THOUGHT PERSPECTIVE

Customer Loyalty: What is it?
How can you measure and manage it?

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Customers make decisions about where to spend their time, money, and effort every day. They might be business buyers between 9 to 5, but consumers the rest of the time. In either case, the scenario is always the same for the seller – to make their product or service offering the preferred choice. They do this by building offers that will:

- Differentiate them from competitors
- Generate significant demand by customers
- Demonstrate superior value
- Build customers' loyalty

Loyalty is more than just behavior

It is a fallacy to assume that a customer is loyal just because they continue to buy from you. There are many reasons why a customer repeats purchasing which have little to do with being *really* loyal. Consider the following:

- There is a contractual arrangement with your company
- It takes too much effort or money to change suppliers
- You are low cost
- Relationship is with an employee and not with your company
- Habits are hard to break
- May actually be in the process of finding an alternative supplier

If any of the above is the case, what do you think is likely to happen should a desirable competitor come around and seek out your customer's business? Loyalty is far more than repeat business…

Loyalty can be defined as customers continuing to believe that one organization's products/services offer remains their best option. It meets their value proposition whatever that may be. They take that offer whenever faced with that purchasing decision.

Moreover, loyalty means hanging in there even when there may be a problem because the organization has been good to them in the past and addresses issues when they arise. It means that they do not seek out competitors and, when approached by competitors, are not interested. It also means being willing to spend the time and effort to communicate with the organization so as to build on past successes and overcome any weaknesses.

In a nutshell, loyalty means a customer wants to do business with you and does.

The challenge for organizations is taking this definition and translating it into actual practice, where specific actions are defined and ideal customer relationships are envisioned. It also means identifying a means for taking this loyalty construct and putting it into measurable terms so that success and failure can be assessed and progress or decline tracked.

Customer loyalty can be measured and monitored

Loyal customers are those who are getting the products and services they desire. They are customers who believe these products and services are superior to those of the competition. Ideally, they are customers who view their interactions as more than simply transactional. They believe there is a relationship that is bigger than just the products or services they buy. Measuring loyalty means measuring the strength of this relationship between buyer and seller, between the organization and its customer.

It is challenging to measure the level of loyalty within the relationship which is why companies so often succumb to simply defining loyalty as the number of purchases made or a continuing pattern of buy behavior. And asking the customer directly about whether or not they are 'loyal' does not provide a valid measure. Customers will often say they are loyal – simultaneously-- to multiple providers.

What we are looking at is measuring those attitudes as well as behaviors that we know make up this concept of loyalty. For example, some of the important attitudes and behaviors expected of a loyal customer include:

- Likelihood to recommend your products and services to others
- Likelihood to continue purchasing your products and services, at minimum, at the same level
- Likelihood of purchasing other products and services you offer
- Believing your products and services are superior to others offered in the marketplace
- Not actively seeking alternative providers to replace you
- Providing your company with opportunities to correct problems and not using these as a basis for compromising the relationship

Based on customers' responses to questions such as these as well as others that evaluate specific aspects of their relationship with your company, a loyalty profile of your customers can be created. Loyalty segments categorize customers as Loyal, Neutral and Vulnerable.

The basis for loyalty segmentation should be sufficiently flexible in that it recognizes and accounts for the uniqueness and special challenges of any one business or organization. And yet must also be based on sound, well-tested research principles and validated modeling.

Business success means having desirable customers who are loyal to your organization. Monitoring the number/percent of your customers in the Loyal segment and doing what it takes to increase loyal customers while decreasing those who are vulnerable should provide the focus of any organization.

Profiling Loyalty Segments

Once the loyalty segments are formed, complete profiling based on demographic and other customer descriptors, is provided. (Such information is usually available from organizations' customer databases and other internal customer data sources). Comparison across the three loyalty profiles can reveal some very interesting and, even surprisingly, significant differences which would otherwise have remained hidden.

The example shown here happens to be that of a business to business loyalty profile. Note that the diversity across loyalty types is not unusual. For this company, it was very helpful to learn, for instance, that their West coast customers were far more vulnerable. While at a very early point in their analysis, this finding -- coupled with the market share potential-- suggested the possible need for organizational restructuring.

	Loyal	Neutral	Vulnerable
Segment Size	23%	46%	31%
Average Annual Expenditures	$25,900	$18,400	$20,100
Share of Expenditures Received	62%	39%	19%
Percent of Product Line Purchased	38%	20%	11%
Average Size of Customer Organization	Medium	Medium/Small	Large
Location	East/Midwest	SW/SE	West
Critical Needs	Product Line	Delivery Time	Order Cycle

But demographic and descriptive profiling is just part of the information required for organizations to manage customer loyalty. Organizations need to know why loyalty segments exist – why are some customers *loyal* and others *vulnerable* or just plain in between *neutral* towards you? And they need to hear this information directly from the customer – not management's best guesses or gut level feelings. Without customer input, organizations are held hostage to a loyalty goal that has no answers.

