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## Most Loyal Customers Aren't Profitable

05/18/09

By [Tom Ryan](#)

The authors of *Why Loyalty Matters* certainly value customer loyalty. But they also contend that only 20 percent of a firm's customers are actually profitable and most of a company's profitable customers are not loyal.

In an article on [harvardbusiness.org](http://harvardbusiness.org), the two authors - Timothy Keiningham, global chief strategy officer at Ipsos Loyalty, and Lerzan Aksoy, associate professor of marketing at Fordham University - wrote that instead of stockpiling loyal customers, both *B-to-B* and *B-to-C* businesses should be asking:

1. Which loyal customers are good for the business,
2. How do we hang onto them, and
3. How do we get more customers like them.

The authors note that the simple solution to improve customer loyalty in tough times is to offer off-price deals, a strategy that has proven to improve loyalty in the past. But they also note that it's a flawed strategy.

"This doesn't mean we should not find ways to be more efficient so that we can pass cost savings on to our customers. But price-driven loyalty is always the lowest form of loyalty. It means that we aren't offering differentiated value to our customers," the authors wrote

Mr. Keiningham and Ms. Aksoy said that's why it's essential to determine which loyal customers are profitable. Unprofitable loyal customers tend to be loyal either because of unprofitable pricing or exchange policies or they ask for excessive services they're not willing to pay a fair price for.

By comparison, profitable loyal customers are driven by key differentiating aspects to a business' products or services.

"The key to a successful loyalty strategy is to become crystal clear as to what these are, and to focus on tangibly improving these elements," wrote the authors. "It is also imperative that we actively let customers and prospective customers know that these are the things the company stands for and that the firm is committed to being best at. By doing this, our best customers will have the necessary information to clearly articulate why our organizations deserve their loyalty in good times and in bad."

*Why Loyalty Matters* is scheduled to come out in June 2009.

**Discussion Questions: Do you agree that most "loyal customers" are actually unprofitable customers? If so, what are the challenges of having customer loyalty programs account for that? What do you think of the suggestions cited in the article for honing in on profitable, loyal customers?**

- [When Customer Loyalty Is a Bad Thing - Harvardbusiness.org](#)

### Comments

I don't agree with the authors' premise, that most loyal customers are in fact unprofitable. If you start with the assumption that loyalty is defined only by price-sensitivity, you might draw the same conclusion...but there is a lot more to developing the top 20% of customers who drive the majority of retailers' sales.

First, start with the definition of loyalty as commitment to a particular retailer. Customers who are most motivated by price in their shopping decisions are also most likely to jump from store to store based on who offers the best deal at any given time. Good customer relationship management (CRM) is built on customer service, having the most relevant merchandise content for the target customer, and developing techniques to drive a bigger "market basket."

It's not all about price, even though a narrow definition of a "loyalty program" might be limited to extra discounts or special rewards. It's really about developing the level of commitment to drive top-line sales and take market share from competitors.

**Richard Seesel, Principal, Retailing In Focus LLC - Braintrust Panelist**

Virtually all loyal customers are profitable, when you factor in time...the long-term benefits of word-of-mouth far outstrip any pros/cons specific to a round of discounting.

**James Bickers, Editor, Retail Customer Experience**

Loyal customers don't have to be unprofitable. It's all a function of how you incent customers in the first place. If you're a chronic discounter for example, your loyal (by visit) customers may be totally eroding your bottom line. The key is to find rewards that foster loyalty without selling the farm.

**Ryan Mathews, Founder, CEO, Black Monk Consulting - Braintrust Panelist**

I've never seen this measured with any real credibility before, so I just don't know. Doesn't help that if you don't have a loyalty card, every supermarket cashier in America just says "Oh, well I have one right here we can use." Could it be that Walmart has had it right all this time?

**Warren Thayer, Editor, Refrigerated & Frozen Foods Retailer, BNP Media - Braintrust Panelist**

If a company's loyalty program is based solely on price, it will draw customers that may be loyal in name only. If the same company offers great customer service, provides relevant, valuable information and a strong customer experience, it will attract customers that are more deeply loyal and more profitable.

So the quality of the program can have a large impact on the quality of the customers. This does not mean that a retailer needs to completely overhaul its loyalty program. The program should be used to experiment with different propositions for consumers to see which ones work to meet the retailer's goals.

