Introduction
CEOs worldwide consistently cite customer loyalty as one of, if not the, most important strategic objectives of their firms. Over 40,000 books and hundreds of thousands, if not millions, of articles have been written espousing the virtues of customer loyalty.

But customer churn remains high for many companies and industries. The auto industry, for example, only retains 54% of its customers. ABN AMRO Mortgage holds on to 20-30%.

In part, that flows from approaches that are strategically naive or weak in execution. But at a more important level, it comes because leaders have been misled by a torrent of literature that monotonously reiterates false findings about loyalty and wrongly advocates simple solutions.

Most of what we’ve been told about customer loyalty is just plain wrong. The simple truth is that the science studying the subject was incomplete, and incomplete frequently means wrong. The marketing community has deified the early pioneers of loyalty and these individuals have misled leaders and followers alike who have honestly sought out good business strategy.

Take the rule that admonishes us to retain as many customers as possible because the value of customers increases over time. We also know from applying the Pareto Principle (or 80/20 Rule) that some customers are far more important than others to revenues and profitability. Indeed, it’s likely (especially in services) that 60% of a business’s customers could actually be generating negative profits — costing the business money! Given that fact, one can easily see how the mandate of keeping all the customers possible could actually be a recipe for disaster.

But why have loyalty advocates been so adamant in recommending that we keep all our customers? They’ve made a faulty assumption: that all customers get more valuable with age. This observation is a naive one, based on a simplistic interpretation of customer cohort groupings. And there are many other myths we’ve foolishly accepted or even embraced.

The Number One Goal?

MYTH: The number one goal should be customer loyalty. Many companies these days are customer-centric, following the prevalent belief that customer loyalty is the number one goal of any firm. It’s not hard to find articles, however, that show such a philosophy does not lead to success:

- In a Sacramento Bee article, “Broke But Beloved,” Bob Shallit wrote about WINFirst, the troubled cable, telephone and Internet provider that had “very loyal customers.”
- In the Florida Times-Union, a story appeared under the headline, “Loyal Following Couldn’t Keep Jacksonville, Mich.-Based Jacobson’s Going.”
- Business Wire told of Garden Botanika Inc.,
which filed a voluntary bankruptcy petition although it “re-
 mains an industry leader with high sales and extremely
 loyal customers.”

In fact, many of the dot-com disasters could have re-
 ported similar results: loyal customers but no profits. It’s a
 reminder that the fundamental purpose of any business is
to identify and satisfy customer needs at a profit. The
problem is that customer loyalty can be purchased
and frequently is. To paraphrase an old saw, “You can’t buy
things for a dollar, sell them at 99 cents and make up the
difference in volume.”

Retention Over Acquisition?
*MYTH: Firms should emphasize retention rather than
acquisition efforts.*

The underlying logic of this myth rests on the trade-off
between the costs of acquiring new customers and the
costs of maintaining current ones. Conventional wisdom
(seeded by the maxim, “It costs less to retain a current
customer than to win a new one”) suggests that, all other
things being equal (which is most often not the case), your
odds are greater of receiving some return from investing in
a current customer than from chasing a potential one.

The most obvious flaw in this misconception is its
complete disregard for the product life cycle, with its four
stages: introduction of the product, growth, maturity/satu-
ration and decline. When firms are in the introductory and
growth phases of their offerings, customer acquisition is
critical. Conversely, when products are in the maturity and
decline phases, customer retention takes on much greater
importance. Firms ignore the differing strategic objectives
of the product life cycle at their peril.

Make All Customers Loyal?
*MYTH: Companies should strive to make all customers
attitudinally or behaviorally loyal.* The fundamental as-
sumption underlying this myth is that all customers are or
can be made to be profitable for a firm. An examination of
customer profitability invariably reveals that while organi-
izations will always have some highly profitable cus-
tomers, they’re also likely to have some highly unprof-
itable customers.

Customers can be broken down into three categories:
desired customers, break-even customers and costly cus-
tomers. For most firms, the desired customers (usually
about 20% of the customer base) will generate between
150% and 300% of total profits; break-even customers
(the middle 60-70% of the customer base), as their name
suggests, roughly break even; and the costly customers
(about 10-20%) lose 50-200% of total profits!

Clearly, making the majority of customers more loyal
isn’t a wise investment decision for most companies. In-
stead, managers must make reasoned decisions about
which customers truly represent assets to their firms’ fi-
nancial health, and target loyalty efforts to them.

Loyalty = Market Share?
*MYTH: Companies with more loyal customers will always
have higher market share.* While it may seem counterintu-
itive, firms with the highest loyalty levels frequently don’t
have the highest market shares. Generally, organizations
we tend to associate with having fiercely loyal customers
represent smaller, exclusive groups: Harley Davidson own-
ers, Fender Stratocaster owners, Jimmy Buffet fans and so
on. Devotion to Macintosh computers was compared in
one sociology article to the devotion of a religion, but
Apple lost out to the Microsoft-Intel combination.

In heterogeneous markets, market share leadership
won’t typically be associated with the highest levels of loyal-
ty, as niche players who address the unique needs of small-
er segments will naturally enjoy a more loyal following — at
the expense of being less attractive to the total market.