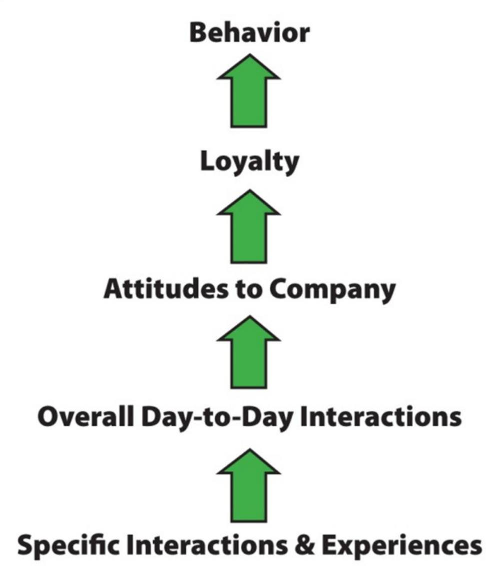
Understanding the Loyalty Segments

So what causes one customer to be loyal and another to be almost out the door?? The creation of the loyalty segments assigns each customer to a segment but does not provide any explanation as to why they are in that particular segment. To implement change that is directed towards improving loyalty -- *in other words to manage loyalty* – requires in-depth understanding of:

- Customers' underlying preferences for the products/services being considered
- What customers value in those products and services under consideration
- Customers' experiences, perceptions, and beliefs about the organization itself as well as about its products and services – particularly in areas that are highly valued

The Loyalty Research Center has developed a model that describes how daily interactions (as perceived by the customer) between customer and provider will ultimately drive overall company perceptions and lead to attitudes of loyalty (or not) and behavior.

Applying this loyalty model to individual companies requires breaking down the customer relationship into its various aspects – starting with day to day activities and ending with important attitudes, known to influence loyalty. Identification of organization-specific model elements generally begins with a Qualitative Phase. This becomes the basis for subsequent quantitative measurement.



Understanding how customers perceive performance on each aspect and measuring the relative, 'quantitative', impact of each on overall scores and loyalty is vital to identifying critical actions to take.

The basic model elements appear in the accompanying box and represent these interactions, experiences and attitudes that ultimately drive your businesses' success.

In addition to gathering performance feedback and perceptions, customers are asked to share any problems they may have experienced, as well as satisfaction in their resolution.

The following table includes actual results for one company. Note that several pieces of important information are included: Loyalty impact priority, performance ratings (ratings of *Excellent* and *Very Good*), and problem experience for each Loyalty Segment:

	Impact Level	Loyal	Neutral	Vulnerable
% who experience problems		12%	18%	41%
% of problems unresolved		10%	23%	64%
Top 2 Box Evaluations				
Order cycle time	1	64%	67%	39%
Desired delivery time	2	71%	41%	44%
Overall sales	3	78%	62%	53%
Overall customer service	4	82%	55%	49%

From this one chart, there were many learnings for our example client gathered through customer feedback; but first and foremost they learned that…

"*Loyal customers' experiences and perceptions are distinct from those of Neutral customers. There is yet an even greater gap between those identified as Loyal versus Vulnerable.*"

Here are just a few of this client's discoveries:

- Problems are experienced and remain unresolved far more often by the Vulnerable segment in comparison to others. Note the low percent having outstanding problems among the Loyal customers. This is not an unusual finding.
- Interactions are listed in priority order in terms of their impact on loyalty. It was a surprise to find that Order cycle time carries the impact that it does and that it scores so weakly across all segments, but especially among vulnerable customers.
- Other areas of interaction also revealed considerable differences among the segments. Consistently, Loyal customers' perceptions are most positive.

Also noted by our client was the fact that the majority of customers <u>did not</u> fall into the Loyal category!!!

Taking Action

The previous chart provides just an inkling of the rich information that is potentially available from customers. As in the case above, companies are likely to find vast differences among their loyalty segments in terms of perceptions, experiences, and attitudes. The question now becomes – What do you do with all this good information? Undoubtedly, the first thing to do is to understand why differences exist.

Variations among segments can be the result of:

- Inconsistent levels of service and/or product quality provided
- Customers have different priorities
- Customer needs or expectations vary

In each of these cases – whether it be actual performance differences on the part of the provider, or different demands on the part of the customer, loyalty levels are likely to be affected. In the first two scenarios, the provider is able to self-correct by focusing on those areas of weaker performance – especially where it counts the most - as revealed in the customer feedback results.

