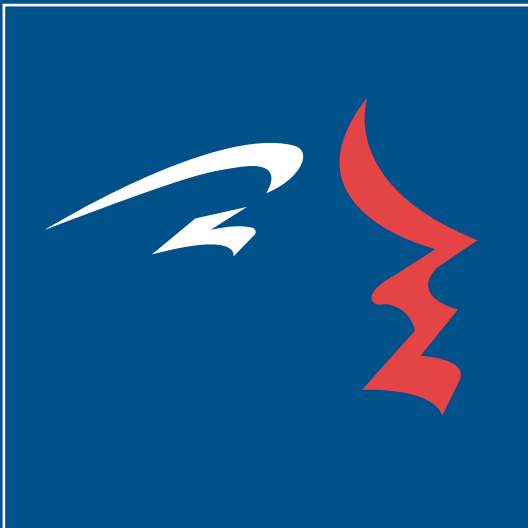


# VALORIS ABRAM HAWKES

## CREATING VALUE IN THE NEW ECONOMY



## MEASURING CUSTOMER LOYALTY

What does customer loyalty mean in practice and can it be applied at all? The question may seem an odd one, now that customer loyalty has become such a widely accepted concept; yet so often the reason for adopting something new is simply that a key competitor, or another respected business, has already done so.

Can the concept of loyalty be applied to a purchase made every 5 - 10 years; or if the product is bought only once? The very idea of loyalty implies allegiance and faithfulness, a continuing relationship, which is rarely if ever part of the way in which many products are supplied to the market. Perhaps an individual could be loyal to a retailer or an adviser who regularly considers their needs; but to the manufacturer?

6 Laurence Pountney Hill

London, EC4R 0BL

**T** +44 (0)20 7626 1331

**F** +44 (0)20 7626 1332

**E** [uk@valoris.com](mailto:uk@valoris.com)

**W** [www.valoris.com](http://www.valoris.com)

And if we can agree a definition for loyalty, can it be monitored and measured anyway? Again, the idea of loyalty is of an emotion, surely, a feeling of commitment, a memory of past actions leading to current and future obligations. Is it possible to set a ruler against these intangibles and compare like with like in order to make some kind of improvement in business performance?

This paper addresses these issues and seeks to provide answers which turn them into practical business opportunities. Our aim has been to demonstrate that it is possible to measure and manage customer loyalty, using a logical process to resolve these issues.

## **Definitions - exploring meaning**

Definition of 'customer loyalty' is essential if there is to be any kind of control and management. Or rather, consideration of the possible types of customer interaction which could be referred to as 'loyalty' will provide a basis for deciding how customer relationships might be managed in order to satisfy both customer needs and commercial imperatives.

The definitions of loyalty fall into three broad categories:

- *Transactional* loyalty, in which the customer's buying behaviour is seen to change or be changed, although what motivates that change may be unclear. These are often the most popular choices, as they relate most closely to commercial results.
- *Perceptual* loyalty, in which the attitudes and opinions of the customer are the key, but there is not necessarily evidence of an impact on purchasing. Sometimes these are regarded as more significant, because they are seen to reflect possible behaviour patterns that could be created in the future, not patterns of what has happened in the past.

- *Complex* loyalty, where there is a combination of these two effects.

Within each of these categories there are a number of terms, all of which have been, or are being, used as definitions of loyalty.

### **Transactional**

- *Cross-selling* - seen as loyalty when a customer buys a new, different product or service from the same supplier, rather than choosing an alternative. For example, after buying a holiday, the customer takes up the offer of foreign currency.
- *Up-selling* - a customer buys more from the same supplier, usually of the same product or service; such as increasing the amount saved in an investment.
- *Repeat purchase* - obviously, buying the product again, when the same need arises. Another mail order purchase, perhaps, or a loan for home improvement from a mortgage provider.
- *Persistency* - maintaining a relationship rather than concluding it. Customer loyalty is clearly poor for a credit card issuer if more than half the cardholders lapse within the first two years.

### **Perceptual**

- *Satisfaction* - an easy and obvious use of 'loyalty' is within the context of the degree of satisfaction felt by users of a product or service; the kind of emotion articulated in response to the question 'how was it for you?'. However, customer satisfaction can be a misleading measure as there are many examples of customers changing supplier despite high levels of satisfaction with the product and service that they have received.
- *Awareness* - here, loyalty is seen as a function of the extent to which the business is known within its

target market, driven perhaps by word-of-mouth recommendations or simply the extent of knowledge of the supplier.