Convert Switchers?
*MYTH: Companies should seek to change switchers into
loyal customers.* Even if all customers were equally prof-
itable, the logic behind this myth would be dubious be-
because as all managers know, different customers derive
value from their shopping experiences for different reasons. Two relatively universal customer segments most prone to switching are commonly referred to as variety seekers and deal seekers. The variety seeker is motivated by curiosity about and a desire for new experiences in product types and brands. The deal seeker is primarily motivated by price. Trying to change those customers is like trying to get a leopard to change its spots: it never works.

**Retain 5% More?**

**MYTH:** Retaining 5% more customers increases profits by 25-85%. In a landmark *Harvard Business Review* article, Bain & Company consultant Frederick Reichheld and Harvard professor W. Earl Sasser claimed “companies can boost profits by almost 100% by retaining just 5% more customers.” Later in the article, that claim is refined to “reducing defections 5% boosts profits 25-85%.”

Almost overnight, this seminal article validated customer retention and spurred the quest for customer loyalty in firms worldwide. Unfortunately, despite publication in a prestigious journal, the promise is flawed on at least three basic levels:

- The company needs to be generating relatively small current profit percentages to expect such a high percentage increase. If we assume there are no additional costs associated with increased retention rates and that each customer contributes equally to revenues, a firm would have to have a pathetic 5% rate of return to increase profits by 100% from a 5% increase in retention rates. More typical returns substantially reduce the potential financial impact of improved retention.

- The ability to generate further profits by improving retention is highly contingent on the firm’s current retention rate. If we take away the assumption that there are no additional costs associated with increasing the retention rate for customers, it becomes very likely that there will be diminishing returns. At some point it will no longer be cost-effective to dissuade potential defecting customers from defecting. This means that for firms with low retention rates — high churn — it will likely cost less to increase retention by 5% than it will for companies with already high customer retention rates. For virtually all firms, it will never be cost-effective to retain 100% of customers. Therefore, depending on where a firm is positioned with regard to its retention-profit function, the return on investment of improving customer retention by 5% can be either positive or negative.

- Most firms have costly customers who chew up 50-200% of total profits. The size of losses generated by these customers determines if the firm operates in the black or the red. It doesn’t take a rocket scientist to realize that retaining 5% more customers won’t make money unless they’re the right customers.

**Invest in Loyalty Programs?**

**MYTH:** Most loyalty programs are a sound investment. If the only source of information you had on loyalty programs was the sales material from vendors who coordinate such programs, you’d be tempted to consider them a fail-safe road to riches. Despite their popularity among chain stores, and quite contrary to popular belief, however, most loyalty programs actually lose money for their sponsors!

The economics of these frequently touted remedies just don’t make sense. Loyalty programs are expensive to create and maintain, and they often produce disastrous results. A study by McKinsey & Company found the investments in these programs, including IT, training and so on, cost large retailers up to $30 million in the first year, while annual maintenance costs can total $5 to $10 million a year thereafter. That requires a store-by-store increase in sales of about 6% per cent, on average, just to break even on the costs of the program. For most retailers, that’s an unattainable same-store-sales growth rate.

Moreover, the vast majority of loyalty programs don’t contribute to any increase in sales. Although this phenomenon is more pervasive in some retail categories than others, consumers who have loyalty cards don’t seem to end up spending much more than those who do not. Even
where there are increases — in grocery stores, members of loyalty programs spend 48% more than non-members — you need to ask whether frequent shoppers are signing up for the program to be rewarded for something they would do anyway. Likely a large percentage of loyalty card customers — possibly the vast majority — are accumulating points or discounts without having changed their purchasing behavior from before they were members.

Setting the Record Straight
There are many more myths. But more important, there are also some loyalty truths that you can follow to help your company build loyalty in a sensible fashion:

1. Don’t manage for customer retention before you manage for customer selection. You probably don’t want to keep all of your customers — create and apply loyalty strategies and tactics selectively. Make sure your loyalty efforts are directed primarily at those you want to keep, and make offers that are relevant to those desired customers.

2. Customer loyalty takes more time to grow than most management teams have to give. Planning and patience are required.

3. Focus on customers’ share of wallet. Don’t disregard those customers with current low shares — customer polygamy is the rule these days. But don’t accept your current share. Learn how to improve your share of your customers’ loyalty.

4. Loyalty requires mutually beneficial interaction — most loyalty programs are tilted in the company’s favor.

5. The chain of events from loyalty to profits is twisted and complex. Learn the specific response patterns of your company and your industry.

6. Satisfied and loyal employees can make a difference, but customer satisfaction and loyalty can and often do happen in the absence of employee satisfaction and loyalty.

7. Customer loyalty and brand imagery are far from independent — you must manage them hand-in-hand.

Conclusion
To dismiss loyalty as a viable strategy because of the fallacious myths associated with it would be to throw the baby out with the bathwater. Customer loyalty should be a central mission for organizations — so long as there’s an adequate understanding of the truth behind the various claims made for it and an adequate understanding of its potential return.

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