

## Price delegation and the impact on customer loyalty

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### ABSTRACT

Conventional wisdom has frequently portrayed the positive influence behind customer loyalty. After all, customer loyalty represents a customer's intention to continue buying from a firm. However, extant literature has recognized the existence of two types of customer loyalty: loyalty to the selling firm and loyalty to the salesperson. We explored the risks behind customer loyalty to the salesperson and then, how to use price delegation as a way to mitigate such risks. We examined the impact of different degrees of price delegation by conducting a survey among customers. Participants' feedback was gathered to create a customer loyalty index. The findings support our hypothesis that a lower price delegation results in lower customer loyalty to the salesperson.

Keywords: price delegation, customer loyalty, pricing



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## INTRODUCTION

Numerous articles have been written regarding customer loyalty and how important this construct is to the success of any business. Customer loyalty can be defined as the customer's intention or predisposition to continue buying from the same firm (Thakur, 2016). As a result, customer loyalty has a direct impact on a firm's financial performance by a) increasing customer share, b) gaining a price premium and c) growing market share. According to a study from Bain & Company, customers spend more with a vendor, the longer the relationship with them. In some industries, such as apparel and groceries, the increase in spend was around 67% and 23% respectively in periods subsequent to their initial purchase. The same study shows loyal customers spend more by buying other products from the same vendor. Adding other products along upsell offerings results in a price premium that allows selling firms to recover their investments as often one-time transactions are not profitable. The Bain study also shows that word of mouth is a key contributor to bring new customers. In overall, the average buyer would refer 13 people after ten purchases (Bain & Company, 2000). Failure to properly manage customer loyalty can have definite financial consequences. In 1992 Air Miles launched a program in the U.S. aimed to increase their customer loyalty base. Due to the complexity behind the benefits to their loyal customers, the program shut down resulting in a \$25M write off (Forte Consultancy, 2011).

However, customer loyalty does not come with downsides. The extant literature recognizes there are two types of customer loyalty. Customers can be loyal to either the selling firm or the salesperson (Bendapudi & Leone, 2002; Palmatier, Scheer, Steenkamp, 2007; Hongsheng, 2012). While customer loyalty to the salesperson enhances the overall customer loyalty, this statement is undermined if the key salesperson no longer works with the customer. The loss of a key contact person may impact the firm's relationship with the customer. According to American Express' estimates, more than 30% of a financial advisor's clients would be lost if he/she were to leave the firm (Tax & Brown, 1998). When the possibility of a salesperson leaving the firm is high, existing research recommends management should communicate directly with the customer to emphasize the salesperson's limited ability to structure deals (Palmatier, Scheer & Steenkamp, 2007). By doing so, management is able to dismiss any impression that the salesperson owns the relationship. Bendapudi & Leone (2002) studied how non-compete agreements have been traditionally used to deal with these risks and how some courts are ruling against these clauses and even some states have enacted laws to limit or eliminate such clauses. As a result, an alternative mitigation strategy could be keeping multiple contacts. By having several points of contacts, for instance, sourcing and pricing, the relevance of any single employee in either side is diminished.

However, no study has explored how price delegation could be used to disrupt a key salesperson's ability to structure a deal. Price delegation consists on empowering salespeople to set the price. By varying the degree of pricing authority, the appearance of who owns the relationship (e.g. firm or salesperson) can be shifted. The purpose of this study is to assess how price delegation can be used to manage customer loyalty. By doing so, firms can control how much loyalty can be owned by the firm rather than the salesperson.

## CONCEPTUAL MODEL AND LITERATURE REVIEW

Palmatier, Gopalakrishna & Houston (2006) studied relationship marketing investments and their return. Such investments were classified in three types: financial, social and structural. Financial programs include discounts, free products and other financials benefits. While social programs appear to have the highest social return, they also concluded that salesperson and firm factors may impact the effectiveness of such programs. Palmatier et al (2007) studied how these marketing programs affect the relationship between the customer with the salesperson and/or the firm. They concluded perceived control from the salesperson on financial programs may undermine the relationship between the customer and the firm and if needed, such programs should be managed jointly between the salesperson and the firm

Palmatier, Scheer & Steenkamp (2007) studied both, customer loyalty to the firm and customer loyalty to the salesperson. Because customer loyalty to the salesperson also increases the risk of losing business if the salesperson leaves the firm, they recommend firms to manage the benefit-risk trade off accordingly. Some of their recommendations include direct communication from management with the customer, setting the salesperson with limited ability to provide benefits and implement procedures to limit salesperson discretion.

