

Castles in the air

The dangerous illusion of customer loyalty



A triumph in woolly thinking

An academic phoned me up the other day, asking me the question ‘Is marketing a science or an art?’

As we talked about it, it struck me that a better description of a lot of marketing today is Alchemy.

The alchemists, remember, were driven by a single obsession: to turn base metals into gold.

Marketers have a similar obsession: to turn customers into gold for the company by making them 'loyal' to the company's brands, so that they deliver a rich and secure income stream long into the future.

As part of their quest, the alchemists set out to isolate 'phlogiston' which they believed was the element of fire (to complete the quartet of earth, water, fire and air). Just imagine what wonders you could do if you managed to isolate phlogiston and deploy it at your command! But they never found this magic ingredient. Because it does not exist.

Likewise, in my view, marketers will never find the magic ingredient of brand loyalty. Because it does not exist.

The alchemists failed to turn base metal into gold because they were asking the wrong question. If you ask the wrong question, your chances of find the right answer is very slim indeed.

Marketers will never discover the secret of brand loyalty. They will never turn customers into assets of the company. Because they are asking the wrong question. On the wrong quest.

So tonight I won't try to provide answers. Instead I'll focus on questions. Are we asking the right questions?

Brand loyalty is a high point of wooliness in a profession notorious for its woolly thinking. The concept 'Loyalty' is similar to earth, water, air. It's broad enough to encompass many different things such as repeat purchase, customer retention (which is not the same as repeat purchase), an emotional bond between the customer and the brand, customer 'lock in' via carefully constructed or accidental barriers to exit, habit and inertia.

The word 'loyalty' lets marketers slide between one concept and the other without having to be clear about what they are doing or why.

Loyalty generates metrics confusion. How are we supposed to measure loyalty? By customer defection rates? Repeat purchase? Share of wallet/requirement? Satisfaction? Delight? Brand equity (whatever that is)? Word of mouth recommendation?

It also muddies the water when it comes to marketing priorities. What is the real secret of brand loyalty? Is it superior product value? If so, 'loyalty' is a redundant notion. To ensure brand loyalty all you have to do is continue offering superior value.

Or is loyalty 'something extra'? In which case, what is that something extra? Is it building 'a relationship'? In which case what does 'relationship' actually mean (is 'relationship' just another phlogiston?) Or is it launching a 'loyalty scheme'?

Companies have tried to doing these things with only mixed success. They invested vast sums in CRM, which in many cases degenerated into white-elephant software projects that probably did more to undermine 'relationships' than build them.

And as we know most loyalty schemes are not about loyalty at all. They are price incentives under a different name. Yet often the incentive is not high enough to change the customer's choice - and usually the customer is a member of many competing loyalty schemes anyway. So the net result is zero.

Loyalty myths

If we look into how the notion of loyalty became so important it's rather odd.

The bandwagon was launched by researchers claiming to have discovered that 'loyal' customers cost less to acquire and less to serve, recommend the brand more, buy more, and deliver higher margins.

However, since then empirical research has challenged every one of these claims. Sometimes, there is some positive effect. But often there is an opposite effect. For example,

- ❖ in many industries the most profitable customers are heavy category spenders who buy across a broad portfolio of brands - and are not particularly 'loyal' to any of them.
- ❖ Most word of mouth recommendation comes from new customers where the new purchase is still top of mind, not old ones.
- ❖ Many longstanding customers expect to be rewarded for their loyalty by lower prices and better service - which costs more to deliver - not less. And so on.

So, as with alchemists who claimed to have finally discovered the great secret, it's probably good advice to take their claims about loyalty with a pinch of salt.

Brand narcissism

So what is the problem with loyalty?

It really is very simple. The wish is father to the thought. Unbridled, unadulterated loyalty is the brand manager's - and the CEOs - dream. And they want their dream to come true.

Loyalty is an expression of marketing's endemic occupational disease. Brand narcissism. The urgent and overwhelming desire to make the brand the centre of everyone's attention; for the brand to be the object of unending, universal, adoration and adulation.

For this to happen, the brand needs to get customers to glorify the brand. So that is what marketers set out to do: to organise customer attitudes, emotions and behaviours around the needs of the brand.

So: their measures of success in this quest revolve around success *for the brand* ... Success for the brand - *not the customer*. Measures like sales volume, market share, margin, repeat purchase, willingness to recommend and so on.

"Hang on" you might say. "Every company worries about measures like market share, repeat purchase, and so on. There is nothing wrong with that!"