### **Complex**

- *Lifetime value* - the commercial benefit of the relationship with a customer can be calculated over time, to generate a 'lifetime value'. This may be the current and potential value generated during the entire relationship with a customer, but is more usually the actual value during a set period; generally from the time of the first transaction to the present day.
- *Brand value* - Strongly branded businesses often rely on the strength of their communications, and their wide consumer awareness, to give customers a sense that they must be dealing with the 'right' organisation, such that they may not even consider the relative benefits of a competitor. Indeed, the purpose of branding is entirely to ensure that the customer returns to a given supplier again and again. American Express or First Direct are good examples of highly regarded organisations, with reputations for excellence that extends well beyond their customer base.

Which is the right definition? Answer: all of them, or more helpfully, all are useful measures of business performance and therefore demand to be monitored and understood. Of course, all are relative to the definition of the customer: ie, the person or organisation that is supposed to behave in certain ways or believe certain things, so there may be a preference for one or other of these 'definitions' depending on the target market and customer base.

### **Definitions - exploring implications**

For loyalty to be real, it must be defined in terms of the customer. They must know who they buy from

and why they should be loyal to them before their behaviour can be influenced. They must have some idea of the alternatives if they are to make an informed decision - loyalty is generally not an issue in a monopoly situation. However, even the most powerful business has to bear in mind that the customer may choose not to purchase. Many consumers would rather spend their money now, perhaps on leisure, than invest in a life assurance policy that only pays out in 10 years or after their death!

It must also be remembered that the customer is not necessarily the same as the end-user. The supply relationship may not be direct when, for example, there is a complex channel of supply from manufacturers, through wholesalers, to retailers and their own customers. Through this funnel, each level must consider who is supposed to be loyal, to whom and why. It may be both desirable and possible to influence the loyalty of the end-user, even if he or she is not in a direct relationship.

In the case of retailers or intermediaries, the customer relationship often exists with both managers and their staff. It may be relevant, for example, to ensure that both the retail or branch staff as well as the 'buyer' for the organisation are loyal. The same would apply to the employees of any institution that is part of the distribution channel.

The 'customer' may also be more than just the individual who has signed the cheque. Other family members may be involved in the transaction, or may be the purchasers of similar products. The buyer may therefore not be the user or beneficiary of the product.

In short, the question of loyalty measurement should take account of the full complexity of the decision-making that leads to the start of a transaction, and of all the experiences that result from its completion.

The definitions that matter are the ones that relate to commercial advantage and can be equated to business performance.

### **Putting measurement into place**

The choice of definition does not have to be exclusive. All or some of the definitions listed above can be used to determine the type of customer loyalty desired. Once the choice has been made it becomes possible to consider how relevant information will be collected to, first, find how much loyalty there is to the business now; and second, to identify and measure any changes over time.

The sources of information for such measurement are generally direct customer research and the statistical analysis of the customer database.

### **Research methods**

The full range of quantitative research methods can be used to measure loyalty.

- Telephone surveys are a simple method for reaching customers and testing their attitudes to the business. They have the advantage of speed, but the disadvantage that some customers dislike being contacted in this way. Many companies have used the telephone to collect satisfaction information very rapidly by employing agencies to contact, within a few hours, customers who have made service calls. Their opinion of the quality of the service is then based on very recent experience and, consequently, is likely to be an accurate reflection of performance.
- A similar and less intrusive method is the postal questionnaire. Many financial services companies send them with welcome communications, policy documents or promotional material. Distribution by intermediaries can also be arranged sometimes. Such questionnaires are cheap, but response rates are lower, the collection of information is often slow

and respondents are, of course, self-selecting - which may induce bias.

- The most costly research technique is undoubtedly face-to-face interviewing, by trained interviewers, at home or in the workplace. It has the benefit, however, that personal opinions and views can be explored in more depth, and the interviewer can verify answers by inspecting actual documents.

These methods can be run as a single, stand-alone exercise (ad hoc research) or run continuously, for example when questionnaires are sent with all policy documents.

There are, however, some other issues that need to be considered when using research to measure loyalty.

- Sample selection is crucial. The details of the respondents must be matched against the profile of the customers and the target market, to ensure that the conclusions drawn are statistically significant and a valid guide to the real situation or future intention.
- The design of questionnaires must be managed carefully so that the phrasing results in meaningful responses. Asking 'are you loyal?' will clearly not work! Popular questions in such research, however, are 'Would you recommend this company to a friend?' or 'Would you buy again if the opportunity or need arose again?', which typically elicit a more useful response.
- The final research issue to consider is how much data will be collected and what will happen to it. Large scale surveys generate considerable amounts of data, often in great detail. If it is to be used to its full potential, there should be agreement as to how it will be analysed and

reported to business managers so that they can take appropriate action.

