

CUSTOMER MANAGEMENT

VOLUME 12 ISSUE 1

JANUARY/FEBRUARY 2004



The real meaning of loyalty

- the key to growth

ALSO INSIDE:

WHY RAVING FANS ARE YOUR BEST CUSTOMERS - **PAGE 18**

HOW TO RECOGNISE CUSTOMER THINKING STYLES - **PAGE 22**

IS YOUR CALL CENTRE PERFORMANCE DISCONNECTED? - **PAGE 44**

PLUS

OFFSHORE OUTSOURCING SPECIAL - **PAGE 52**



STRATEGY AND PRACTICE FOR THE CUSTOMER-DRIVEN ENTERPRISE



The **real** meaning of loyalty

- the key to growth

Customer loyalty is still the Holy Grail for customer service and management leaders, and gaining and keeping loyal customers is increasingly recognised as the key to business growth. So what does it all mean and how can we achieve it? Frederick F. Reichheld and Philip J. Deane think they have the answers

The concept of business loyalty may seem paradoxical. After all, loyalty is about self-sacrifice, and business requires the pursuit of self-interest. Right?

Not really. This apparent paradox dissolves on closer inspection. Far from conflicting with business interests, 'loyalty', which we define as the willingness to make sacrifices and investments to strengthen a relationship, is key to sustainable growth. The greater loyalty a company inspires among its customers, employees, suppliers and shareholders, the greater its profit potential. When stakeholders thrive, an organisation thrives.

How so? Bain & Company research over the past decade shows that companies putting customer and employee loyalty at the centre of their business model beat the average costs in their sectors: their average costs are 15 per cent lower, and they post 2.2 times the rate of growth. The cost benefits of retained customers come from the amortisation of initial acquisition costs and lowered ongoing customer-service costs.

The growth comes from loyal customers' increased purchases over time, their willingness to pay premiums for additional service, and referrals. In sectors ranging from services to manufacturing, a 5 per cent increase in customer retention converts, on average, to a 25 per cent increase in the value of those retained customers over their lifetimes.

The makings of loyalty leadership

We are describing a process far richer and more demanding of business leaders than simply incorporating loyalty cards or other incentive programmes into a marketing strategy. Companies that are 'loyalty leaders' build loyalty systems around tar-

geted customer groups, tailoring the value proposition, processes and employee behaviour to best service these segments. These companies define and measure loyalty results just as carefully as profits, with implications for their employee, marketing and customer strategies.

Yet, no sector has the corner on loyalty leadership. Indeed, a diverse group of companies have earned their loyalty stripes. They run the gamut from technology-based firms such as Cisco Systems, Dell, eBay, or software-maker Intuit to retailers like US fast-food chain Chick-fil-A or Belgium's value grocer, Colruyt. Loyalty leaders include service companies such as Enterprise Rent-A-Car, manufacturers like Harley-Davidson, and a plethora of financial service firms from credit-card issuer MBNA to insurer USAA, mutual fund company Vanguard, and banks like the UK's First Direct.

What do these firms have in common? They focus on relationships. They get close to customers, employees, vendors and channels, and work thoughtfully with their partners, especially in tough times.

Winning the right customers

Consider the response to customer crises of Enterprise Rent-A-Car, the largest rental car company in North America. It faced a dilemma after the World Trade Centre and Pentagon attacks of September 11, 2001, as stranded travellers across North America clamoured for cars. While the company's business model was built on putting customer relationships first, its neighbourhood branch structure lacked the logistics systems to track or offer one-way rentals. Nonetheless, many branch ▶

THE MEANING OF LOYALTY: SIX BASIC RULES

Preach what you practice: At Harley, shortly after a layoff of 40% of the workforce, the leadership team sat down with employees and hammered out the five principles that would define mutually beneficial relationships. Twenty years later, this credo provides the foundation for all major decisions at the firm. At Vanguard, Jack Brennan felt it was so important to explain the principles he and his management team would live by, that he published them in a booklet, which has become the basis for leadership training and evaluation at Vanguard.

