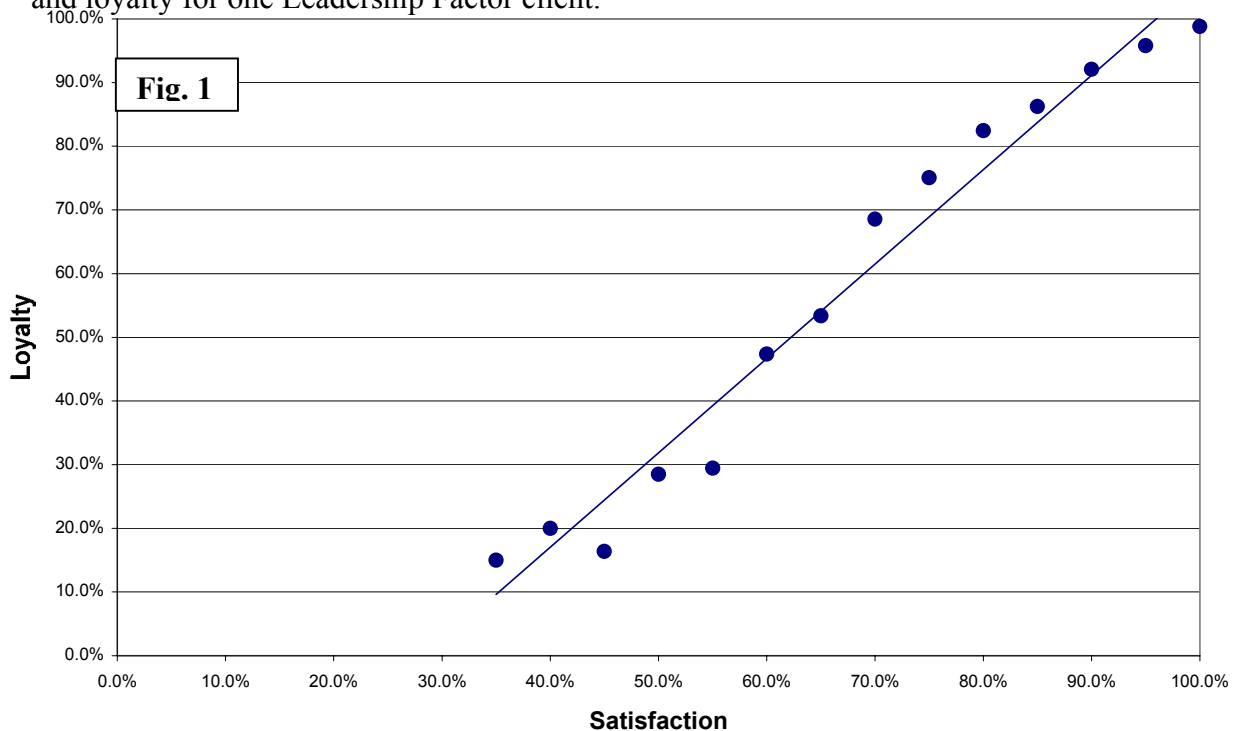


Customer satisfaction, loyalty and profit – understanding the links between service and the bottom line

Customers are becoming ever more demanding, and in most markets they have more options to choose from than ever before. At the same time perceived ‘switching barriers’, the inconveniences of changing supplier, are being reduced. A good illustration of the effect of these changes is in the financial market, where the growth of internet and telephone banking has presented consumers with a breadth of new alternatives at the same time as measures are being taken to ease traditional switching barriers such as the transfer of standing orders and direct debits.

Different markets show very different customer loyalty profiles. The Leadership Factor’s experience has shown that, for example, in some manufacturing sectors customers may have very little choice over which supplier to use. This can lead to complacency, and the feeling that customer loyalty is irrelevant since they have no option but to come back. Such reasoning is flawed on two counts. 1) Customer loyalty goes beyond mere retention to a range of attitudes and behaviours, something which will be covered in more detail later. 2) Customers do come back when they have no other choice, but they will be vulnerable if any competitor arrives on the scene. Companies that are in a virtual monopoly situation can be vulnerable to this way of thinking.

The difference between markets is due to a combination of factors – the amount of competition, the sophistication of the customers and the perceived switching barriers. If all competitors were equally easy to use then we would expect an almost perfect correlation between customer satisfaction and loyalty. Fig.1 shows the relationship between satisfaction and loyalty for one Leadership Factor client.

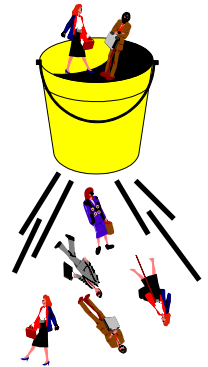


Why does customer loyalty matter?

