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Why Customer Loyalty Isn't as Valuable as You Think

Faithfulness to Brands Doesn't Vary Much, So Focus Instead on Recruiting New Users

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As the recession bites and marketers turn their attention to making dwindling budgets work harder, many will be misled into thinking the answer lies in relatively inexpensive loyalty campaigns for their existing customers. It's a seductive argument: "We can't afford expensive customer-recruitment campaigns, so we'll just work our existing customer base harder and increase our share of their purchasing."

There are, after all, only two ways in which marketing might affect volume sales: New consumers might buy the brand (penetration growth) or the existing buyers might buy the brand more often (loyalty growth).

Hopefully, however, our analysis of the Effectiveness Awards cases in the IPA DataBank will succeed in driving home a vital lesson that many have failed to learn from professor Andrew Ehrenberg's lifetime work on loyalty. Ehrenberg has proved that behavioral brand loyalty within a category simply doesn't vary much from brand to brand -- it is pretty much fixed, with consumers buying across a portfolio of brands to fulfill their category needs. The only slight exceptions are brand leaders, who tend to enjoy slightly higher loyalty than challengers, as a mathematical consequence of their greater penetration, making life harder

for competing brands. In summary, Ehrenberg's work suggests that recruiting new users to a brand is much more fertile than trying to increase frequency of purchase.

So why is it that so many marketers and their agencies persist with loyalty strategies? The roots of this obsession with loyalty appear to go back to a famous pronouncement by management consultants Bain & Co., sometime in the 1980s, that a 5% improvement in customer retention can cause an increase in profitability of between 25% and 85% (depending on the cost structures of the business). Suddenly the customer-relationship-management movement was born, and marketing went loyalty mad. The problem with the pronouncement was that it was merely a thought experiment: a "What if?" idea worked through theoretically to its logical conclusion on profits. It was based on the observation that a brand's most profitable customers were always its most loyal

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ones. Turn less loyal customers into more loyal ones, and in flow the extra profits -- in theory. At the time no one had actually observed a business successfully turn its back on (expensive) customer-recruitment marketing and prosper through (relatively inexpensive) customer-loyalty communications. Few have observed it since, because it is extremely difficult to do. Consequently, the IPA data strongly support Ehrenberg's view that penetration growth is a more profitable objective for brands than loyalty growth. In fact, the IPA DataBank gives loyalty a very hard time.

WHAT COUNTS MOST

Increasing your customer base yields more profits than increasing loyalty



Source: IPA DataBank

Despite being a very common communications objective, pursuing loyalty is considerably less profitable than pursuing penetration. Not only that, but where campaigns that ostensibly target loyalty are highly profitable, they are much more likely to have achieved that profit through penetration growth than through loyalty. But that doesn't mean brands should turn their backs on keeping their existing customers happy. Clearly an unhappy customer will become someone else's customer, and so penetration will ultimately be lost. More important, a happy customer can become a powerful recruiter of new customers. So, not surprisingly, the DataBank shows that the most effective campaigns aim to talk to both new and existing customers -- and ideally turn the latter into advocates for the brand. Paradoxically, the loss of unhappy customers may have the effect of making the remaining customers appear on average to be happier -- and therein lies a danger in measuring the attitudinal loyalty of one's customers. In this context the true value of the customer commitment studies and research models that have proliferated in recent years lies in the leading indication they provide of future penetration growth or decline.

The benefit of creating happy customers who help recruit new ones has been validated in recent years by Bain & Co.'s development of the Net Promoter Score -- a measure of a customer's preparedness to recommend a brand to their friends. They have shown that a high NPS correlates with long-term profit growth. Thus, many of the DataBank campaigns that targeted loyalty by publicly demonstrating how well they treat their customers in fact ended up recruiting many new ones. Telling noncustomers that your existing customers are well-treated is, not surprisingly, a good way to attract them. Two major U.K. brand leaders are examples: O2 mobile communications and retailer Tesco. O2's loyalty strategy turned out in fact to be a hugely effective recruitment one: Two-thirds of the very considerable growth that ensued came from new customers, with the remainder from reduced churn.

And the same observation applies to the pinnacle of U.K. loyalty programs, the Tesco Clubcard. There are clearly many benefits of building a database of 11 million customers, but a major part of the payback of this scheme -- which costs Tesco almost £100 million per quarter -- is the effect it has had on the acquisition of customers and on the ability of Tesco to persuade them to extend their purchasing beyond the original core grocery categories. So in practice, what people refer to as "loyalty" campaigns often involve the cross-selling to customers of other related products. The bottom line: Marketing communications do not appear to be able to influence loyalty significantly, whereas they can make a big impact on penetration. So as you consider how best to spend your hard-won marketing dollars, don't be tempted by the "fool's gold" of loyalty -- it will probably turn out to be a whole lot less valuable than you'd hoped.

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