Effects on New Customer Acquisition by Retained Customers in Professional Services

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Abstract
Is there a way for a firm to successfully balance between retaining clients and selling to new customers? When can new clients be gained through the existing relationships? This paper sets out to study the effects on different kinds of relationship substance within the present business relationships, on the number of new customers added to the supplier. The conceptual model is tested on a sample of business relationships in professional services. The results show that the relationship satisfaction of present customers (a less embedded type of substance) provides more new customers to the supplier. Satisfied customers create opportunities for word-of-mouth referrals to potential users. Satisfaction also increases retention, while a more embedded kind of relationship substance, organisational change in the customer firm, reduces customer retention, at least in the consulting business. Retention in its turn has a negative effect on the number of new customers to the supplier. The results suggest that a firm's deep collaboration with present counterparts partly exclude the addition of new customer relationships. The supplier has less time and efforts to invest in new relationships and it gets increasingly difficult to explain what other firms may gain from a similar co-operation. Satisfied clients in referral networks, who have experienced an explainable result, can be a source to add new customers. An implication for management is to select between deep client collaboration on one hand, and widening or renewal of the customer base on the other. Operations with standardised services need to be managed separately from customised activities. The use of referral networks increases if used in the more standardised approach.

Introduction
The international sales development and consulting firm Mercuri International (MI) has over forty years of experience in the training business, mainly in Europe. Up until the 1990's, large client projects with extensive adaptation including analysis, workshops and coaching were rare, and occurred in certain regions only. The bulk of the business consisted of standard or moderately adapted training programmes to a large number of buyers. At this time MI served about 10000 clients in more than 40 countries. Clients were not remarkably loyal (about 30% of the buying clients during two years came back to buy in the next half year period). Revenue stability and profitability was achieved by replacing lost customers with new ones from a large number of potential buyers (by active selling and use of referrals). A normal client project would include four to six training days with a sales team in one year.

During the 1990's, internal and external demands were put on MI to manage larger client projects, in order to serve multinational buyers across borders and develop entire sales processes in client firms. Outsourcing of training departments and the forming of corporate universities were new opportunities for MI. The number of clients had to come down, as the project size increased. MI consultants had to be prepared to spend many months in close client contact and foreclose other clients.

Around mid 1995, one of the larger Western European units of MI began to work with a key client approach, as the unit rapidly gained business from a large telecom firm and the local branch of a big bank. New consultants and freelancers were brought in to cover the large training needs. New practices had to be learnt, using modern web-based technology and forming company unique business games. The example showed the gains and risks for MI. Never before had this type of customers gone into large partnerships with MI, but never before had the risks been so large! When the projects were done and continuous business didn't appear to the extent expected, it was hard to turn back to serving many clients in a more standardised way. Many of the 150 buyers from the previous years had been neglected. Revenues became unstable and many consultants left as they felt that the environment they worked in could not keep up the challenging atmosphere.

At the end of the 1990's, MI was a company running standard programmes for some clients while others bought customised consulting services, the majority of orders being in between those extremes. The task of keeping clients as well as gaining new ones, and the challenge of being both a preferred partner as well as a standard supplier, was a difficult one to handle simultaneously. The decision in 1999 was to separate operations into three separate business models, to be able to expand in all the fields:

1. Standard programmes delivered to large audiences by standard marketing.
2. Adapted programmes used when building up assessment centres or corporate universities, in projects sold and handled by team of consultants.
3. Customised consulting services sold by management to a few large buyers, and the services being executed by consultants with conceptual background, in a way s similar to management consulting firms.

In 2000, it remains to be seen whether the separation of tasks will lead to the desired stability in terms of revenues and profit.

The case above illustrates a fundamental business problem: to develop existing relationships in depth, while at the same time attract new ones. This is problematic because developing existing relationships is quite a different business compared to attracting new relationships. Development of relationships implies that firms adapt to each other to achieve a match in their capabilities (Hallén, Johanson and Seyed-Mohammed 1991), and develop an understanding of their relationship specific assets (Anderson and Weitz 1992). Such deepening of relationships is laborious and requires both the seller and the buyer to manage not only their own relationships, but also the resources, activities, and actors surrounding them (Håkansson 1992).

