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The Loyalty Illusion

When it comes to dealing with customer retention problems, customer experience is a more useful concept than loyalty.

An insight from our Marketing, Sales & Service Practice.

A recent survey showed 2.5 times as many loyalty schemes are operating in the UK now as there were 10 years ago[1]. But if you're contemplating joining them in the belief that a loyalty scheme will solve your customer retention problems, we'd ask you to think again.

The trouble with loyalty schemes

So what are the problems associated with loyalty and loyalty schemes? First of all, as has often been pointed out before, the phrase 'loyalty scheme' is a misnomer because these schemes just don't make people loyal. Look at the loyalty cards in your own wallet: how many of these companies do you honestly feel loyal to? If the answer is as many as one, we'd be surprised. Various studies have failed to find a link between membership of loyalty schemes and customer lifetime value[2]. The more schemes there are, the less likely they are to work[3].

Even if a loyalty scheme does manage to create loyalty, it's an extremely expensive way of doing it. Safeway is believed to have saved £50m per year by discontinuing its loyalty scheme. However, by pulling out of a scheme you risk damaging your brand and customer relationships.

As well as being expensive and risky, loyalty schemes are clearly not necessary since many organisations manage to grow successfully without them. Those that do run loyalty schemes often find it hard to achieve significant take-up – only 27% of WH Smith customers have its loyalty card, even though it was launched as far back as 1997 with a relaunch in 2003[4].

These unpalatable truths are probably among the reasons that loyalty schemes do not always achieve the intended results. Even Nectar has lost some participants recently, including founder member Debenhams[5], which has said it has no plans to launch its own loyalty scheme. Admittedly, organisations don't always make the best possible use of loyalty schemes. For example, some want to use them in completely inappropriate situations. Football clubs are the most unlikely organisations to need to increase loyalty, yet even they have been dabbling in loyalty schemes.

A flawed concept?

It's not just the schemes that are problematic. The concept of loyalty itself is ill-defined in a commercial context. Most of us have an instinctive feeling for what the human emotion of loyalty is. However, this emotion doesn't appear to have much to do with our behaviour when shopping, and is certainly not an important or reliable driver of retention.

To the extent that customers are ever loyal to a company, they only remain so for as long as it suits them. One bad interaction can undermine loyalty that has taken years to establish (making the overall return on investment in a loyalty scheme even worse than it looks).

Another problem with loyalty is that it is hard to measure directly – particularly if you try to quantify its emotional element, as opposed to its supposed behavioural impact. The best emotional measure of loyalty that we have is arguably customer satisfaction: compared with its main rival, Net Promoter Score, customer satisfaction gives a more granular view of performance and is also a more accurate predictor of company growth. We know that a Totally Satisfied Customer generates 17 times more revenue than a Somewhat Dissatisfied Customer[6].

Since that's the case, it makes more sense to target retention efforts directly at customer satisfaction itself, rather than at feelings of loyalty, surely best regarded as an effect of satisfaction. And while we can't directly control customer

satisfaction either, we can control its cause – the customer experience.

After loyalty...

It's easy to see how customer experience determines customer satisfaction and hence retention. Common sense tells us that if you give someone a great experience, they will be happy and will come back for more.

There is plenty of evidence that providing a differentiated customer experience is a way to stand out from the crowd in an increasingly commoditised environment. For example, Waitrose's delivery partner, Ocado, retains customers by providing excellent service. In addition, customers who do not order for a few weeks are tempted back with reminders and offers. Obviously, this costs money, but because it has a direct effect on customers' experience and hence their purchasing behaviour, it's a more effective investment than a Tesco-style loyalty scheme.

Targeting customer experience

So how do you set about measuring and improving the customer experience? We have room to give only a flavour of our approach here, but the first step is to understand and document the customer journey. Look at your organisation from the customer's viewpoint, taking into account the different situations under which they will interact with the organisation. Look particularly at the exceptional situations - if the customer genuinely forgets to pay their phone bill, are they put on a credit blacklist? Talk to customers and find out how their interactions affect their experience. Quantify this impact so that you can assess the benefits to be gained from investing in each interaction and prioritise investments accordingly.

Once you understand the customer journey from customers' own perspective, you can start to design the kind of experience that would cause customers to keep coming back to you. You'll want to identify and target the areas where you can most effectively differentiate your company from competitors. You may also be able to save money by eliminating actions that don't contribute to a positive customer experience.

Ironically, 'loyalty schemes', or reward schemes as we prefer to call them, can help you to improve the customer experience - but not in the way many companies think they do. Rather than instilling feelings of loyalty, the value of a scheme like Tesco's Clubcard is to allow the operator to find out what sort of experience customers want, and then provide it. Insight like this allowed Tesco to launch its 'Finest' range with confidence, for example.

Incidentally, you might actually collect some loyalty along the way. The only thing that is likely to create the human emotion of loyalty in a commercial context is a consistently positive customer experience: specifically, finding that your personal values align with those of the company. Adopting green policies is one way to show that you are in tune with customer's concerns – counter intuitively, perhaps, there is evidence that many customers actually like being charged 5p for plastic carrier bags.

By studying the customer experience you stand a better chance of finding opportunities for alignment of values, with a possible increase in loyalty. But the fact remains that loyalty itself isn't essential, and is better regarded as a by-product of customer experience strategies rather than an aim in itself.

We helped renowned telecoms brand Orange to apply this approach in order to create a fresh focus on delivering the customer experience. Orange identified a need to re-focus its customer proposition and take out costs in its customer experience delivery. Capgemini Consulting was brought in to help develop a clear market position for the Orange brand and to provide employees with a better understanding of how the brand could be affected by the customer experience. Taking a highly collaborative approach, a joint Orange-Capgemini team has ensured a renewed

vigour around the customer experience based on a greater understanding of what the customer wants and how this should be delivered.

Conclusion: customer experience – the better bet

As we have argued, to focus on loyalty may not be the best investment, especially in view of the uncertain return it brings. Focusing instead on customer experience brings reliable and tangible results.

Instead of launching loyalty schemes in the hope of improving retention, companies will do best to concentrate on improving the customer experience, treating loyalty as an 'optional extra'. If you use reward schemes at all, regard them as a tool for collecting information or for promoting sales, and not as a differentiator for your customers.

The importance of loyalty really is an illusion; perhaps the word 'loyalty' should really be banned altogether from marketing vocabulary. After all, a marketeer's job is not to manipulate emotions but to increase sales, and the management of customer experience is the logical way to do that.

Sources

1) Source: GI Insight, January 2008
2) W. Reinartz & V. Kumar, Harvard Business Review, July 2002
3) Meyer-Waarden,L. , "The effects of loyalty programs on customer lifetime duration and share of wallet" Journal of Retailing, Volume 83, Issue 2, April 2007, Pages 223-236
4) Pigsback, Online user survey, March 2008
5) Source: http://www.mad.co.uk/Main/Home/Articles/91ca3bd80b4445d796faff403b69509f/Debenhams-exits-Nectar-in-review-of-loyalty-strategy.html
6) Source: John Coldwell, Infoquest, 2001

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