Customer loyalty: how to measure it, understand it and use it to drive business success.

Since it is now widely recognised that it is much less costly and much more profitable to keep existing customers than to win new ones, customer retention has become a major goal for most organisations. In principle it's simple. You just have to keep your existing customers. But how? Many companies have adopted the idea of customer loyalty to spearhead their retention strategies, but it is very doubtful whether the loyalty concept is fully understood or effectively implemented by many who embrace it.

Loyalty is a historical word, rooted in feudal times when allegiance to the sovereign was fundamental to the success, perhaps even the survival of the state. The Oxford Dictionary's definition of the word 'loyal' is:

"True or faithful (to duty, love or obligation); steadfast in allegiance, devoted to the legitimate sovereign or government of one's country."

On that basis, why should anybody be loyal to a commercial enterprise? What legitimacy does the enterprise possess? Why do its customers have any obligation to show allegiance to it? Of course they don't, and the more the education, confidence and power of consumers have grown, the more they realise it. In fact, in the twenty-first century it is the other way round. It is the customer who is king and the supplier that needs to be loyal to its customers!

It is the woeful misunderstanding of the loyalty concept amongst senior managers (and especially amongst the marketing profession – the very people who ought to know better), which has been responsible for the plethora of misguided strategies which have been introduced in the name of securing customer loyalty. Many involve cheap attempts to bribe the customer. How many leaders have secured the long term loyalty of their citizens / followers / employees by such tactics? Whether you are president of a country or a company, loyalty has to be earned. Why should increasingly educated and confident customers continue to give their business to the same supplier? The answer is simple. To secure customer retention in a competitive market the supplier's total value package has to match customers' requirements better than anything offered by competitors.

Types of loyalty

There are many reasons why suppliers retain the business of their customers. As shown in Table 1, we can identify five main types of loyalty. Most bear little relation to the true meaning of the word loyalty, involving very little allegiance, devotion or duty.

(a) Monopoly loyalty

Monopoly loyalty is an extreme example, but does illustrate the point. Where customers have little or no choice, their 'loyalty' is far from devoted. It is often resentful. Our experience based on hundreds of customer satisfaction surveys shows that customers with little or no choice often feel very dissatisfied.

(b) Cost of change loyalty

Other suppliers are notionally in a competitive situation. Their customers could use alternative suppliers – in theory. In some situations, however, the cost, difficulty or hassle factor involved in changing suppliers is so great that customers will do it only as a last resort. Again, our research shows that they will live with much lower than normal levels of satisfaction before they switch suppliers. But this reluctance to change suppliers cannot be described as 'loyalty'. It certainly involves little allegiance, duty or devotion.

Types of Loyalty	
Monopoly loyalty	I have no choice
Cost of change loyalty	I can't bear the thought of all that hassle
Incentivised loyalty	I might as well collect the points
Habitual loyalty	It's so handy
Committed loyalty	They're the best

Table 1: Loyalty Types

(c) Incentivised loyalty

Incentivised loyalty has possibly been the most over hyped marketing strategy in recent years. It may have some effect on customers who are not spending their own money, frequent business flyers being an obvious example, but the success of Southwest Airlines in the US and Easyjet in the UK is already dispelling that myth. Most people in the UK hold the 'loyalty' cards of more than one competing supermarket, store group, airline or petrol station. They see the loyalty points as something they may as well take when it meets their wider needs to use that supplier. Tellingly, the UK supermarket which has gained most market share in recent years is ASDA. It offers a very wide product range and focuses on value, promoted in it's 'everyday low prices' slogan. Until recently it was the only one of the big four UK supermarket multiples which did not have a loyalty card! At the end of May, Safeway followed suit, abandoning its ABC Points Card.

(d) Habitual loyalty

Habitual loyalty may be the most common form of repeat business. As time becomes an increasingly scarce commodity for many consumers, familiar routines that can be quickly accomplished with minimal thought become part of the lifestyle. The weekly food shop is conducted at the same supermarket because it is convenient and familiar. Petrol is bought at the filling station that is passed every day on the way to work. Colleagues meet in the same pub after work. Companies with high levels of customer retention may feel a misleading sense of security because allegiance to suppliers in these situations can be very low. If a new supermarket, pub or petrol station opens which is more convenient, bigger, more modern or more competitively priced, the original supplier may find that there was very little 'loyalty' under-pinning the previous levels of customer retention.