At the same time as firms manage the deepening of relationships, they often want to attract new customers through more standard, and easily understandable sales efforts. But standard practice is a very different way of organisation, in conflict with the management practice of customised service (cf. Lawrence and Lorsch, 1967, Galbraith, 1994). It has also been found that customers respond differently in the two instances (Garbarino and Johnson, 1999). Strategies for 'enhancing' standard customer relationships into customised ones have often proved rewarding, but difficult (Grönroos, 1990).

The managerial problems associated with deepening relationships have been studied by marketers (Hurley and Hult, 1998, Deshpandé and Webster, 1993), relationship marketers (Grönroos, 1990, Berry, 1995), and industrial marketers (Anderson and Weitz 1992, Blankenburg Holm, Eriksson and Johanson 1999). Each of these authors has developed models for learning and/or relationship development. But little effort has so far been put into understanding the counteracting forces associated with the dual strategy of developing relationships at the same time as new ones are attracted. *The purpose of this paper is to fill this gap by studying how new customer acquisition is negatively influenced by retained customers*. To put the problem into the context of relationship development, the paper studies the mechanisms behind customer retention in terms of the more or less embedded substance built up in the relationships, and how this substance affects the opportunities to attract new customers, directly and through referral networks.

The paper is structured so that the first section builds the theoretical argument, which ends in hypotheses. The conceptual model is tested on a sample of *business relationships* in professional services, initiated in 1994-96. The relationships have been studied up to end 1998. The results and managerial implications follow lastly.

A Model of Business Relationship Development

Business exchange between two parties begin in a multitude of ways, ranging from a unilateral initiative of either party to an influence from third parties (units in the same company group, external business counterparts or other organisations who actively initiates the first contact). Common to new business relationships is the making of small pledges of commitment by the parties to do business, as they gradually feel each other out (Anderson and Weitz, 1992). The gradual investment in the relationship makes the parties learn more about each other and each other's business situation. The longer-term aspects of the relationship affects and is affected by each episode of interaction (Ford, 1990). Finally parties may enter into lasting business relationships, including ongoing exchange, a considerable degree of commitment (Anderson and Weitz 1992, Blankenburg Holm et al. 1996), and significant inter-firm adaptations (Hallén et al. 1991, Alter and Hage, 1993). Idiosyncratic investments often involve adaptations in production, R&D, logistics and administrative routines (Cunningham and Homse 1986, Hallén et al. 1991).

Business relationships do not exist in isolation. Empirical observations show that firms have a number of interdependent business relationships (Håkansson and Snehota, 1989), and that co-ordination in business relationships take place within the setting of a business network (Blankenburg Holm et al., 1999). The network is actively influenced by firms as they co-ordinate their respective business network relationships to fit in with their co-operation (Browning, Beyer and Shetler, 1995; Porac, Thomas and Baden-Fuller, 1989). The position of a firm in relation to other parties is a result of earlier actions. It defines possibilities but also constraints to future actions, because of the relationships being connected to other relationships (Cook and Emerson, 1978 and 1984). The emerging of new business relationships as well as the development of existing ones needs to be analysed within their context of other business relationships, with an understanding of the dynamics involved.

The Negative Influence of Customer Retention on Customer Acquisition

Customer acquisition is a strategic task for firms that need to replace lost customers, expand business or find counterparts with specific competencies. Traditionally, selling to new customers has been regarded as a unilateral task directed towards a mass market of anonymous buyers. But the business relationship development model requires a revision of the customer acquisition concept. This is because the development of relationships is so resource consuming. Interactions in international industrial business relationships have been found to include an average of 11 employees from both parties (Hallén,1986). The adaptations to match each other's unique assets are also very resource consuming (Hallén, Johanson and Seyed-Mohammed, 1991), representing a considerable commitment (Anderson and Weitz, 1992).