**Max Goldberg, Founding Partner, The Radical Clarity Group - Braintrust Panelist**

I searched myself on this one and realized that the only retailers that have my loyalty are actually e-tailers. And the reason I'm loyal to them is product selection with shipping and return policies coming in a squeaky close second. I'm one of those who can't stop talking about Zappos' free shipping both ways and no-longer-surprising express shipping upgrades.... Aha! I've come to expect them! Does that make me an undesirable loyalist when they've baked that into their model and I buy 90% of my shoes on Zappos (with traditional retailers getting my impulse business)?

A few food etailers have my loyalty because they stock items that I can't find in Northwest Arkansas, and I'm willing pretty much whatever it takes to get them. I don't necessarily agree that loyal shoppers are the worst shoppers for retailers; I'd put online shoppers in that category. We're spoiled!

**Carol Spieckerman, President, newmarketbuilders - Braintrust Panelist**

There are two sides to this issue of customer profitability and loyalty, both of which are often misunderstood. The first is the idea that only 20% of "loyal" customer are profitable and thus, 80% of loyal customers are break-even or unprofitable. Based on our experience, and with a dash of healthy skepticism added, on the one hand it's not surprising that the authors would contend that so many "loyal" customers are unprofitable. Too many loyalty programs are poorly designed, poorly managed and poorly measured. The flip side is the authors' contention, rightly so in many cases, that most (at least many) profitable customers are not "loyal." This is what we refer to as Loyalty Opportunity, which is the beginning of a foundation for loyalty strategy.

Loyalty programs should be designed around not only profitable (and loyal) customers but even more importantly, they should also be designed to create loyalty from this majority of

customers that are profitable yet not profitably in a sustainable, or "loyal" way. After all, true "loyalty profit" is a function of incremental revenue, not of marginal costs associated with such revenue. Done right, this is by definition a profitable endeavor.

Last, the idea of "loyalty" is a bit of a misnomer for many categories. The levels of category, product and brand involvement--engagement--vary quite a bit. The idea of customer sustainability, or habit, is a much better definition and one that is easily linked to financial measures and predictable outcomes.

**Phil Rubin, CEO, rDialogue - Braintrust Panelist**

Wait a second, these guys are saying that price is not the only thing? We have to provide service to? And great products? Holy cow, I better write all this down. For all these years I've been telling my clients to...be competitive on pricing, provide better service and...wait for it...have a strong and unique merchandising program.

The whole point of a loyalty program is to track customer behavior and increase margin. The recent invention of the computer allows us to see who is profitable and who isn't. The suggestions here are great but if haven't been doing them since day one of your loyalty program, you have essentially wasted your resources.

**Doron Levy, President, Captus Business Consulting - Braintrust Panelist**

Of course, the pivotal issue here is how one defines a "loyal customer." Is it someone who shops at a certain frequency (say, at least once a week)? Someone who spends more than a certain level per quarter? Someone whose purchases span a wide range of categories (implying that they don't cherry pick by channel)? Someone who shops predominantly at your store? Or merely someone who carries your loyalty card?

The problem with focusing on a single definition of loyalty is that in many ways, it's a red herring. The world shouldn't be divided into the "loyals" and the "disloyals"--rather, retailers and manufacturers alike should slice the shopping population differently for different objectives.

Job 1 is to determine your goals. Once you have determined \*what\* you want to achieve, only then should you take a good look at the customers with whom you are succeeding (and whose with whom you aren't), try to determine what motivates them, and amplify the aspects of your offering that matter most. The real thesis of the article should not be that most "loyal" customers are unprofitable, but rather that most \*customers\* are unprofitable. Loyalty programs are simply a tool for collecting data on who's who and for directing targeted incentives at specific subsets of the populations to try to nudge their behavior in a particular direction.

If your current loyalty program is merely an undirected way to reward shoppers who have a particular piece of plastic on their keychain, then you are wasting a huge opportunity to understand and strengthen your brand.

**Ben Sprecher, Founder and President, Incentive Targeting, Inc. - Braintrust Panelist**

Replace the term loyal customer with frequent customer. On more than one occasion, retailers describe who their customer is, not who it should be. A loyal or frequent shopper that is not your target customer is likely to be unprofitable. Too many retailers have the left-over customer and don't expend the effort to attract their ideal or target customer.

**W. Frank Dell II, CMC, President, Dellmart & Company - Braintrust Panelist**

In our work with shopper card data, we have learned that it is most important to generate profitable volume on an aggregate basis. It can be problematic to focus only on loyal customers. It is better to think of a customer base as a portfolio of different groups. Not unlike a product or stock portfolio, some groups are very profitable, but contribute low volume. Others offer high volume and loyalty, but may not be as profitable.