Never profit at the expense of customers or partners: Harley management insists on win/win solutions, not just profitable solutions. For example, when it was time to build a new plant, instead of abandoning their unions to build in a right-to-work state, Harley invited the presidents of its two main unions to join the site-search committee. In return, the unions have cooperated with new productivity initiatives. This same commitment to win/win solutions kept Harley from developing a direct sales Web site for popular Harley merchandise, since that would steal sales from Harley's dealers. Rather, the Harley site describes merchandise, then lets buyers choose a dealer near them to service their needs.

Be picky: Vanguard is famous for turning away investors who expect to churn their money. The firm has a very clearly defined set of target customers who appreciate the value of low-cost, long-

term investing. Vanguard limits exchange activity in order to discourage market timers. In the go-go 90s, Vanguard's brokerage arm did not woo the active traders who appeared so profitable for Schwab and Merrill Lynch, but focused on customers with clear potential for a long-term, mutually beneficial relationship.

Keep it simple: Simplicity marks the strategies of loyalty leaders. For example, they typically organise their companies into teams that are much smaller than their competitors'. Smaller teams keep decision-making simple, improve responsiveness and accountability, and are vital for building loyalty. Loyalty leaders also keep their value proposition simple and easy to grasp. For Colruyt, this means making it easy for customers to find what they want and for shareholders to assess the wisdom of corporate moves and reward good strategy. Whereas Colruyt competitors like GB and Delhaize experimented with a range of brand positionings that ultimately blurred their identity, Colruyt has stuck to its knitting and worked to standardise operations and store procedures. Colruyt customers know what to expect; shareholders see the wisdom. Consequently, in the midst of the 1993 economic downturn, Colruyt's shares held their value and rose on the Brussels market. By the end of fiscal 1994, Colruyt's multiple of market capitalisation to book value was 3.1, higher than GB's 2.2 and Delhaize's 1.5. In 2002, Colruyt shares climbed 17% while Delhaize shares plunged 70%.

Reward the right results: Vanguard recently introduced Admiral Shares for many of their funds. These shares reward loyal customers with even better value. For employees, Vanguard developed a Partnership bonus plan that offers rewards based on their contributions to the company's operating efficiency and the performance of Vanguard funds relative to its competitors. Too many companies today penalise loyal customers with mediocre service and high prices—if you were foolish enough to remain loyal to your cellular phone company or long-distance provider over the past few years, you are probably paying far above market rates. Loyal customers are often treated like stupid customers across America, but never at Vanguard.

Listen hard and talk straight: Some executives dismiss the Enterprise Rent-A-Car philosophy of 'put customers first, and employees second, and profit will take care of itself' as disingenuous or naïve. But a fundamental component of the Enterprise formula is to pay employees a share of the profits they help generate. With this reward system, and transparency over where and how the money is made, profits do tend to take care of themselves. That said, Andy Taylor keeps his ear to the ground. When he realised that some branch managers were focusing on short-term profitability at the expense of customer service, the company developed a rigorous measure for customer satisfaction by branch and used it as a basis for promotions.

managers made cars available to get their customers back home.

What's more, their actions anticipated corporate policy. Alexis Hocevar, then vice president and general manager of Enterprise's New Orleans region, explained that, "We knew we had to do the right thing and worry about the rest later." Three days after the attacks, with the nation's transportation system still crippled, Enterprise headquarters told its then more than 4,300 US locations to permit out-of-state one-way rentals for stranded travellers and waive or reimburse drop-off fees.

Thousands of vehicles in Enterprise's US fleet of 480,000 were displaced. Some were sold, while others were retrieved by employees or transported

back to branches on flatbed trucks. "There will be losses," said Enterprise's chairman and CEO, Andy Taylor, who stayed in touch with employees via e-mail during the crisis. "But right now we're just concerned about taking care of our customers." In addition, the Enterprise Rent-A-Car Foundation donated more than \$1 million towards the relief efforts in New York and Washington DC.

Despite these sacrifices, on the anniversary of the attacks Enterprise was leading its sector in a struggling economy. This was no lone phenomenon. Other loyalty leaders that sacrificed short-term profits also saw longer-term benefits as the economy strengthened. After September 11, Southwest Airlines, a low-cost, US carrier, set aside

Companies that are 'loyalty leaders' build loyalty systems around targeted customer groups, tailoring the value proposition, processes and employee behaviour to best service these segments. These companies define and measure loyalty results just as carefully as profits, with implications for their employee, marketing and customer strategies

its refund policy of issuing coupons, redeemable within the year, for ticket cancellations and offered cash to travellers forced to abandon plans. While other carriers cut back services and personnel, Southwest maintained its air routes and kept employees on the payroll. One year later, Southwest, too, led its sector. And Dell, which invested to jet parts in from Taiwan and hire 18-wheelers to get computers to New York and Washington DC to re-equip damaged offices, captured most of the profits in its sector.