Because of the resources committed to one business relationship, it will be very difficult to manage the acquisition of new customers at the same time as existing customers are retained. Even though customer retention has positive effects, such as cost reduction when customers are kept compared to selling to new customers (Grönroos, 1990), and long term profitability (Reichheld , 1996, Kalwany and Narayandes, 1995; Blankenburg Holm et al, 1996, 1999). It is thus likely that customer retention has a negative effect on the acquisition of new customers.

Hypothesis 1:
The higher the customer retention, the lower the number of new customers to the supplier

Effects of Built-up Relationship Substance on Customer Retention

Different kinds of built-up relationship substance is likely to have different effects on the customers willingness to continue to do business with the supplier, or his long term view of the particular relationship. *Relationship satisfaction* is an overall assessment that the relationship contributes something good to the parties. The customer may sense that the particular supplier relationship has fulfilled his demands or increased his profits. This attitude relates to the *actor* dimension as defined in the network approach. Relationship satisfaction has been found to increase customer retention greatly, suggesting that satisfied customers stay with the seller (Eriksson and Löfmarck Vaghult, 1999). This strong finding is one of the tenets of relationship marketing, that lasting and deep relationships is the result of the parties involved being satisfied with the outcome of their work. We can thus hypothesise that:

Hypothesis 2:
The higher the customer's relationship satisfaction, the higher the customer retention

Changes and adaptations in the firms due to the interaction represent a more embedded kind of substance. Adjustments and *organisational changes* may be a consequence of the co-operation, or an active step to better co-operate with the particular supplier and co-ordinate resources and activities within their respective networks. Such changes related to the *activity* and *resource* dimensions are therefore embedded in a portion of the overall network structure. The evolving nature of such network structures means that customers learn more about the supplier's context and network ties. The customer may in fact overstep the supplier, to do business with the supplier's suppliers, or other, supplementary suppliers (Johanson and Wiedersheim-Paul, 1975). Large commitments, such as change of management and organisation, lead to an expected reduction of commitment to further business development. The customer instead turns to other suppliers, offering more potential gains in business relationship co-ordination.

In the specific case of consulting services as in the present data, customers have been found less inclined to commit to future development after a period of successful implementation organisational change (Eriksson and Löfmarck Vaghult, 1999). Organisational change was here defined as a change in a broader and deeper portion of the customer firm than just the one where the purchased service was originally intended). This means that we do not only see generic but also specific reasons why organisational change can be expected to have a negative effect on retention. In this specific case, the customer is "done with" buying consultant services (and decides perhaps to wait until another reason turns up to bring in consultants, who are one or many singular tasks in their area of expertise). The satisfied customer must therefore find, or be suggested, more room for improvement in the same or in new areas. The seller needs to continually uncover new areas for business development, focus on process consulting, and incorporate business from other actors by exploring the network around the parties. We thus hypothesise:

Hypothesis 3:
The higher the organisational change in the customer firm, the lower the customer retention

Relationship satisfaction and organisational change represent two different levels of embeddedness of substance, the former less embedded than the latter. According to relationship development models, we expect relationships to develop from low levels of co-ordination and adaptation, through idiosyncratic investments, to interdependent systems of activities, resources and actors. Relationship satisfaction has been found a prerequisite for more deeply embedded relationship co-ordination (Eriksson and Löfmarck Vaghult, 1999) . Before the customers' businesses can be changed, they need to understand and appreciate what the supplier can actually do for them. We can thus expect a positive effect from relationship satisfaction to organisational change:

Hypothesis 4:
The higher the relationship satisfaction, the higher the organisational change

The effect of Existing Relationships on New Customer Acquisition

One consequence of customer satisfaction has been assumed to be retention (the customer stays). If we assume that the relationship takes place within a network setting, such emotions may be spread also to other parties in a *referral network.* A satisfied customer will spread the word to business associates and counterparts about the successful (or profitable) development. An example of analysis of informal marketing communication (Reingen and Kernan, 1986), shows that the stronger the social tie with a personal source, the more likely it will be activated for the referral flow. A type of referral network of relevance to professional service providers is likely to include existing customers and their business associates, where the particular product or service of the provider could be used. If a number of companies are in contact regarding their experiences in the particular field, a referral network is in place.
Our hypotheses to be tested are:

Hypothesis 5:
The higher the customer satisfaction, the higher the number of new customers to the supplier

Hypothesis 6:
The more successful users known to present customers (the larger the referral network), the higher the number of new customers to the supplier

The effect of Embedded Substance in Existing Relationships on New Customer Acquisition

We have assumed and proved that deep collaboration with one customer, leading to real organisational change in the customer firm as an effect of the collaboration or as an adaptation to the counterpart, decreases retention as the customer looks less long term at co-operation. The less embedded relationship substance such as relationship satisfaction increases retention. Deep states of collaboration is an investment in the counterpart and this situation leaves less room (and need) for investment in new counterparts. Our hypothesis to be tested is:

Hypothesis 7:
The more organisational change in present relationships, the lower the number of new customers to the supplier

Data and Method

This paper is concerned with customer retention and new customer acquisition in the area of professional services. Eighty new customer relationships to one and the same professional services firm (Mercuri International, MI) have been explored over time and the consequences such as new counterparts to MI and the customers have been examined. All first purchases in the 80 relationships were initiated sometime during 1994 to 1996. In 1996 and 1998, quantitative surveys were run with decisionmakers in the 80 customer firms and with the corresponding consultant in MI (using the same, mirrored questions to both sides). 13 customer firms in the sample were also interviewed about the relationship.

Mercuri International (MI) is an international sales development and consulting firm, running courses for sales staff and leaders in client firms and giving advice and support in their implementation of marketing strategies. Out from about 10000 customers world-wide buying their services yearly, relationships with 80 firms in eleven countries have been studied up to the end of 1998. In this second questionnaire, which is used in the present study, customers from 43 firms replied together with MI consultants and there were replies from consultants only in 25 cases giving a total of 111 respondents. The quality of data is judged to be good due to the customised terminology used in the questionnaire.

Within the sample of 80 relationships, some seem to have developed significantly from the initial phase, while other appear in fact to be non-existent at the end of 1998.

About 30% of the customers do not see MI as a supplier anymore and in all of these cases, purchases have declined or ceased. About 50% companies see MI as one of possible suppliers, even if some of them bought less or not at all in 1998. 11 firms see MI as their exclusive supplier.

The data were processed using LISREL, a statistical technique and computer program that traces structural relations in a set of data (Hayduk, 1987; Anderson and Gerbing, 1988;

Bollen, 1989; Jöreskog and Sörbom 1993). In order to trace structures, LISREL utilises two independent sources of variation between variables. Firstly, estimated linear regression coefficients are used. Secondly, the technique uses covariance between the error residuals of the linear regression estimates. The true variation of variables is approximated better when both regression estimates and error term covariances are used (Lord and Novick 1968; Jöreskog and Sörbom 1993).

Structural models are formed by defining relations between latent variables, which are higher order variables, representing underlying commonalties of the observed variables. Groups of observed variables are indicators of a latent variable, which is often interpreted as a theoretical construct. The formation of constructs and models together with the error covariance and correlations make up the fundamental dimensions of LISREL. The formation of constructs and models may be described as causal dimensions, whereas the pattern of covariance in error terms and correlations may be described as a structural pattern in data.

The method for assessing validity stems from the basic dimensions used in modelling. We assess the validity of our structural model in three dimensions: a) nomological validity, meaning the validity of the entire model; b) convergent validity, meaning the homogeneity of constructs in the model; and c) discriminant validity, meaning the degree of separation between constructs. Estimates for assessing validity are derived from the structural model and a measurement model, which contains no structural relations. All three validity dimensions should be confirmed in both models. The key statistical estimates result from both error covariances and correlations, but their separate contribution can also be estimated.

The measures of nomological validity are χ^2 and degrees of freedom, which measure the distance between data and model, and an estimate of a non-significant distance, the p-value, which should be above 0.05 for significance at the 5% level (Jöreskog and Sörbom 1993: 111-131). Convergent validity is confirmed if indicators load only on their constructs. Convergent validity is judged by factor loadings, t-values and an R2 value, which measures the strength of the linearity in the relation (Jöreskog and Sörbom, 1993: 121). Discriminant validity is assessed from the measurement model. Correlations between latent variables should be significant, and not be unidimensional. Significance is investigated by the t-values of correlations. Testing of unidimensionality is done by forming an approximate confidence interval from error terms and correlation coefficients. An interval including 1 suggests unidimensionality, and thus rejects discriminant validity (Jöreskog and Sörbom, 1993: 117).