I'll return to that in a second. But the point I'm making here is slightly different. 'Loyalty' did help to expand marketer's horizons in one way: by highlighting the importance of time in the marketing equation. With loyalty, we are not just talking about a one-off transaction. We are talking about many, repeated transactions - or even a 'relationship' - receding into the future.

The secret of all long-term relationships is that they deliver win-wins: benefits for both sides. Enough mutual benefit for them both to want to keep on reinvesting in the relationship, because that way they will benefit more.

But how many loyalty measures can you think of that measure benefit for the customer? What are the equivalents of market share, margin, sales volume, repeat purchase and willingness to recommend for the customer?

Fact is, because the quest for loyalty is often driven by brand narcissism, it tends to forget the need for ongoing mutual benefit. Because, behind all the rhetoric about 'customer focus' the real motive is the glorification of the brand.

If you are 'loyal' to someone, you are happy to do things for them. So if customers are 'loyal' to brands, they are happy to do things for the brand. Fred Reichheld, the original loyalty guru, defines loyalty as "the willingness of someone - a customer, an employee, a friend - to make an investment or personal sacrifice in order to strengthen a relationship".

And most times, companies end up pursuing loyalty in the hope that the *customer might be willing to make a sacrifice for the brand*: by paying more or forsaking a better offer from elsewhere 'out of sheer loyalty' - as you would do for a friend.

And that in my view, is the danger of 'loyalty'. It sidetracks marketing departments onto a wild goose chase. A quest to turn base metals into gold. A quest to persuade customers, thanks to some magic hocus-pocus conjured out of their marketing book of tricks, that they ought to make a sacrifice, or forsake a better offer from elsewhere, out of loyalty to the brand.

Here is just one example from Tony O'Reilly, the former Chief Executive of Heinz. He defined loyalty with these words: 'The acid test of brand loyalty is whether a housewife, intending to buy Heinz Tomato Ketchup in a store and finding it to be out-of-stock, will walk out of the store to buy it elsewhere or switch to an alternative product'.

So the acid test of loyalty, then, is whether the customer is willing to incur extra cost and inconvenience for the benefit the brand. Which sets Heinz marketers off in a quest for the magical, extra ingredient that will get housewives doing this for them - rather than face up to the facts. If Heinz tomato ketchup is not on the shelf when the housewife wants it, then the company's supply chain is bust and needs fixing.

That has been the ultimate effect of loyalty in my view: to induce marketers to waste huge amounts of time, money and effort in a quest for the elusive magical ingredient of 'brand loyalty' *while simultaneously* encouraging them to ignore areas where their business is bust to some degree or another. Because, if the customer were really loyal, they would forgive these shortcomings.

Not surprisingly, most customers don't fall for this notion of loyalty. Which is why, in most industries, 'churn' rates are increasing, not declining.

The real issue

So what's the way forward?

Well, first things first.

In reality, the notion of 'loyalty' (or, let's say, repeat purchase) is *built into* the very notion of 'brand'. The whole idea of building a brand - an easily understood and relevant value proposition that is clearly recognised in the market place - is to encourage repeat purchase. The customer knows it is good value so why not buy it again. Also, it's easy for the customer to recognise, find it and buy it.

This is the only reason for investing all that money in branding: there is no point in building a brand if you are only going to sell once, and move on. Ask any cowboy builder.

So, for discrete products - where all the value is embedded into a product which the customer buys in a single transaction - there was never any reason to invent the extra notion of 'loyalty'. Because, actually, that's why brands were invented in the first place.

However, something important changed as the economy evolved from manufacturing to services, such as banking and telephony, which require ongoing, repeated interactions between company and customer.

For discrete products, all marketers had to do was focus on customer acquisition (i.e. product benefits), because the things that persuaded the customer to buy the first time tended to be the things that persuaded him to buy a second time too.

Often, that still remains true. What is the main reason for an existing customer to pick a Ford versus a VW or a Toyota? To buy this or that flat screen TV or digital camera? Because it's a better, cheaper product that fits his or her particular needs better. Exactly the same as before. No difference.

However, when we apply this 'customer acquisition is everything' mindset to services with ongoing interactions over a period of time, we create a

problem for ourselves. This time, value isn't delivered in a single transaction. It is delivered over time, across all the different interactions that make up the contract. So a pure customer acquisition mindset means that marketers tend to ignore the importance of these ongoing interactions.