What is meant by customer loyalty? It is a phrase that can be used to embrace a range of customer attitudes and behaviours. On most of The Leadership Factor's surveys customer loyalty is measured in two ways: loyalty behaviour is gauged by a measure of **retention**, or intention to buy again; loyalty attitudes are termed **commitment**.

Why should you worry about customer retention?

- **Customer lifetime value.** This phrase relates to a very simple concept. Every interaction you have with a customer should be done on the basis that their value to you is the total of all the purchases they will ever make, not that one sale. For example your most valuable customers are probably not those who make the biggest purchases, they're the ones who come back again and again. This way of thinking also allows you to consider marketing approaches that don't require you to make back the cost of acquiring a customer in a single sale.
- **The cost of acquisition.** It has been demonstrated that it is up to 20 times more expensive to acquire a new customer than it is to keep an existing one. A traditional sales approach can be likened to pouring new customers into a bucket with a hole in the bottom – the weaker your levels of customer retention the larger the hole.



Why should you worry about customer commitment?

Committed customers have been shown to demonstrate a number of beneficial behaviours, for example committed customers tend to:

- **Come to you.** One of the key benefits of establishing a good level of customer loyalty is that you don't have to sell to them, they will come to you when they need a product or service, and they may even come on spec to see if you have new products.
- **Buy more often.** Loyal customers come back more and more often, since they enjoy the service they receive from you. If customers find themselves forced to use you against their will they will come as little as possible.
- **Try new products.** If customers are happy with what they've bought from you before, they will be more willing to try new products. Perhaps they will even trust you to suggest products suitable for them.
- **Recommend you.** Another key benefit – loyal customers can become your most effective marketing tool (far more trustworthy than salesmen in the eyes of other customers) and they're free.
- **Buy only from you.** A strong relationship of trust can mean that customers will prefer you even if it is more difficult or more costly to use you than a competitor.

- **Look only at you.** The holy grail of customer loyalty – customers at this stage trust you to provide a good product/service at a reasonable cost, and will not go to the trouble of shopping around before buying.

The key to these is the establishment of trust based on good service, reputation and image. To illustrate how this works, imagine that you have just started dealing with a supplier. To begin with you probably check every invoice carefully, but after a while (if they've all been correct) you'll tend to assume that the invoice will be accurate. Eventually you may not even bother checking the invoice unless something catches your eye. Of course, the moment something goes wrong you go back to checking every item. Similarly if someone else tells you of a problem your trust in the supplier would be damaged.

Why should you monitor customer satisfaction?

Any breach of this trust can seriously damage the relationship you've built. Which is why it is so essential to monitor customer satisfaction, and correct any problem areas. Where a complaints system can allow you to see why some customers (those few who bother to complain) are unhappy, a customer satisfaction measurement (CSM) programme allows you to actively identify specific problem areas based on statistically sound information and correct them.

It will also enable you to prioritise improvement based on an understanding of what the 'key drivers' of satisfaction are, the areas that will have the greatest impact in improving customers' overall perception of you. Once a CSM programme has been established it can be monitored and fed back to customers over time, informing them of actions you are taking and sending a strong message about your commitment to customer service.