Interpretation of a valid model should be done with the awareness that each relation in the model is a part of the broader context of the model itself. There are many counteracting and reinforcing structural effects within a model. It is therefore essential to view one part of the model in light of it being contextual to the model. A simple example is a causal chain where the construct *a* causes *b* causes *c*. In such a model, *a* has an effect on *b*, and *b* has an effect on *c*, but *a* has also an indirect effect on *c* that is mediated by *b*. The effect of *b* on *c* is thus the total effect of the direct effect of *b* on *c* and the indirect effect of *a* on *c*. The correct interpretation of this simple example is that *b* has an effect on *c*, in the context of *b* being affected by *a*. Patterns of causal effects are often very complex, which is the reason why it is recommended that the researcher be as parsimonious as possible in structural modelling (Bollen 1989). Another implication is that validity cannot be assessed piece by piece. It is not correct to investigate the causal effect from *a* to *b* in one model, and then *b* to *c* in another, in order to conclude that *a* has an effect on *c*. All constructs and relations have to be assessed in one and the same model.

Construct Validity

The discriminant validity was supported in a measurement model. The following discussion of convergent validity is based on estimates and measures from the structural model. In this case, the figures are not very different.

The validity of constructs used as building blocks is high. Table 1 shows key statistical estimates for assessment of validity. Two of the constructs are single item, meaning that the convergent validity is not relevant, but that discriminant is. Customer retention is equal to a question of whether the respondent has a long-term view of the co-operation with the supplier. This captures the will of the respondent to stay in the business relationship.

Table 1. The Constructs and their Indicators.

Indicator	*Abbreviation in Figure 1*	*Factor Loading*	*T-value*	*R2-value*
Retention				
Customer has a long term view of future co-operation	LONGTERM	1.00		1.00
Relationship Satisfaction				
High total satisfaction with the co-operation with MI	SATISF	0.80	6.45	0.64
Working with MI gave higher profits	PROFIT	0.51	4.88	0.26
Organisational Change				
Effects of co-operation on other areas than sales	INFAREA	1.00		1.00
Referral Network				
The number of other firms with positive experience of MI known by the customer	POSOTH	1.00		1.00
New Customers to Supplier				
The number of new customers given to the supplier as a result of interaction with the particular customer	NEWCUS	1.00		1.00

Relationship satisfaction captures two indicators that concern the satisfaction and profitability resulting from the relationship with the supplying firm. Of these two indicators, satisfaction seems to be closest to the construct.

Organisational change is a single item construct where the effects of co-operation on other areas than sales, in the customer firm, is captured. The effect on other areas than those primarily in focus by the supplier can be considered a representation of organisation having changed on a more significant level, and more throughout the company than a single company function. It may also indicate that the customer makes changes in order to fit better the key service sold by the supplier. Examples of organisational change in the case of the customers of MI from the written comments in the questionnaires are the way marketing, sales management and sales management is carried out, the structure and roles redefined in the organisation and the way production and purchasing is now planned.

Referral network is a single item construct capturing the size of the referral network of the customer firm, represented by the number of companies known to the customer where there are positive experiences from using MI. A large number of known users would mean a large potential contact net for referrals regarding experiences. It is assumed of benefit for the supplier if each customer is surrounded by such a group of speaking partners.

New customers to supplier is also a single item construct capturing the number of new contacts to the firm as a consequence of working with the particular firm.

Results

The research presented in this paper sets out to study how professional service suppliers can get new customers through their existing ones. In order to test the hypotheses, a structural model was made. It is presented in Figure 1. The key statistics of the model are somewhat poor, and reflect the low sample size available. The most problematic estimate is the p-value of 0.03, suggesting that the model is acceptable at the 3%, rather than 5%-level. The RMSEA is 0.12, which is a bit too high to be good. However, the model's GFI is an acceptable 0.97, and the t-values, factor loadings, R2-values, all suggest that the model is valid. The slightly poor p-value of 0.03 is probably explained by that the sample size is comparatively low, so the model may be better estimated with a larger sample size than that available here.