Colruyt got it right

Analogous stories play out in Europe. For example, in Europe's 1993 retail downturn, Belgian food and dry goods retailer Colruyt, another loyalty leader, far outperformed its better-known national competitors, Delhaize and GB (today a unit of Carrefour). At a time when consumer spending in Belgium was falling and Delhaize and GB were cutting their workforces amid declining sales and profits, Colruyt saw increasing earnings and continued expansion, then went on to widen its market lead as times improved. In 2002, in the midst of Europe's recent downturn, Colruyt added stores and staff and saw financials jump again, while sales and operating profits at Delhaize contracted.

What's Colruyt's formula? Colruyt targets its investments to build customer loyalty. It spends money on features customers really care about, saving elsewhere and ploughing the benefits of conservative spending into low prices on its shelves. For example, Colruyt has invested in technology to speed consumer purchases, evolving its process from punch-card checkout to quick-swipe bar codes. In an era of retail makeovers, Colruyt has merely modernised its logo. It actually cut costs in the process by opting for a design that used a third less signage.

Such loyalty leadership can pave the way not only back to normal, but, in the long run, to 'better-than-normal', because building loyalty actually builds profitability and, ultimately, the economy.


Investing in employees

Of course, customers of Enterprise, Dell, Southwest and Colruyt experience their firms' loyalty strategies through the action of frontline employees. Loyalty leaders see employee loyalty as bedrock for building customer loyalty. Just ask

John J. 'Jack' Brennan, CEO of Vanguard, the world's fastest-growing and second-largest mutual fund. "Superior loyalty fuels our growth and reduces our costs," says Brennan. The proof? At Vanguard, a three-percentage point decrease in its fund redemption rate is the equivalent of retaining \$15 billion, which goes a long way toward reducing costs and boosting shareholder returns. To foster the kind of employee loyalty that fuels such customer loyalty requires aligning people processes like recruitment, training and performance management around loyalty objectives. It also requires role models. Mr. Brennan walks the talk, regularly pulling duty on Vanguard's frontline telephone service lines, alongside Vanguard's crew, and interacting with dozens of his 15 million clients.

Harley-Davidson likewise demonstrates the economic benefits of superior loyalty. Eighty percent of Harley's unionised employees believe the company deserves their loyalty, almost double the typical loyalty of union members across America. And Harley is prospering—adding jobs and profits at record levels—with a discretionary product that ought to be sensitive to economic downturns.

Belgian grocer Colruyt, too, starts with its employees. It inculcates a simple, guiding principle throughout its rank and file that focuses employee actions. To paraphrase the rule: 'Good brands, no frills, best prices'.

Colruyt, Vanguard and Harley are among a number of loyalty leaders showing the way to continued growth and prosperity. What has enabled these companies to continue to build loyalty, and what can enable others? After more than a decade of analysis, we have discovered that leaders who build long-term relationships follow six basic rules (see panel on p12). For companies like Enterprise, Vanguard, and Harley-Davidson, their continued prosperity is proof that loyalty pays, especially in difficult economic periods. In a recent Bain survey, called the Loyalty Acid Test, we asked frontline employees across the United States: "Do you believe your organisation deserves your loyalty?" Only half gave a positive answer. However, 70 to 80% of respondents said 'yes' at loyalty-leading organisations including Enterprise, Vanguard and Harley-Davidson. Now is the time for even more leaders to prove to their employees that they are indeed worthy of loyalty and for leaders to sustain that proof. 



AUTHOR INFORMATION

Frederick F. Reichheld is a Bain & Company Fellow and author of *Loyalty Rules! How Today's Leaders Build Lasting Relationships*, Harvard Business School Press, 2001 and *The Loyalty Effect: The Hidden Force Behind Growth, Profits, and Lasting Value*, Harvard Business School Press, 1996. Philip J. Deane is a partner in Bain's London office and heads the UK loyalty practice