It really takes a mix of shoppers to achieve profitable volume overall. While loyal shoppers may be a part of the mix, they are not always the total solution.

**Ray Jones, Managing Director, Dechert-Hampe & Co. - Braintrust Panelist**

Loyalty is simply very fleeting these days. People have changed their shopping habits,; where they buy, what they buy and who they buy it from--and they do it on a regular basis. Basically, they can be loyal to one store this week and another the next.

The question is, what's going to hold on to them long term? Get beyond price and maybe the 10% discount from a loyalty card, and it's a matter of developing that customer experience you talked about earlier.

**Len Lewis, President, Lewis Communications, Inc. - Braintrust Panelist**

What comes to mind here is the phrase, "It takes a village." Virtually all types of customers are necessary to make a profitable business. It's just as important to have the "time starved, random, full priced shopper" who makes purchases at full retail at the closest outlet to their immediate need without regard for loyalty, brand or service...as it is to have the extremely loyal, highly frequent, value oriented shopper who cleans out the clearance racks.

Applying the same P&L tactics to prove value in either case makes little sense. Both provide a necessary component to the overall operating mix. Understanding segmented customer sets and their incremental value to the overall P&L is key to evaluating programs.

**Scott Thomsen, Partner, LaunchMedia, Inc.**

There is no way to have this debate in the absence of data. However, you do need to look at the right information. The real question is not "are my most frequent customers profitable?" but rather "what are programs or offers that I put in place making my most frequent customers incrementally more profitable (or less unprofitable)?" Economics is always "on the margin." A lot of retailers, and consultants, and companies generally, get this wrong.

**Jonathan Marek, Senior Vice President, Applied Predictive Technologies - Braintrust Panelist**

As Mark Twain wrote, "There are three kinds of lies: lies, damned lies, and statistics." I'm sure a case can be made that only 20 percent of customers are actually profitable. I would also guess that a case could be made that only 20% of customers are unprofitable. If anything the authors got us thinking about that connection between loyalty and profitability.

What's also missing is the impact of customer advocacy. Some of your unprofitable customers, or actually even people who aren't even customers can create additional customers.

**Doug Fleener, President and Managing Partner, Dynamic Experiences Group - Braintrust Panelist**

While I agree completely that loyalty need to be earned through means other than price, I disagree with the initial premise of the article, that the focus should not be on "loyal customers." This suggests that the only way "loyalty" is being created in the current climate is by buying it. Further, in the retail world, the statement that only 20% of customers are profitable couldn't be further from the truth. A successful retail business, especially smaller, entrepreneurial retailers, is built around attracting and retaining a core customer base of repeat customers. Those customers are often the very best source of new customers, brought in by any number of relatively inexpensive initiatives.

**Ted Hurlbut, Principal, Hurlbut & Associates - Braintrust Panelist**

How do you define "loyal"? If it is purchase frequency, then most often these customers are not profitable. This is because they figure out the price game (aka promotional strategy), especially in "high-low and clear" models, and buy when there is little margin left in the goods sold. How do you define "profitable"? Ah now here is a better question. And it gets to the reason we like to say, "retail ain't for sissies."

**'IMRetail'**

The article didn't really discriminate between customers that are part of a loyalty program

and those that are just frequent customers, so I'm not sure if I believe the "only 20% of loyal customers are profitable." That would certainly depend on the context and the retail segment.

For example, in grocery where it takes almost no effort to get a loyalty card and the benefits are simply discounts, I would agree with the statement. You're just chasing customers that want discounts, and its probably not profitable to find them. But if you look at loyalty programs that try to influence behavior, like Best Buy's program, then you instill greater loyalty in a profitable way.

**David Dorf, Director of Technology Strategy, Oracle Retail - Braintrust Panelist**

Loyalty is not defined by a card or what card holders' purchases are in total. Loyalty is owned by the customer, not the retailer. Calling card programs loyalty programs is the first mistake. The second is not understanding loyalty and its ownership in the first place.

No matter what a retailer does with a card or any other 'program', the customer will still own their loyalty. They own and make decisions based on loyalty when they continue to choose one retailer over another, when they have choices. It's that simple. It's defined by their experience and never will be defined by a reward or a card swipe.