### **Customer databases**

The use of customer databases to track changes in behaviour, generally in respect of transactions, is the only accurate measure of most transactional types of loyalty. Although straightforward in principle, some of the questions emerging from the implementation of a measurement system are new to many businesses.

Not least is the definition of a customer, product or transaction. Many insurance customer databases, for example, will classify the customer as a policyholder; for some it will be the person who pays the premium. If the intermediary customer is measured, it may be one or several managers at the intermediary office (or offices), but perhaps not the staff who deal directly with end-users.

And what is a product and a transaction? A common difficulty occurs when a system defines a product upgrade or changes to the premium as a new sale; from the customer's perspective it may be no more than a minor adjustment to an existing relationship. In this context, the guiding rule is that the measurement of loyalty should be built around the customer's view of what they are doing, or planning to do, not that of an actuary or IT manager.

Customer databases may also pose challenges with regard to the continuity of data that they hold, and for how long - which is often the key barrier to the full use of customer lifetime value and potential value as a measure of loyalty. Hence the tendency to look at simpler measures, such as customer attrition rates.

To achieve a successful and accurate measurement of customer loyalty is likely to demand significant investment in customer database development and analysis. The benefits may not be immediately

evident, especially if customer histories have to be built from scratch. The business case to justify the investment must, therefore, be carefully calculated using estimates of the current performance and the scale of benefits that would arise if an improvement were achieved.

### **Knowledge is power - data is not**

The issues related to monitoring and measuring loyalty can occupy much time and resource. At the end of the debate, a lot of data may have been collected, but little improvement may have occurred. It is not just because the timescale for business improvement is extended, although that may be true; it could be that the final output has failed to take account of the needs of operational management. There is a need to not just measure, but also to use, the information generated.

How can loyalty information be used to create commercial benefit? It is not an idle question, nor one to which the answer is always obvious without careful consideration of the competencies and opportunities that face a business. We can generalise, however, to say that there are certainly four possible answers to the question.

- *To evaluate investment* - the impact on customer loyalty can be a crucial element in justifying certain investments. Most obviously in this category is systems development, particularly databases for customer management and information.
- *To segment markets/channels* - a common and powerful use of loyalty data, especially when it is linked to profit through a lifetime value calculation. The segmentation can be generated by separating any of the loyalty factors listed earlier, to then support the development of more attractive products, differing levels of service, etc.
- *To manage communications* - if loyalty is low, then a programme of communications may help to

influence customer perceptions, by raising the company's profile or stimulating contacts that then meet customer expectations.

- *To manage promotions* - the most popular use for many businesses is the offer of a reward scheme of some kind; points collection being a favourite in many consumer sectors. Few of these schemes exist in the long-term and protection sectors, however, as they depend on multi-purchases for the full benefit; but other mechanics are possible.

As has been suggested already, measuring customer loyalty is a vital part of the management information needed to run any successful business. Careful planning of the monitoring and measurement systems will be well rewarded by improved control over performance.

## Conclusions

By now, you may feel that it would take a detective to decide on a verdict among all these alternatives. A comment from one of the best may help here. Father Brown, G K Chesterton's clerical sleuth, once commented "It isn't that they cannot find the answer, rather that they do not know the question".

The answers to how to measure loyalty are described above; the steps can be summarised as:

- Define your customer.
- Identify the type of loyalty that you require to support your business goals.
- Put in place the relevant research/data collection, storage and analysis methods to deliver the information you need.

Your challenge is to define the question that drives this process: why do you want to measure loyalty? Is it to help the business grow market share? Or to improve profitability? Achieve a higher level of customer satisfaction? Maximise take-up of a new product? Enter new product/market sectors? Answer the prime question - 'what are we trying to achieve?' - and the solutions should become quickly apparent.

## Author

Michael Brewer is a Partner at Valoris Abram Hawkes, the UK's foremost market and customer management consultancy.

Should you wish to discuss *Measuring Customer Loyalty*, or any other business growth issues, simply call any member of our consulting team. You can contact us at:



**VALORIS ABRAM HAWKES**

6 Laurence Pountney Hill, London, EC4R 0BL

**T** +44 (0)20 7626 1331

**F** +44 (0)20 7626 1332

**E** [uk@valoris.com](mailto:uk@valoris.com)

**W** [www.valoris.com](http://www.valoris.com)