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A Dynamic Model of the Duration of the Customer's Relationship with a Continuous Service Provider: The Role of Satisfaction

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Abstract

Many service organizations have embraced relationship marketing with its focus on maximizing customer lifetime value. Recently, there has been considerable controversy about whether there is a link between customer satisfaction and retention. This research question is important to researchers who are attempting to understand how customers' assessments of services influence their subsequent behavior. However, it is equally vital to managers who require a better understanding of the relationship between satisfaction and the duration of the provider-customer relationship to identify specific actions that can increase retention and profitability in the long run. Since there is very little empirical evidence regarding this research question, this study develops and estimates a dynamic model of the duration of provider-customer relationship that focuses on the role of customer satisfaction.

This article models the duration of the customer's relationship with an organization that delivers a continuously provided service, such as utilities, financial services, and telecommunications. In the model, the duration of the provider-customer relationship is postulated to depend on the customer's subjective expected value of the relationship, which he/she updates according to an anchoring and adjustment process. It is hypothesized that cumulative satisfaction serves as an anchor that is updated with new information obtained during service experiences. The model is estimated as a left-truncated, proportional hazards regression with cross-sectional and time series data describing cellular customers perceptions and behavior over a 22-month period.

The results indicate 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 organization. Customers who have many months' experience with the organization weigh prior cumulative satisfaction more heavily and new information (relatively) less heavily. The duration of the service provider-customer relationship also depends on whether customers experienced service transactions or failures. The effects of perceived losses arising from transactions or service failures on duration times are directly weighed by prior satisfaction, creating contrast and assimilation effects.

How can service organizations develop longer relationships with customers? Since customers weigh prior cumulative satisfaction heavily, organizations should focus on customers in the early stages of the relationship—if customers' experiences are not satisfactory, the relationship is likely to be very short. There is considerable heterogeneity across customers because some customers have a higher utility for the service than others. However, certain types of service encounters are potential relationship “landmines” because customers are highly sensitive to the costs/losses arising from interactions with service organizations and insensitive to the benefits/gains. Thus, incidence and quality of service encounters can be early indicators of whether an organization's relationship with a customer is flourishing or in jeopardy. Unfortunately, organizations with good prior service levels will suffer more when customers perceive that they have suffered a loss arising from a service encounter—due to the existence of contrast effects. However, experienced customers are less sensitive to such losses because they tend to weigh prior satisfaction levels heavily.

By modeling the duration of the provider-customer relationship, it is possible to predict the revenue impact of service improvements in the same manner as other resource allocation decisions. The calculations in this article show that changes in customer satisfaction can have important financial implications for the organization because lifetime revenues from an individual customer depend on the duration of his/her relationship, as well as the dollar amount of his/her purchases across billing cycles.

Satisfaction levels explain a substantial portion of explained variance in the durations of service provider-customer relationships across customers, comparable to the effect of price. Consequently, it is a popular misconception that organizations that focus on customer satisfaction are failing to manage customer retention. Rather, this article suggests that service organizations should be proactive and learn from customers *before* they defect by understanding their current satisfaction levels. Managers and researchers may have underestimated the importance of the link between customer satisfaction and retention because the relationship between satisfaction and duration times is very complex and difficult to detect without advanced statistical techniques.

(Customer Satisfaction; Durations; Retention; Defensive Strategy; Proportional Hazards Model)