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MARKETING

Why a Loyal Customer Isn't Always a Profitable One

BY TIM KEININGHAM, LERZAN AKSOY, ALEXANDER BUOYE, AND LUKE WILLIAMS

A lot of companies look at customer loyalty the wrong way.

Without question, loyalty is important. Loyal customers hang on for years, devote a larger share of their wallet to the company, and recommend the company to their friends. Customer loyalty, in short, helps drive profits.

But what too many companies fail to understand is this: Loyalty does not always equal profits. In fact, many companies don't know how to recognize—and thus encourage—the kind of customer loyalty that's really worth having.

Wrong Definition

We conducted an in-depth investigation into companies' commonly held beliefs about customer loyalty and came to several conclusions: Most company surveys wrongly define what constitutes a business's most loyal, and thus desirable, customers; lots of managers chase after these customers mistakenly thinking they hold the key to bigger profits; and the majority of customers whom many companies see as loyal are not even profitable customers.

So let's be clear about what customer loyalty is.

To be considered loyal, it shouldn't be enough for a customer to feel a bond to a company, or to simply stick with the relationship. It should also require certain actions, or shopping behaviors, on the part of the customer.

Most corporate measures of customer loyalty focus only on feelings. But our research shows that knowing how customers feel about a company is a poor predictor of how they will behave toward the company. If data about buying behaviors are added to the mix, it can help a company identify not just who its truly loyal customers are, but which ones are profitable.

Looking at customer actions and attitudes, our research showed a very large percentage of loyal customers—often more than 50%—are not profitable for most companies, because their loyalty is driven largely by expectations of great deals. In one case, a company mispriced a product, which led many of its loyal customers to buy the product in large quantities—making some of them the firm's largest customers in the process. We suppose you can call them loyal customers if you want, but they aren't good for the bottom line.

The target audience for any company should be customers who are not only loyal in both attitude and action, but also profitable. But research consistently finds that profitable customers tend to make up only around 20% of a company's customers. Break-even customers represent around 60%, and unprofitable customers around 20%.

Synchronizing Goals

The goal, then, is to increase the number of Profitable Loyals, our term for customers who rate highly on their attitude and behavior toward the company, and on their value to the company—the sales they generate, minus the cost of serving them. When customer value is included in the measure of loyalty, the goals of improving loyalty and financial performance are synchronized. Indeed, the percentage of Profitable Loyals a company has in its customer base tends to be much more strongly correlated to its financial performance than other common loyalty metrics.

Not every customer has the potential to be a Profitable Loyalty. But each company can do its own research to discover what may be restraining the spending of customers who rate highly in attitude and behavior toward the firm. Surveys also can identify what is holding back loyal customers who are profitable but could be spending even more.

Creating and nurturing real customer loyalty requires satisfying customer needs and wants at a sustainable profit. Too often, customer-loyalty experts have ignored the latter in the belief that loyalty and profitability are synonymous. Unfortunately, the marketplace has shown that this is not true.

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