(e) Committed loyalty

Contrast the 'allegiance, devotion and duty' of the previous four loyalty types with the loyal customers of a football club. All three words apply to their loyalty which is often rooted in their core values (they were brought up to *believe* that Manchester United are the greatest!), rather than in their attitudes. But a business is not a football club. It commands no emotional, irrational loyalty. It must continually earn its customer retention by delivering that total value package which meets its customers' requirements at *every* customer encounter.

Real customer loyalty involves more than just making repeat purchases. It represents a positive level of commitment by the customer to the supplier and it is the degree of positive *commitment* which distinguishes truly loyal customers. The degree of customer commitment can be used in customer satisfaction measurement to segment the customer base and identify those customer groupings that are most at risk of defection. Often, customer loyalty segments will have different needs and priorities, they will certainly have different perceptions of the performance of your organisation and, consequently, you will often need to define distinct strategies for different loyalty segments.

	Our customers	Competitors' customers
FAITHFUL	Totally committed, rate our performance highly, little interest in competitors	Totally committed, rate competitor highly, little interest in us
VULNERABLE	Apparently loyal customers but high level of inertia or some interest in competitors	Repeat buyers with competitors but little positive commitment and some interest in us
FLIRTATIOUS	Little positive commitment, actively interested in alternatives	Little commitment to competitors, may be receptive to our advances
AVAILABLE	Customers showing a strong preference for alternative suppliers	Competitors' customers who already rate us as superior to their existing supplier

Table 2: Loyalty segments

	Our customers	Competitors' customers
FAITHFUL	Reward loyalty, stimulate referrals, strong focus on service recovery factors	Don't target
VULNERABLE	Strong focus on PFIs, communications campaigns and rewards to build positive commitment	May be worth targeting if competitors are failing to meet their need in areas where you perform strongly
FLIRTATIOUS	Objective assessment of costs and benefits of retaining this group. Strong focus on closing any perception gaps	Go for the jugular, especially where you believe your strengths match their priorities
AVAILABLE	Cut losses. Chances of retention very low	Should be easy prey but make sure they're not habitual switchers

Table 3: Strategies based on loyalty segmentation

The concept of commitment

The concept that businesses should focus on when seeking to maximise customer retention is therefore not loyalty but commitment. Customer commitment will often be reflected in customers' behaviour. They may choose to recommend a favoured supplier. They might demonstrate commitment by travelling further than necessary or by paying a higher price. Commitment might also be reflected in their attitudes. Committed customers will believe that their chosen supplier is the best in its field. Our research shows that many apparently 'loyal' customers rate their current supplier as the same as most other companies in the field, making them an easy target for competitors' advances.

Whilst it is naive for a commercial enterprise to expect its customers to be 'loyal', it is feasible to aim for customer commitment. Most organisations have some customers who are committed to them, but often it is too few. Our surveys show that in many cases no more than 10% of the customer base is 'committed', even to some very well respected suppliers. However, the value of those committed customers is immense. As well as remaining with the supplier longer, committed customers buy more often and tend to buy a wider range of products from the supplier. They are less price sensitive, prepared, according to PIMS to pay an average 9% price premium. They recommend more and consider competitors less. Above all, they feel more committed. Whereas it may be unrealistic to expect devotion and duty, affinity and commitment are attainable. But only with considerable effort. Suppliers have to earn the huge rewards that a committed customer base provides. This has implications for strategic and operational decisions but those decisions must be based on sound information. It is the collection of reliable information on customer loyalty and its optimal use for management decision making that form the basis of the remaining three articles in this series.

Learning points

- Customer retention and customer loyalty are not the same thing. Customers may stay with a supplier through habit or perceived switching costs without feeling loyal to it.
- The concept of loyalty is rooted in the past, emphasising characteristics such as allegiance, duty and devotion. It is unrealistic for most commercial enterprises to expect their customers to have such feelings towards them.
- It is their degree of positive commitment to the supplier which characterises the most loyal customers.

- To effectively manage customer loyalty companies need reliable measures which track the level of customer commitment, clarify its drivers and quantify its benefits to the business.