Hence the shift in focus from 'customer acquisition' to 'customer retention'. But this shift is *not* - and never will be - about 'brand loyalty'. The real focus of customer retention is exactly the same as the original focus on unique selling points. It's about delivering the customer the benefits he wants and expects - except this time it's over a period of time via many different interactions rather than a single transaction.

The real driver of customer retention, then, is keeping the brand promise for the duration of the contract as a whole. The *measure* of success may be the same: reduced defection rates. But the *substance* is different. It is not about 'loyalty'. It is about value delivery ...

If the product is good, it is worth buying again.

And if the relationship experience is good, it is worth experiencing again.

Full stop. No need for magic ingredients.

Metrics miasma

Which leaves us with just one little, question: what is a good product from the customer's point of view? And what is a good relationship experience?

Or, to put it another way, ***what are the customer's metrics of success*** - and how are we helping to improve them?

In the days of single, discrete products it was easy to answer this. (Well, it may not have been easy, but we had some clear things to focus on. They basically revolved around the consumption or usage experience: did it taste good, feel good, look good, sound good and so on.)

But with this notion of customer retention the horizon expands:

- ❖ from a single instant - the transaction - to a series of different interactions (total customer journey from purchase, to delivery, to use, to maintenance and repair, consideration of a new purchase, disposal/sale, and the process of making a new purchase)

- ❖ and from a focus on the product, to company and customer *processes*

Do we know what the customer metrics of success are at each and every stage of this journey: delivery, maintenance and repair, consideration of a new purchase, and so on? What is the customer desired outcome for each step? Is it to save money? To save time? To show off? To have a thrilling, breath-taking experience? To minimise the hassle?

My own framework for thinking about this is the acronym OPTIMA where:

- O stands for operations, or what is the work I need to do, the skills I need to bring to bear, the infrastructure I need to deploy and so on.
- P stands for passions. Which emotions are generated by this experience? Stress, anxiety, anger, irritation? Or calmness, reassurance, amusement, interest? And which emotions would I like to be generated? What about the process of managing my money, or running my car? If I am doing the annual MoT, what are the main emotional benefits I am looking for? How do these differ from driving the car, filling up with petrol, renewing an insurance policy, or considering my next purchase?
- T stands for time. How much time do I have to invest in this task? And is it time well spent? Do I want to invest more time doing it, or to save time?
- I is for information. What information do I need to complete this task and achieve my desired outcome, and where can I best get it from? What information do I need to provide other parties - and what is the best way of sharing this information?
- M is for money. Do I want to spend more to get more? Or do I want to save money here, so I can spend it on something else which is more rewarding? Remember, we are talking about every stage in the journey here from purchase and use of the car itself through maintenance, repair, insurance and so on.
- Finally A is for attention. How much attention do I want to - and need to pay - to this task? Is it so fascinating and rewarding that I wish I could devote more mind time to it? Or is it an interruption getting in the way of all the other things I need to worry about in my day?

If we think about 'a good experience' - whether it is having your car serviced or going on a fabulous holiday - each 'good experience' has an 'OPTIMAL signature' as it were: something defined by the desired

outcome, with its own particular mix of wanting to invest ‘more or less’ time, money, attention etc in different aspects.

This Optimal signature is not an amorphous concept like ‘customer satisfaction’. Customer satisfaction is often a bit like the alchemist’s ‘earth’ or ‘air’ - made up of many different elements which are not identified, measured, understood ... or actionable. It’s more about **Return on Investment for the customer** calibrated across the dimensions of value that matter to that customer: work, emotion, time and so on.

This, I think, is the secret of customer ‘loyalty’. What is the customer’s ROI from each step or task in the relationship? Is it high enough for him to want to invest more? Or low enough for him to divert his investment elsewhere?

And what are the particular metrics of success - at every step of the customer journey?

OPTIMAL segmentation

But if we stop there, we still have a problem. Because customers are different. Some are image-oriented and aspirational mode. Others are a utility-minded and cost conscious. Some are control freaks. Some have an “I’m just too busy, simply help me sort it with the least possible hassle” attitude? So what are the main customer segments as defined by their Optimal signatures? And do we know what these signatures are?

And perhaps it is not just a ‘type’ of customer. Perhaps these Optimal signatures apply differently to different parts of the customer journey. For example, perhaps, when it comes to actually using his car, the customer is image-oriented and aspirational. But is he the same when it comes to his annual MoT? Or does he shift modes, to utility-minded and cost conscious, or convenience seeking?