Figure 1 in here

The structural model in figure 1 show how our key constructs are related to each other. The dependent variable is the number of new customers a professional service supplier gains from working with one specific customer. The results show that relationship satisfaction greatly increases the number of new customers to the supplier (coefficient for causal relationships is 0.85 in Figure 1). Another way of gaining new customers is from positive word-of-mouth referrals from a specific customer to the supplier's potential customers. This is illustrated by the effect of relationship satisfaction on referral networks (0.65), and the effect from referral networks to new customer to supplier (0.23). Apparently, some of the satisfied customers generate new customers for the supplier through positive word-of-mouth. The results confirm hypotheses 5 and 6. In the 1998 questionnaire, the respondents give examples of the new contacts received by MI. These show that in the particular business setting, the consultant firm is getting the references from the same business, from the associated firms such as owners, or from the dealer networks or channel partners of the customers firms:

> *"Other groups in T corporation"*
> *"More than four new contacts with other financial services companies"*
> *"E International, that is the new role of the former MD"*
> *"More than four new contacts, that is with client's customer"*
> *"The owning company, for them we have run a workshop in 1998"*
> *"The channel partners of C, and references for new clients"*

A more complicated picture emerges when we look at the lower half of Figure 1. To start unravelling the relationships, we see that customer retention has a negative effect on new customers to the supplier (-0.43). The more committed a firm is to develop a specific relationship in depth, the less the firm will allocate resources to develop other customer relationships. Apparently, a customer is retained because there is potential for further development of the relationship, which leads the supplier to foreclose alternative customers to focus on the current one. This suggests that the rewards of developing an ongoing business relationship may be greater than the rewards from an additional customer. Alternatively, the same phenomenon could be explained by the customer's wish to continue to exploit the benefits from working with the particular supplier, demanding more of adaptations and commitment, which leads to a high use of the time and efforts available in the supplying firm. There is simply not room for more than a few 'developed' relationships (so they do not lead to new relationships being initiated).

Customer retention is increased by relationship satisfaction (0.75), but decreased by organisational change (-0.21). This is because the customer's overall satisfaction generally leads to more business, but sometimes, for instance when organisational change has been implemented, the customer is 'done with' the supplier's services. The supplier has effectively implemented their services at the customer firm, and the customer now reduce their service buying to reap the rewards of the changes implemented.

Management Implications

Customer acquisition is an important task of any firm. The balance between getting new customers and deepening the collaboration with existing customers is of high managerial relevance. The most important conclusion from the present research is the need to choose between on one hand, the use of positive word-of-mouth referrals from existing customers to gain new counterparts and on the other hand a deep collaboration with satisfied, retained customers. The choice depends on the different mechanisms at work in the two processes.

A firm pursuing the first alternative (adding new customers by using the existing network) will most likely need to work differently from one going in the second direction (deep collaboration). The first alternative will mean a continuous active sales approach towards prospects, especially those within the business network of the existing partners, to make maximum use of referrals. The use of meetings between customers at the provider, to exchange experiences and ides of how to benefit more from the provided solutions is one measure that could be taken. In this situation, new customers need to be kept satisfied but there will be less time and efforts available for deep collaboration. Also, there is an obvious problem of interpretation when such a collaboration process and deeply customised solution is to be made understandable to others.

In the second alternative, the supplier will try to deepen collaboration with existing partners, possibly by co-operating with other suppliers who can add value and increasing the number of areas in which the services can be of use to the customer. In this case, each relationship will demand a lot of resources and the professional handling of each relationship will be the task of a key account manager or project leader. It will be difficult to find the energy and resources to add many new clients. Referrals may hardly be used due to the complexity of solutions and possible demands from the customer to keep such information between the parties.

It is likely that the combination of customised activities to a few partners and a broad approach to the market with more standardised solutions is a difficult one, unless handled as separate organisations or business areas.