Hongsheng (2012) studied customer loyalty to the salesperson. His study provides a comparison between customer loyalty to the salesperson and customer loyalty to the firm. It emphasized both positive and negative aspects of customer loyalty to the salesperson and provided few ways to mitigate any risk that may arise from such relationship. However, it did not address the use of price delegation as a way to mitigate the risk behind customer loyalty to the salesperson. Table 1 provides a comparison of customer loyalty to the salesperson and customer loyalty to the firm.

Contrast Item	Loyal Sort	Customer loyalty to the salesperson	Customer Loyalty to Firm
Behavior		Customer relies on salesperson when buying	Customer relies on emotions, attitude, intention and behavior to the brand or firm
Forming Mechanism		Business friendship	Brand Attachment
Influencing Factors		Salesperson's individual capability, professional skills and interpersonal skills	Trust, commitment, value, satisfaction between customer and selling firm
Customer Benefit		Confidence, social interest, special interest treatment	Lower selecting and purchasing costs, self-image, special treatment
Firm Benefit		Premium, sales effectiveness, sales growth	Premium
Customer Drains Risk		Salesperson defection cause customer defection	Customer loyalty transfer cause customer defection

Table 1 Comparison between customer loyalty to the salesperson and to the firm - Source: Hongshen (2012)

Bolman, Roehm & Schetzle (2014) proposed two methodologies to calculate the value of customer loyalty to the salesperson. The intention was to enable management to identify which salesperson has greater value and how to use customer loyalty to the salesperson to create a sustainable competitive advantage. Neither methodology considered risks behind customer loyalty to the salesperson, which could result in huge financial implications for any firms given the possibility of losing customers.

Figure 1 show the theoretical model of our study. Customer loyalty to the salesperson is conducive to firm financial risk (Palmatier, Scheer & Steenkamp, 2007; Hongsheng, 2012). However, our study posits this risk can be minimized if price delegation is managed adequately. Price delegation is structured in many firms as a combination of discount authority and the approval cycle time. Discount authority represents the discount level a salesperson is empowered to offer in a given deal. Approval cycle time represents the length of time from the

moment the customer request pricing to the time pricing is approved and provided to the customer in the form of a quote. By varying the degree of discount a salesperson is empowered to offer and/or by making the salesperson to obtain additional approvals (e.g. longer approval cycle time) so that a quote can be issued, a firm can actually convey to the customer a sense of who owns the relationship.

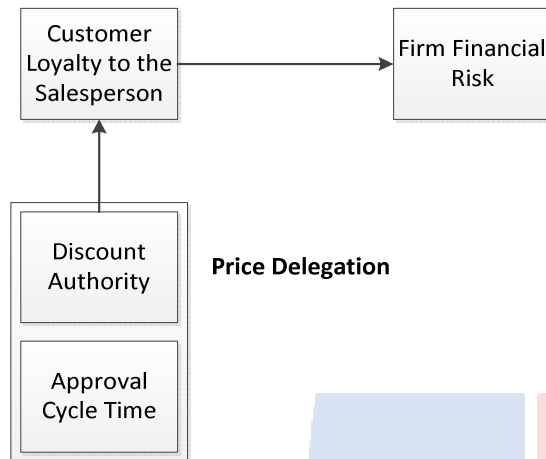


Figure 1: Theoretical Model of the Impact of Price Delegation on Customer Loyalty to the Salesperson

## HYPOTHESIS DEVELOPMENT

Normative theory provides support for the practice of price delegation as salespeople are closer to the customer and therefore, they are more likely to price the right solution to the customers (Wilken, Corneliben, Backhaus & Schmitz, 2010). However, agency theory, which explains the relationship between principal and agents, provides us with a different perspective. In this case, the principal would be the management who seeks to delegate the pricing authority to the salesrep or the agent. According to agency theory, the agent has better information and, due to conflicts of interests between principal and agent, the agent will pursue his own goals. In addition, there is an uneven distribution of risk as the agent may be making the decisions but resources are owned by the principal. As a result, the agent is incurring little or no risk because all losses are absorbed by the principal (Fazlzadeh, Mohammadi & Sepehrfar, 2011). Agency theory can help us understand the financial risk a firm can be exposed if a salesperson owns a customer's loyalty. After all, a salesperson may become a free agent at any moment and pursue his/her own interests. Signaling theory then provides us with the basis to support the development of our hypothesis. This theory explains that one party conveys signals to another party about some relevant information (Connelly, Certo, Ireland & Reutzel, 2011). In this case, the signal is the limit on pricing authority to ensure customers understand the decision-making power resides on the firm and not the salesperson. Thus, the first hypothesis is developed:

### **H<sub>1</sub>: Discount authority is positively related to customer loyalty to the salesperson**

Likewise, and consistent with Bendapudi & Leone (2002), the more people required to make a price decision, the less autonomy will be enjoyed by the salesperson. As more people are involved in the decision-making process, the expected length of time to obtain price approval is

longer. The lower autonomy will drive customer's perception that salesperson does not own the relationship but the firm. As result, our second hypothesis comes as follows:

## **H<sub>2</sub>: Customer loyalty is negatively related to approval cycle time**

It is important to note our study posits that the forming mechanism behind customer loyalty to the salesperson is the relationship between the salesperson and the customer and is influenced by the salesperson's individual capability. The latter is what we are trying to influence by reducing his/her pricing authority. However, the forming mechanism behind customer loyalty to the firm is the brand attachment and is influenced by factors such as trust, commitment, value, etc. (Hongsheng, 2012). Therefore, weakening customer loyalty to the salesperson should not result in weaker customer loyalty to the firm.

## **RESEARCH DESIGN**

### **Sample**

In order to test our hypothesis, we will conduct a survey with sales professionals from a variety of business-to-business (B2B) manufacturers. Industries to be selected will include those where price delegation is a common practice, such as those where demand is highly price elastic, customers are aggressive bargainers, product and/or services are complex, customer classes and sizes vary widely and products are perishable (Stephenson, Cron & Frazier, 1979). Such industries include manufacturers of computers, electronic equipment, medical devices and industrial goods. We have reached out the Manufacturers' Representatives Educational Research Foundation who will provide us with the contact information required to perform our survey.

Based on this directory, we are expecting to draw a random stratified sample of 3000 industrial customers. We will be running a multi-wave mailing, consisting of presurvey card, survey, follow-up card and a second survey to the companies selected. We are expecting to obtain responses from 600 customers or a response rate of 20%. To determine the appropriate sample size for our testing, we ran an a priori power analysis using a statistical test of point biserial model correlation. The following inputs were entered: alpha of .05, power of .80, and an effect size of .05 to ensure strong correlations and the expected large sample size. Participants will receive background information on the survey along instructions on how to complete the survey.

## **STUDY DESIGN**

### **Research Design and Methods of Data Collection**

The purpose of the survey is to assess customer's loyalty when presented to different scenarios of discount level and approval cycle time. Participants will be exposed randomly to different discount levels ranging from low to high discount authority. Low discount authority is defined less than 5% discount off list prices. A medium discount authority is defined up to 30% discount off list prices. A high discount authority is defined as greater than 30% discount off list prices. Likewise, approval cycle time is defined in hours following similar format. A short approval cycle takes up to 24 hours. A medium approval cycle takes up to 4 hours. A long approval cycle is less than 1 hour.

Survey will include inquiries to assess customer's loyalty based on their likelihood of referral, likelihood of repurchase and likelihood of upselling upon being exposed to the scenarios above. All inquiries will be conducted using a 5-point Likert-type scale (1 = strongly disagree to 5 = strongly agree). As the intention is to assess customer's loyalty to the salesperson and customer's loyalty loyal to the firm, survey's questions will be designed to track responses regarding the salesperson as well as the actual company.

*Likelihood of referral:* the relevance behind this measure resides not only on the simplicity of the construct itself but also the credibility it provides regarding the subject being inquired.

*Likelihood of repurchase:* The more loyal a customer is, the more likely he/she will purchase again and the less likely he/she will switch to another vendor.

*Likelihood of upselling:* The more loyal a customer is, the greater his/her trust will be and therefore, he/she will be more likely to buy new products and/or offerings from the same firm.

Based on the survey's responses, a Customer Loyalty Index (CLI) index will be calculated. A CLI index is a measure that equally weights the value of referral, repurchasing and upselling (Pascal, 2016). The CLI score will then be tabulated where: 0 – 2: Weak customer loyalty; 3: Medium customer loyalty; and 4-5: Strong customer loyalty. Measures for customer loyalty to the salesperson and customer loyalty to the firm will be available. Correlation analysis, measurements of central tendency and regression analysis will be performed to determine the relationships between our independent variable of customer loyalty to the salesperson, price delegation which is our moderator selected and our dependent variable of firm financial risk. We will use Jmp software to determine correlations by using the multivariate capability to assess relationships and correlations between the variables. Reliability amongst each item will be assessed based on Cronbach's alpha using inter item analysis. Goodness of fit or, how well our model fits the observations, will be assessed by aligning the measurements from a total item correlation with the respective mean.

