Is Customer Loyalty Dead?

Last week, we held a strategy session with senior brand executives at a new client. Over the past several years, growing a base of loyal customers for their brand has been a painful slog. In spite of spending a lot of time and money enhancing loyalty programs and basing incentives for client-facing staff on loyalty metrics, growth in loyalty and advocacy has been disappointing at best.

So we decided to take a step back and ask a difficult question: Is customer loyalty dying (or dead)? In a world awash with online and offline information and transactions, are customers so fickle that trying to build loyalty is a misguided or even futile exercise? Can brands get more bang for the buck by making customer loyalty a secondary consideration to driving big initial impacts among target prospects?

We know our new client is not alone. Many struggle with this dilemma. After all, we know that "loyal" customers are significantly more profitable and reliable than new customers or infrequent buyers. We also know that nurturing a core group of loyal customers (historically, at least) has been the key to building successful, long-lasting brands like Apple, Starbucks, IBM, and Levi Strauss. Today, things may be different. ***Have changing economic structures and business models hit a tipping point where it is becoming so difficult to build loyalty that it may not be worth the investment? Is the marginal cost for building loyalty higher than the marginal benefit of gaining loyalty?***

The answer to this question could radically change marketing strategy for most major brands. To try to answer it intelligently let's take a look at what we'll call the Five Corollaries of Customer Loyalty.

Corollary #1: Not All Customers Can Be Loyal

Most loyalty programs are developed with the inherent assumption that everyone can be turned into a loyal customer, and that everyone should be offered the same incentives for being loyal. To be blunt, this is complete nonsense. Here's why:

- ***Personality traits such as loyalty propensity and experimentalism largely moderate the extent to which individuals can be loyal.*** Research has demonstrated that many people (especially those 35 and under) are more experimental and variety-seeking than others. Of course, these traits vary depending on the category. For instance when it comes to banks (or relationships with market research partners!), customers tend to be much less variety-seeking than they are with fashion products, automobiles, or packaged goods. But while loyalty propensity and experimentalism metrics may differ by category, there are always people who try to at least consider different products and services virtually every time they are in the market to buy in any category.

- ***Purchase contexts for all customers have changed dramatically quite recently – and the pace of change is accelerating.*** This makes it difficult even for customers who want to stay loyal to act on that desire. People used to call Hilton or Hyatt, then they went through Expedia or Travelocity and loyalty to hotel brands became secondary to loyalty to travel aggregators in many cases. Now, is there an opportunity for hotel brands to win back true brand loyalty by texting travelers special offers that just become available in Chicago upon arrival at O'Hare? Understanding channel change and how it affects customers (and successfully measuring this on an ongoing basis) is mission-critical to building brand loyalty. Doing this without breaking the bank is very hard to do. It can also be a complete waste of money if you are analyzing customers who are natural variety-seekers, or those who aren't truly "loyalty-enabled" in today's complex marketplace.

Corollary #2: Not All Customers Should Be Loyal

Trying to build loyalty indiscriminately can be a disaster:

- ***It can kill profits:*** Creating loyalty has large and growing costs (and perhaps diminishing returns) so companies must evaluate net present value (NPV) of customers, understand which customers are likely to be profitable loyal customers in the future, and assign them an estimated overall profit potential. There are a number of ways that this can be done. For a bank, we used transactional and financial data to develop a NPV model (then we used primary research to understand drivers of loyalty for the most profitable customers). This enabled the bank to design their loyalty program so appropriate incentives were offered to different tiers of customers.

- ***It can kill a brand's image:*** A company's key asset is its brand(s). Strong brands translate into traditionally loyal customer bases, e.g. American Express, Harley-Davidson, John Deere, etc. Usually, having a dedicated base of truly loyal customers also means the brand cannot be "everything for everyone." Marketers need to make hard decisions – and have support from executive leadership – that certain customers are not on-brand currently, and are not likely to be on-brand over the long term. Apple's "Get a Mac" campaign is a well-known example of making a trade-off (poking fun at aspiring accountant-types). A more controversial example is Pepsi's sponsoring of gay and lesbian community initiatives. Pepsi has made the calculated decision that refusing to budge from an all-inclusive message is central to the future of their "fun and young" brand image, even if it costs the company millions in sales over the relative short-term due to boycotts by social conservatives.

Corollary #3: True Loyalty Must Be Measured As A Combination Of Behavior And Attitude

We've seen far too many loyalty models take only past behaviors into account ***and mistakenly consider "captives" as "loyals." Captivity does not translate into loyalty.*** Attitudes predict future behavior and only a combination of current attitudes together with past and current behaviors can identify true loyalty. Think of an airline that is basing its loyalty analysis and program perks on flight miles and segments, all the while failing to build emotional bonds with customers. It is likely that so-called behaviorally loyal customers are unhappy and will shift their business to another airline if the other airline matches key status and functional benefits and (I have a hunch many airlines will rue the day Southwest decides to begin flying out of Liberty International in Newark).

Another example: a few years ago, wireless providers faced a major challenge when consumers became able to switch carriers without switching numbers, thus reducing functional switching costs for consumers. Companies that had created attitudinal connections with consumers fared well during that time whereas those who mistook captivity for loyalty continue to struggle years later.

Corollary #4: True Loyalty Can Be Created Through Emotional Connection

When understanding drivers of loyalty, too many companies ignore the value of emotions. Emotions are harder to measure than functional drivers and barriers. However, in recent years innovative techniques have evolved that enable us to quantify the underlying motivators and impulses behind loyalty and switching.

We know that "true loyal" customers need to get something more than just functional benefits – they need to gain emotional value. Moreover, loyal customers are often valuable brand advocates. Until you can create emotional bonding through the brand promise and consistent delivery on that promise, it is not possible to create true loyalty. ***This is especially true in a world where purchase contexts are becoming larger and more complex everyday*** (see Corollary #1). ***Marketers must deal intelligently with the reality that the existence (or non-existence) of emotional connections among the right group of customers is the key to determining the true overall value of any brand.***

Corollary #5: Providing Emotional Benefits Actually Makes Losing Customers Difficult

This is good news, and the best evidence yet that customer loyalty (at least if it is understood and applied correctly) is not dead or dying. Years of research in behavioral economics and psychology suggests that humans are inherently loss averse. Simply put, this means that a loss of any amount would evoke a greater pain in an individual than the satisfaction that would be caused by a gain of exactly the same amount. ***Applied to the context of loyalty, this suggests that consumers would rather hold onto the status quo (unless they***

perceive a sense of loss), than move to another provider that offers the exact same benefits. Or in other words, once a sense of connection or bonding is created, consumers are less likely to "lose" that connection and make the effort to "gain" a new connection with a new brand.

In fact, research shows that when a customer who has faced a problem is given an extra reward or handled in a way that makes her feel respected and valued, the customer ends up being more loyal and satisfied than she was before the problem arose. The more connections are based on emotional benefits and a sense of belonging (brought about by the brand demonstrating attributes like caring), the higher the chance that the customer herself will seek out ways to reinforce loyalty.

Long Live True Customer Loyalty!

Is customer loyalty dead? Our point of view is that traditional, one-size fits all loyalty solutions need to be put of their misery quickly. Rather than becoming extinct, ***customer loyalty strategy must evolve to take into consideration very new, yet still very real marketplace change and sophisticated, deep emotional ties to provide any value at all to brand executives.***

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