Building customer loyalty

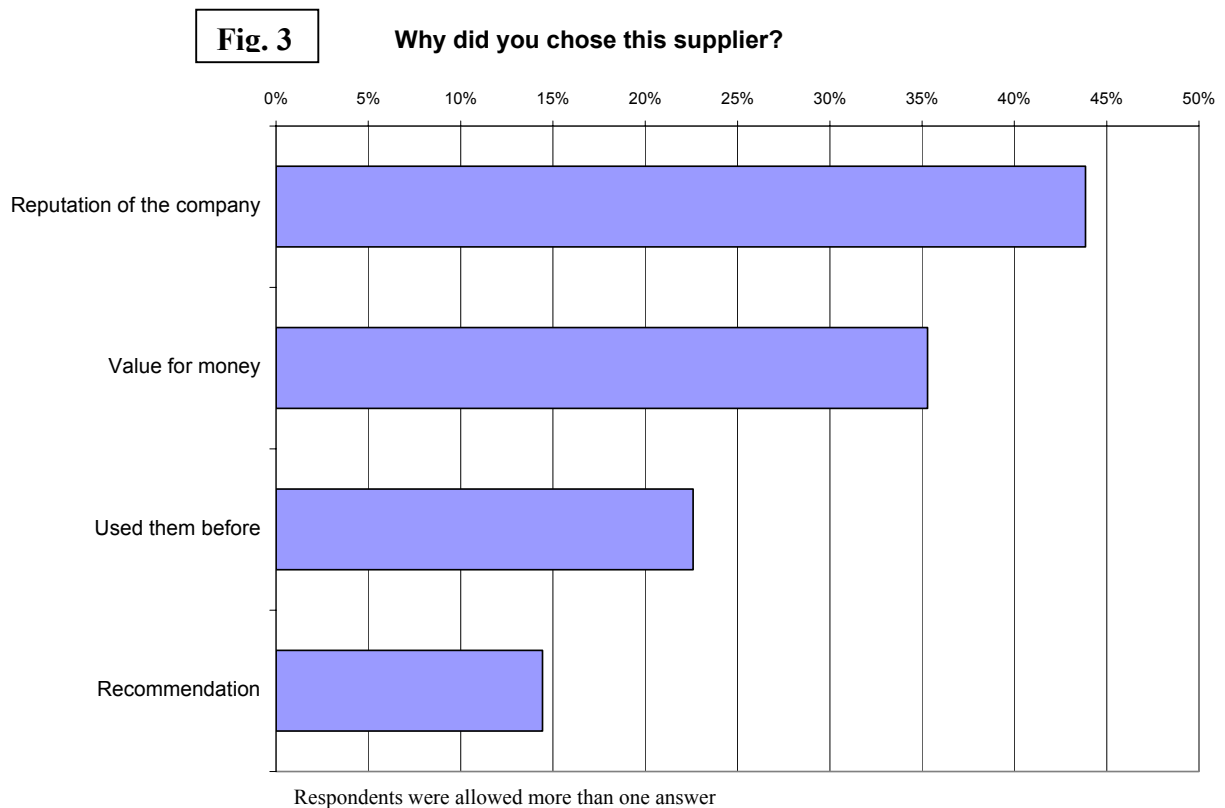
As an illustration of how the process of building loyalty can work, Fig. 2 shows for one consumer client the percentage of customers that requested quotes from other companies, split by whether they had used out client before or not. It shows that this company's strong performance means that past customers are less likely to shop around than others. The company is building a very loyal customer base.

Fig. 2

		Shopped around?		
		Yes	No	Don't know
Used before?	Yes	60.6%	39.0%	0.4%
	No	70.9%	28.3%	0.8%
	Total	67.5%	31.8%	0.7%

$\chi^2 = 26.62, 2df, p=0.00$

Another question (Fig. 3) shows the value of a loyal customer base to this client – their reputation influenced 44% of their customers to use them, 23% were repeat users and 14% chose this supplier based on a recommendation.

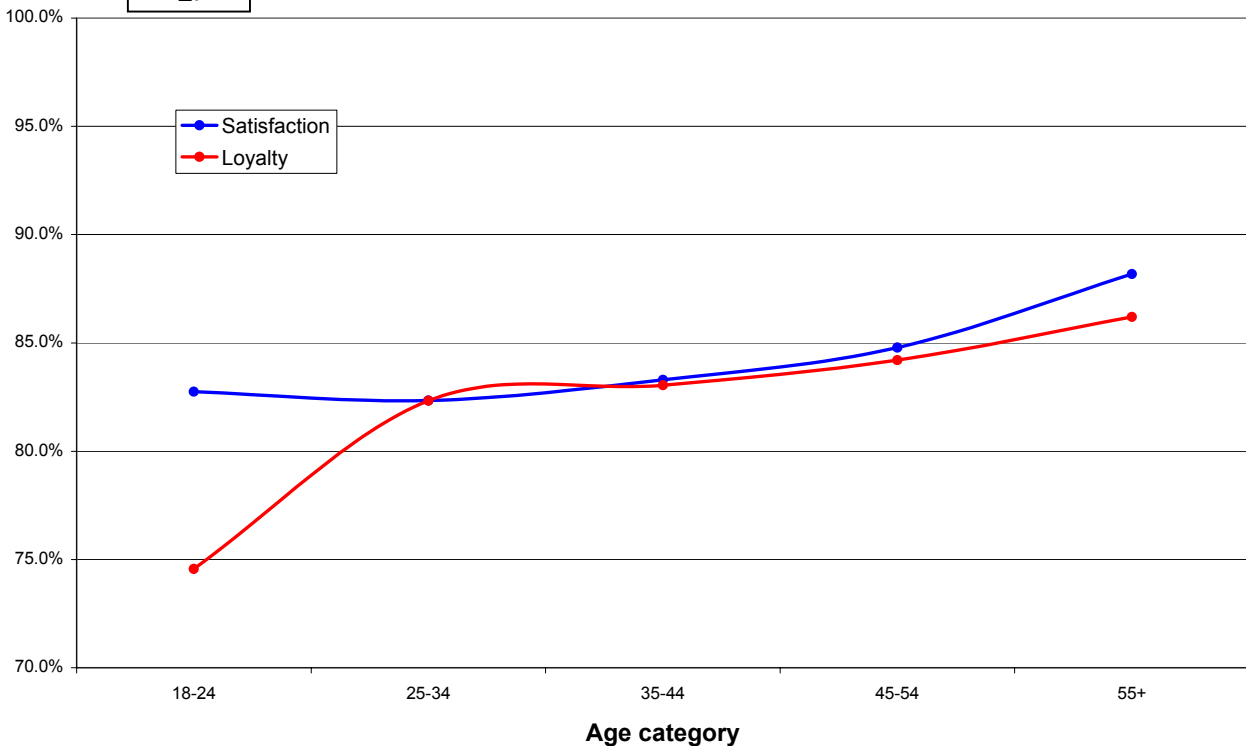


What makes up customer loyalty?