**'Scanner'**

The key to creating loyal consumers is not deep discounting. There is no key to creating loyal consumers. Unless you know why your consumers are not loyal you can not fix the problem. There is no one size fits all for consumers in today's marketplace.

Loyalty relates to whether consumers are continuing to purchase your products over time. That has nothing to with profitability. Profitability relates to whether or not you sell products at a price that covers costs and generates a profit. If your loyal consumers are not purchasing products that generate a profit for you, then your price point is wrong. If consumers won't buy at a price point that generates a profit for you, then something is wrong with what is being offered to the consumers or the way they are being served.

**Camille Schuster, President, Global Collaborations, Inc. - Braintrust Panelist**

It is about price, especially in difficult times. Despite what many of my RetailWire peers contend, products which offer more value and cost less (both against their competition as well as in general terms) develop stronger followings and heightened customer loyalty. These products are more successful and bring their retailers a loyalty that customers look for and enjoy. Without these items, retailers have little to offer to increase or even sustain their customer base who has a different set of values when times are good.

**Kai Clarke, President, Miraclebeam Products, Inc. - Braintrust Panelist**

My eyes glaze over the minute I hear the experts opine about shopper loyalty. The looseness of our terminology in this realm and our impulse to apply a simplistic CRM discipline leads too often to sloppy analysis of a very important set of issues. Let's try to clarify a bit:

- Retailers must make an effort to show loyalty to their shoppers, but shoppers seldom will.
- Affective (emotional) loyalty, where it exists, is a completely different animal from repeat patronage. The former is seldom measured; the latter is often mistakenly interpreted.
- So-called loyal behavior varies widely across different retail channels. The key differentiating factor: frequency of visits in the channel. A truer measure would incorporate a percentage of all trips and/or spending by an individual shopper within the channel.

Shoppers who appear loyal based on traditional CRM metrics recency, frequency, and/or monetary analysis may in fact be dividing their consumption across multiple retailers to synthesize their best personal solution. This behavioral complex will be mostly invisible to the individual retailer, leading to poorly-based analysis and decisions.

**James Tenser, Principal, VSN Strategies - Braintrust Panelist**

If most loyal customers are unprofitable bargain hunters, then the state of retail customer service must be pathetic. If you're not a discount retailer, the rule is differentiate on

something other than price or die. You must give the customer a reason to identify with your brand and be loyal.

Retailers should create and successfully execute a brand strategy that attracts and maintains profitable relationships with their target customer. Every person who comes in contact with the retailer should be treated as a respected, and potentially profitable target customer. Those who don't identify with the brand will go elsewhere.

**Marge Laney, President, Alert Technologies, Inc. - Braintrust Panelist**

It sounds like the authors have mistaken frequent customers for loyal ones...the comment about price sales driving loyalty is a hint. Remember, loyal customers are those with an expressed preference for the brand, not customers who only shop the brand for the lowest prices (unless you are Wal-Mart).

Customers who are loyal tend to purchase deeper into a retailer's product offerings and therefore into the higher margin items, our research has shown. These customers are not "bought" with a loyalty program alone (although poor service can indeed "sell" them away). They are driven by customer experience, which includes a fair price, but not solely by price. The more of these customers, the better.

**Mark Price, Managing Partner, M Squared Group, Inc.**

Well, I hate to harp on the same note as the vast majority of those who have already made their views known. So, I will agree that 'profitable' only enters the picture if 'loyalty' is defined as giving away gross margin to 'loyal' customers. If a 'loyalty' program is not based solely on lower prices to loyal customers, then I would guess that 'loyalty' customers are at least as profitable as the others and maybe more so.

Remember how much money it takes to acquire a new customer. Some people seem to think that they come in for free. It's not so. When one factors that into the equation, and the retailer does not offer lower prices to 'loyal' customers (which should not be the definition of a loyalty program), then 'loyal' customers are more profitable than others (who may just come in to cherry pick your offerings).

**Robert Amster, Principal, Retail Technology Group**

I agree with many of the comments above. I think this train of thought regarding profitability of loyal customers is misleading. I see loyalty as more of a way to be able to track customer purchases, so that a retailer can better segment, market, and respond to their customers in a much more meaningful way. Loyalty program is merely the bait to get them to participate. Rewarding your best customers with gifts and special services is merely a nice gesture. But targeting your promotions to those most likely to spend is just more effective. Look at what Tesco has accomplished over the years with its Loyalty program. They have taken segmentation and targeted promotions to a whole other level.

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