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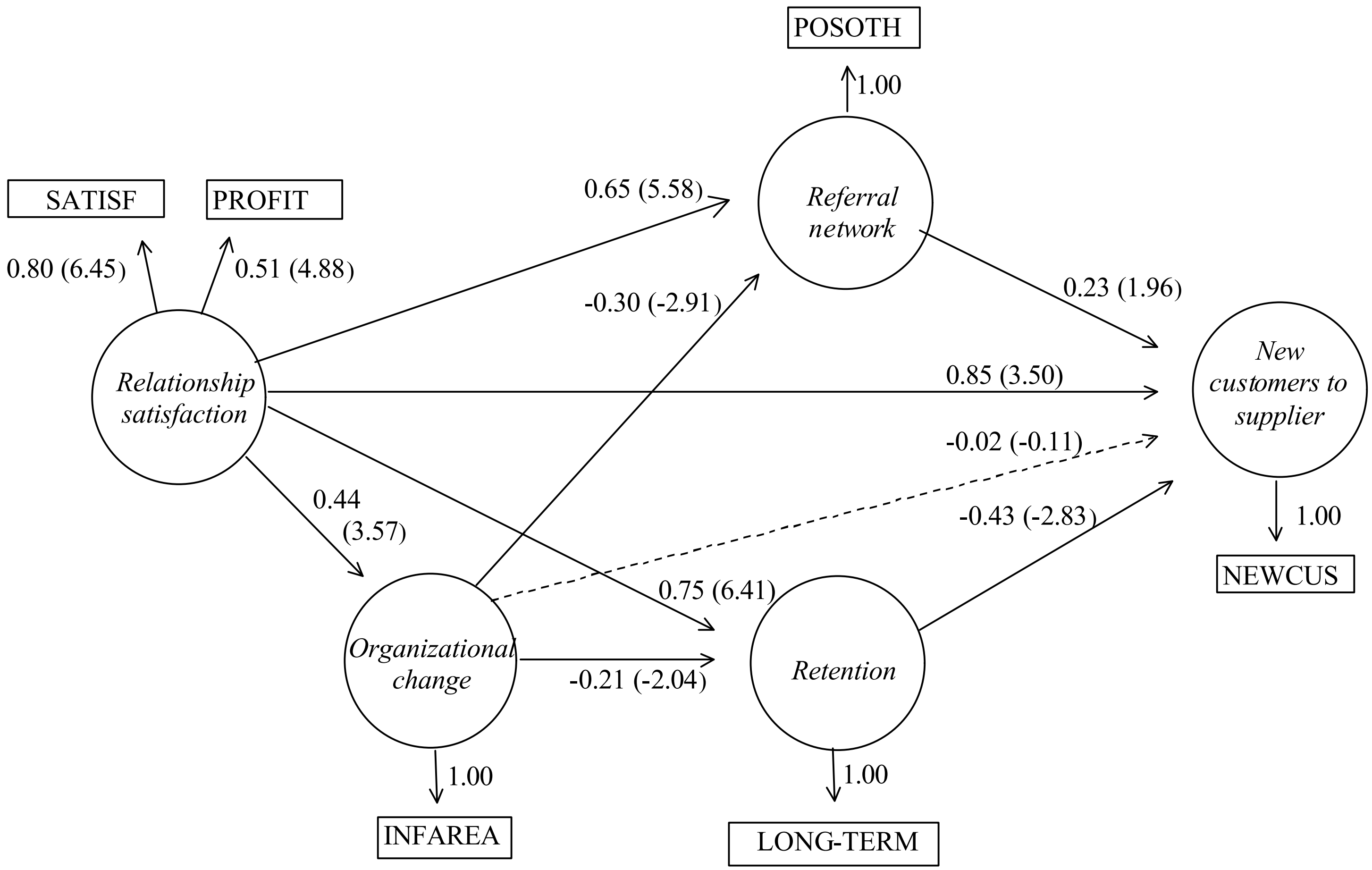
Figure 1. The Structural Model



Note: Model Chi-square with 4 degrees of freedom is 10.43, P = 0.03. RMSEA = 0.12. GFI = 0.97.