The Leadership Factor’s surveys have consistently shown very strong correlations between customer satisfaction and loyalty. Our work, and that of other agencies, suggests that customer loyalty is driven by a combination of customer perceptions such as satisfaction, image and perceived value, and is further subject to something called ‘loyalty personality’. Loyalty personality refers to innate differences in the way customers form their opinions. Commonly these differences can be predicted by a number of geo-demographic factors, such as age, gender, occupation and location.

Fig. 4 shows how customer satisfaction and loyalty vary by age. It is important to note that the shape of the lines is different – satisfaction personality is not the same as loyalty personality, though they are usually similar. In both cases scores tend to get higher with age.

Fig. 4



Common loyalty personality divisions might include:

- **Innovators/risk averse.** Some people will always be on the lookout for the latest product or trend, and will tend to try something just because it's new. If you're not making the most up-to-date product you may have to resign yourself to losing these customers, however good your service is. Rest assured, though, that they're no more likely to remain loyal to your competitors, and tend to be less profitable in the long term than customers who need a reason for switching. Customers who moved to telephone banking when it first came out fall into this category – how many of them are still using telephone banking accounts, and how many have moved on to internet banking? How much money did they make for the telephone bank?
- **Level of involvement.** Some markets are more 'high involvement' than others, reflecting the importance to customers of making the right purchasing decision. Beyond market-wide trends, however, the most significant difference is in how involved your customers feel with you.
- **Perception of switching barriers.** Switching barriers are the perceived obstacles to changing supplier. The key word here is 'perceived'. For instance, how difficult is it really to change bank? Probably not nearly as hard as most people think, but it's in the interests of the big high-street banks to maintain this impression.

One message that is often missed is that it can be okay to write off customers. There are some customers that cannot be kept loyal, just as there are some that cannot be kept happy.

Increasingly the concept of ‘firing’ customers is growing in currency, and it is a valuable idea. The important thing is to make sure you focus on keeping the right customers. The most damaging customer is one who takes up your resources but doesn’t yield commensurate gains. Worst of all they may be damaging you by criticising your performance. These ‘terrorists’ are customers that you are better off without since they’re losing you business and you’re probably making a loss on them anyway.

Concrete advantages

At the end of the day, what’s in it for you? You’ve surveyed your customers’ levels of satisfaction and loyalty, you’ve focused improvement on the drivers of satisfaction and loyalty and seen these soar as a result, and you’ve fired your terrorists. What difference will it have made? The honest answer is that we can’t be sure. We believe that for almost every organisation improving customer satisfaction will improve customer loyalty, which will in turn improve profit. But we can’t prove this is the case for every organisation, and we can’t predict by how much. To predict what an improvement in satisfaction will mean to you in terms of loyalty and profit you have to model the relationships between these items.

Only a small number of companies at the cutting edge of customer research have managed to model the links between satisfaction, loyalty and profit. The perception seems to be that the process is very complex and requires enormous amounts of data, which is far from the case. Of course the more data is available the more reliable and precise a model will be, but the chances are you could make a start with existing financial data.

In simple terms the modelling of a relationship is no more complex than drawing a line of best fit on a scatter diagram. Looking back to Fig. 1 it is obvious that as satisfaction goes up so does loyalty. Getting at the specifics of this relationship and understanding how reliable the equation is requires some statistical knowledge, however, and unless you have a statistical background it is probably best to let an outside agency do the work for you. Such an agency should also be able to employ more advanced techniques such as Structural Equation Modelling and Latent Class Regression, which are only available through specialist software.

As a final thought for those that are still unconvinced about the concrete benefits of making your customers satisfied and loyal consider this: markets are becoming more and more competitive, and consumers are getting more demanding. If you’re experiencing high customer turnover, but your competitors are locking in customers by targeting loyalty, you’re soon going to run out of prospects to pour in at the top of the bucket.

Further information

Author of the article Stephen Hampshire is Business Development Manager for The Leadership Factor. The Leadership Factor is an international agency specialising in customer satisfaction and loyalty measurement. The Leadership Factor conduct in excess of 200 satisfaction and loyalty studies per annum. As well as helping many companies manage their CSM projects, The Leadership Factor run the world’s leading one day seminar on the subject and have presented their training day to over 3500 delegates across the globe.

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