ : Order cycle consistency increases customer value

H₆ : Order accuracy, completeness, and condition vary as customer value

Inventory

Stock levels represent a major distribution strategy decision. Stocks are held so that sufficient goods are available to meet anticipated demand, to absorb variations in demand and production, to take advantage of bulk purchasing discounts, to meet possible shortages in the future, to absorb seasonal fluctuations in usage or demand, and to enable production processes to flow smoothly and efficiently. Sub-optimization and other inefficiencies may result in large stocks or in stock outs (Lucey, 2002).

Storage costs reflect the opportunity cost of tying up capital in inventory and allocating physical storage cost to it. Storage cost is considered a part of physical input in that customers have to sacrifice their own tangibles (Keh and Teo, 2001) for instance warehouses and route trucks. Stocks represent an investment that must be available to produce sales, thus directly linked sales.

Salespeople desire their companies to carry sufficient stocks to fulfill all customer orders immediately. However, this is not cost effective. Inventory costs increase at an increasing rate as the customer service level approaches 100 percent. Management desires to know by how much sales and profit would increase as a result of carrying larger inventories and promising faster order fulfillment times, and then make a decision. Management must know when to order-the reorder level. How much to order is equally important decision. The firm needs to balance order-processing costs and inventory-carrying costs. Marketing managers who want their companies to carry larger inventories need to show that the larger inventories would produce incremental gross profit to exceed incremental

inventory-carrying costs. Optimal order quantity can be obtained by observing how order-processing costs and inventory-carrying costs sum up at different order levels (Kotler, 2001). Inventory can be hypothesized as:

H₇ : Increasing inventory will increase customer value until an optimal level is reached.

Warehouses

Warehousing function concerns the physical holding of finished products before they are dispatched to vendors. Public warehouses, bonded warehouses or privately owned warehouses may be used for such functions. Several storage facilities may be used especially for transit goods. These include containers, transit sheds, in-transit storage, hold-on-dock storage.

Warehouses represent sizeable investments that a producer must be cognizant of. They resolve time and place utilities. (Coyle, Bardi & Langley, 1992). Proximity of warehouses to customer bases builds on the marketing concept and increases customer value (Aila, 2007). Customers are the reason for the firm's existence and thus must be satisfied timely. Geographic locations of warehouses and their sizes are important decisions for logisticians. A firm must examine location in a trade-off perspective (Coyle, Bardi & Langley, 1992). The firm must achieve a desired customer service level at the least total distribution cost. The chosen locations reflect a company's overt intent to serve the respective markets in a consistent fashion. The decisions here are however more enduring and may be very costly to change. Management must thus make proper consideration of all relevant factors.

H₈ : Warehouse proximity to customers determines customer value.

H₉ : Distribution costs increase with increase in geographic locations.

Transportation

Coyle, Bardi and Langley (1992) indicate that a major focus in logistics is upon the physical movement or flow of goods, or upon the network that moves the product. This network is composed of transportation agencies that provide the service for the firm. The transportation area is usually responsible for selecting the mode or modes of transportation used in moving the firms finished goods or for developing private transportation as an alternative. Companies can usually trade off increased transportation costs against decreased lost sales costs (Coyle, Bardi and Langley 1992). Companies however often spend more for inventory and transportation almost simultaneously to reduce the cost of lost sales. Transportation can be hypothesized as :

H₁₀ : Transportation mode choice varies with customer value

H₁₁ : There is a trade off between increased transportation costs and lost sales costs.

Customer complaints

Complaints should be recognized as integral and necessary part of the business environment (Wagner, 1994). They are opportunities to maintain past accounts and to secure new ones. They should not be treated as problems as such (Aila, 2007). Wagner (1994) considered several prerequisites to the development of effective customer complaint management in distribution. He provided a sequential approach to handling complaints and presented a programme for transforming the theory into practice. A customer-centric organization makes it easy for its customers to deliver suggestions and complaints. These information flows provide companies with many good ideas and enable them to act quickly to resolve problems (Kotler, 2001).

H₁₂ : Customer complaints do not affect customer value

Customer value

Occasionally, within the marketing literature, customer value is represented by the word 'value' alone and is given a demand-side orientation by the context in which it is used. For example, when Bolton, Kannan and Bramlett (2000:97) state, "Customers make repatronage decisions on the basis of their predictions concerning the value of a future product/service ..."; or where Heskett, et al (1994:166) claim "Value drives customer satisfaction"; or when Hallowell (1996:28) suggests "satisfaction is the customer's perception of the value received in a transaction or relationship ...", each appears to be addressing a similar concept, customer value.

H₁₃: Customers perceive value and express it in terms of satisfaction.

METHODOLOGY

A study needs to be designed taking into account the tenets of exploratory research and scale development (Churchill 1979; Nunnally, 1978) utilizing qualitative investigation techniques including literature review, observation of existing practices, focus groups, and in-depth interviews. This qualitative investigation may be designed to verify the potential variables functioning as antecedents, moderators, and outcomes of successful customer value management in a distribution system as already hypothesized. A set of distributors attached to specified producers may be studied to test the hypotheses empirically and ground the conceptual framework as described here.

CONCLUSIONS

Brownlie and Saren (1997); however, argue that "Customer value is a dynamic and transformational higher level construct which should not be reduced to a low-level operational measurement" (p. 13). Such criticism would bring about a robust exchange from Anderson and Narus (1998) for whom customer value is stated simply in terms of dollars and hours, but would align more easily with a Woodruff and Gardial (1996) perspective that relies on excavatory means-end laddering techniques to unfold evidence of consumers' deepest desires (Woodall, 2003).

Future research studies and implications for management

The conceptual framework stated here has not been tested. It thus needs empirical investigation to ascertain its soundness and robustness. Scales need to be developed and tested to ensure they measure the desired variables. Presently, the conceptual framework is a tool that can focus managers in designing distribution strategies within value-bases domains. The tested model can guide management thinking in configuring customer value in a distribution system.

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