However, if customers' needs/expectations are sufficiently different from what the provider is capable of offering, then improving the performance of current offerings may not be the answer. A provider's business model may not coincide with the demands of every customer segment. Needs-based segmentation technique will be required to determine whether or not you are serving the <u>wrong</u> customers for your business model. Needs-based segmentation is discussed in a separate piece.

For now, let's assume a simpler scenario where all customers have similar needs and the actions to take are related to performance improvement….really not so simple.

Using the earlier example, we know that their actions focused on:

- Increasing the base of loyal customers
- Improving weaker areas of greatest importance to customers <u>across the board</u>
- Reviewing identification of specific customers in the Loyal and Vulnerable segment
- Determining which customers are most important - to the business- and assuring that their performance concerns were addressed

A plan to increase the base of loyal customers was put into place along with specific targets. They would start by improving those areas <u>most important to customers</u> where loyal customer perceptions reveal that there is room for performance improvement. Their message out to the entire company was:

Overall, results clearly point to the fact that while the Loyal segment generally scores highest across the board, it is also true that Loyal customer scores could be even better. In no area do <u>all</u> Loyal customers give either an Excellent or Very Good rating. Or, how about setting an expectation for reaching all Excellent?

Special, targeted efforts to achieve the above were designed, sometimes, around each identified loyal customer.

There were also plans to further investigate which customers fell into the Neutral or Vulnerable groups. That, in turn, helped determine next actions. What would it take to address a vulnerable customer's specific concerns and was the effort worth it? It was important that improvement efforts were considered *reasonable* given the desirability of that customer to their business.

As a general rule, a good plan of action includes reviewing (especially within the Vulnerable segment) lower performing areas with an eye toward the following:

1. Customers – Are these the wrong customers for your business? Are there customers who do not value the business model under which your organization operates? Will the customer ever change their negative perceptions and what would this take?
2. Perceptions – Do management and employees believe that scores should be higher, i.e., customer perceptions should be better? And what do prospects believe?
3. Drill down – Is there sufficient and specific enough information such that there is an understanding of what customers are expecting/asking for? Is there need for further clarification from customers in order to better understand their perceptions? Could qualitative discussion groups help the level of understanding?
4. Performance – Is performance lacking in one or more areas? Is there a well-defined process? Is the process being implemented correctly? Do employees understand the process? Have the right managers and employees been hired to execute the process? Can technology improve the quality and/or speed of the process? Who is responsible for the process? Is it time for an overhaul?
5. Competition – Are some customer perceptions being driven by what others are able to provide within or outside this industry? How are our competitors able to provide a better experience?

Migrating Loyalty Segments

The ultimate goal of your actions should not only be improvement of performance perceptions but, in the end, increasing the percentage of your customers who are loyal to your company/organization. <u>Why increase your percentage of loyal customers?</u> Go back to the first table and look at the annual revenue spend. In this example the Loyal customer segment spends an average of about $6,000 - $8,000 per year more than the other segments. While not shown here, annual profit margins are typically higher as well. It is usually the case that loyal customers:

- Buy more
- Buy across your product lines
- Will pay for value add services/products
- Require less product usage instruction
- Do not need sales support
- Are more likely to sole source
- Make referrals on your behalf

It is financially beneficial for the business to retain and grow a loyal customer.

Successful companies manage customer loyalty by making improvements based on customer input, identifying desirable customers, and setting goals for increasing the percentage of their customer base that is loyal. A loyalty migration plan is called for.

Customer loyalty migration requires strategies that will move lower level loyalty segments to higher levels, while maintaining and protecting loyal segment members.

Not every customer is desirable. Understanding your customer ROI as a basis for determining future investment in the relationship is important. What level of resourcing is required today? What will it take to improve their perceptions and either migrate this customer to the next segment level or for the loyal customer, maintain their loyalty?

Migrating customers to the next level usually means adding more or different resources, but only at appropriate levels – the right amount, on the right things, for the right customers. It does not mean losing money in the process.

An appropriate migration plan for a high revenue but costly Vulnerable customer may be one of out migration.

Final Thoughts

Unless companies regularly seek input from their customers - by using objective and valid measurement tools and techniques - they really know very little about them. It's amazing, because it is the customers who keep a company in business!!

Think about it….do you really know…..

- What's important and what is valued in the relationship?
- Whether what customers tell your sales people and account managers truly is what they mean? What is said behind your back?
- Whether their continued business means they really want to do business with you? Do you know who the truly loyal customers are?
- How does the competitor's offering affect what they think about yours?
- The true costs of serving your customers relative to their loyalty and revenue/profitability?

And most important of all….are you treating your loyal customers as loyal customers should be treated?

Only your customers know!

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