So, for each step of the journey, do we understand the main Optimal modes?

If we think about things in this way, we begin to segment our customers according to *their particular metrics of success*. And if we don’t think about things in this way, how can we possibly hope to provide them with the ‘good experience’ we have just been talking about?

And if we think about this as a programme for research and action, it is precisely the opposite of the brand narcissism we started out with.

The brand narcissist wants to organise customer attitudes and behaviours around the needs of his brand. But brands which want to maximise the investments customers make in them, seek to organise their own operations, priorities and activities around these customers' metrics of success.

The new win-wins

There is one thing missing from this picture, however - and that is the win-wins I talked about earlier. There's no point in doing this if the win-wins aren't there.

So how can we do this and make sure the company benefits as well?

I think there are two sides to this. They are completely interdependent.

First, **reduced go-to-market costs**. The more a firm helps the customer improve his economics the more the customer is prepared to invest in his dealings with this firm: not only money, but information, emotion (recommendation, forgiveness of mistakes), attention, time.

Today, it's not unusual for companies' costs to fall into two broadly equal lumps: the cost of making what they sell, and the cost of bringing it to market successfully. Typically, the cost of 'making' continues to fall. And the cost of going to market continues to rise.

Organisations that earn their customers' investments of time, attention and information are in a position to massively reduce these costs and increase 'effectiveness'. Specifically, if customers tell them what they are interested in buying and when, what they would like to buy but can't (because it isn't on the market), what irritates and annoys them about existing products and services, and so, then they can reduce the costs and risks of interacting, transacting and delivering value to these customers.

Companies that deliver on customer metrics of success earn their customers' trust and willingness to invest valuable information and attention like this. And this is one way companies can benefit by investing in their customers' success. A much better way than 'loyalty'.

Second, **lean operations**. We all know the success of Toyota and the Toyota Production System. Many things have been written about it.

But one way of looking at it is that lean is the marketing concept of identifying and meeting customer needs applied *not* to product development or marketing communications but the very operations of the organisation itself.

Under lean, value is defined by the customer. Anything that the customer wants is value-adding. And anything else is waste, which we need to eliminate.

The old economies-of-scale-focused mass-production organisation does not internalise customer definitions of value into its operations like this. Instead, it is driven by its own internally-generated metrics: asset utilisation, economic order quantities, unit costs, margin and so on.

The lean insight is that these internally-derived drivers lead to push production and push marketing which are inherently wasteful. Batch and queue is a lot more expensive than aligning production to demand. Trying to organise markets around your sales targets is a lot more expensive - and less effective - than aligning your go to market processes to fit those of your customers.

However, when it comes to applying lean approaches to the customer interface rather than production, I think we are only just beginning to scratch the surface.

One of the early lean insights is that 'quality' is free. The cost of making things right first time is far lower than the cost of making things wrong, and then having to spend time and effort trying to correct the mistakes.

One of the emerging lean insights is that **customer convenience may also be free**. Today, we equate good service with high costs, just as we used to equate high quality with high costs.

But early experiments are suggesting that if lean approaches are applied to the processes of customer service - *including the customers' own processes of seeking and using these services* - huge amounts of waste can be eliminated and significant amounts of time, money and effort can be saved **for both sides**. So it is possible to improve the customers' economics and the firm's economics at the same time.

It's not easy - just as lean production isn't easy. It requires a tremendous amount of careful, detailed process mapping, reorganisation, disciplined continuous improvement and so on.

It also requires big changes in culture and attitude. It means involving customers as equal partners, rather than treating them as targets of sales campaigns.

It means focusing on helping and enabling customers to pull the value they want, when they want it, from call centres, marketing programmes, dealer networks and so on, instead of pushing products through dealers to customers for example. To help them get more value, instead of focusing on the value that can be extracted from them.

It means 'inverting the pyramid' as it were, to see the company and its operations as assets working for customers.

Which - conveniently - is where I started out. The alchemists, remember, spent hundreds of years on a futile wild goose chase: the attempt to turn base metals into gold.

The concept of 'Loyalty' is marketing alchemy: a futile attempt to turn customers into corporate gold; an asset for the company.

My suggestion is that the way forward may lie in exactly the opposite direction. Companies that see themselves as - and organise themselves as - assets or tools in the hands of their customers are best positioned to earn their customers' investments of time, money, information, attention, emotion and so on.

And if you can do that, you don't need loyalty. Even if it did exist.