Means and standard deviations will be determined for each of the item responses to better understand the average score as well as the spread of responses across the scores. Standard deviation will be particularly useful in the Likert-type scale questions as the spread of the responses provide for an opportunity to assess any metadata captured in the survey and then, identify any anomalies that may not fit well with our model. Regression analysis will be performed on our independent variable, moderator and dependent variable with the assistance of Jmp software.

## ANALYSIS

It is expected those customers exposed to scenarios represented with high discount authority and short approval cycle time will exhibit a CLI index of 4 or higher meaning strong customer loyalty. Likewise, those customers exposed to scenarios with low discount and long approval cycle time will exhibit weak customer loyalty. It is expected the overall regression to be significant with the degree of discount authority and approval cycle to be highly correlated with the survey's responses. As a result, our findings will support the notion that price delegation can, in fact, influence customer loyalty to the salesperson. By forcing a salesperson to seek higher levels of approvals, customers' perception of who owns the relationship can be altered. Therefore, loyalty may be shifted from the salesperson to the firm. Overall customer loyalty will remain intact but firms can succeed in managing the risk of a key salesperson's

having too much loyalty. As mentioned before, the risk is greater when sales staff turnover is high or the defection of a key salesperson is likely. Thus, this salesperson may take customers away from the firm.

In addition, those participants with greater degree of price delegation are expected to be able to upsell more often and/or add other products resulting in greater deal sizes but at the expense of lower margins. This definitely represents an opportunity for further research as many firms are facing this dilemma. For instance, firms in the computer industry have leveraged key salespeople from channels like value added resellers (VAR's) and distributors to bring additional revenue but margins have declined around 600bps. Thus, while this study was able to explain how price delegation can affect customer loyalty to the salesperson, to what extent it is beneficial to do so. Firms may own their customers' loyalty and the loyalty could be strong. However, consideration for other factors, such as type of products (e.g. commodity vs specialized products) and macroeconomic factors (e.g. growth expectations, interest rates, etc.), is critical.

## **DISCUSSION**

This study introduces a novel approach to influence customer loyalty to the salesperson by using the degree of price delegation. While customer loyalty to the salesperson enhances the overall loyalty to the firm, we discussed how the former could have negative impact on a firm. As a result, we tested how limiting price delegation through a combination of discount authority and approval cycle time could reduce customer loyalty to the salesperson. Our methodology was based on feedback from participants on their likelihood of referral, repurchase and upsell.

We expect the methodology presented on this paper can be used by sales organizations so that the trade-off between customer loyalty to the firm and customer loyalty to the salesperson can be successfully managed. While many firms manage these relationships by keeping a matrix organizational structure (e.g. multiple contacts, cross-functional teams, etc.) or using tools such as compensation plans to drive behavior, we are not aware of any firms using price delegation to influence the strength of the relationship between the customer and the salesperson.

### **Acknowledgement of the potential threats to validity**

Our study has several limitations. First, our study posits there is a different forming mechanism between customer loyalty to the salesperson and customer loyalty to the firm. However, we have to acknowledge customers are human beings who may form an emotional attachment to numerous objects, including their suppliers, their products, their brands and the salesperson they are working with. As a result, there is inherent risk of degrading overall loyalty to the firm if customers feel the salesperson is not acting on their best interest. Secondly, to ensure customers' responses would not be biased to a specific firm name or brand, our survey did not include any information of that nature. However, customers may be influenced for such factors. Therefore, the outcome may be different in a real environment and controlling for such factors (e.g. trust, corporate image, switching costs, etc.) would be a challenge. Third, we evaluated the impact of price delegation at a given moment. However, the relationship between salesperson and the customer, which is especially critical in a business-to-business setting, is built over time. As a result, a longitudinal study may be required to assess how our results will change as we determine whether the nature of the relationship of the variables under study are dynamic rather than static (Ployhart & Vandenberg, 2010). Last but not least, factors beyond a

firm's control, such as macroeconomic factors, customers' expectations, etc., could also impact the outcome.

Despite these limitations, we found some strong correlations amongst the variables and moderator in our proposed construct. Price delegation, which was set up as a combination of discount authority and approval cycle time, is related to customer loyalty to the salesperson. Customer loyalty was measured through a customer loyalty index (CLI), which is used by many firms and practitioners.

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