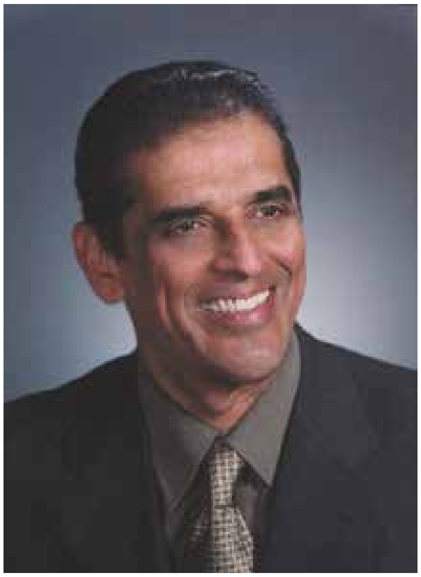

AU CONTRAIRE (3)

The Unbearable Lightness of Buying

Chuck Chakrapani, CMRP, FMRIA

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There are only two ways to increase your sales: get more customers or get your current customers to buy more; that is, increase market penetration or increase loyalty. There is no other way. But which is the better way – increasing loyalty or increasing penetration? Marketers, by a large margin, seem to believe in loyalty rather than penetration.

Les Binet and Peter Field's[1] review of 880 ads found that loyalty strategy was 60% more frequently used than penetration strategy. Companies routinely concentrate on "high value" customers and have loyalty programs to retain them. This strategy is universally accepted and almost never questioned. It seems much too obvious to think otherwise. Yet it may not always be a profitable strategy if it is done at the expense of increasing market penetration.

Most Buyers Are Light Buyers

Increasing penetration means paying as much attention to light buyers as to heavy buyers. It is not intuitively obvious why we should pay attention to light buyers who, taken individually, are not hugely profitable. However, most buyers are light buyers, and they tend to be brand loyal. Far fewer buyers are heavy buyers, and they tend not be brand loyal.

For any given period, a large number of consumers of a specific product do not buy it at all or buy it just once or twice.[2] Frequently bought products, such as products that can be consumed daily or even more often, are no exception either. Can you estimate how many times a year an average Pepsi buyer buys Pepsi and a Coke buyer buys Coke? Take a guess.

On average, a Pepsi drinker buys Pepsi nine times a year. On average, a Coke drinker buys Coke twelve times a year.[3] This phenomenon has been found to hold for most products and services, even for products that can be consumed several times a day, as we noted above.

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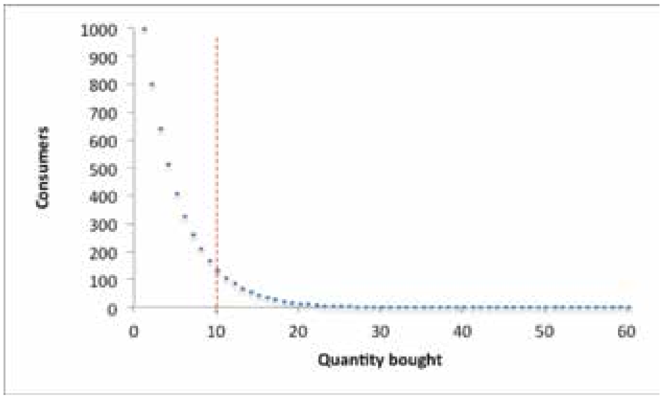
Buyers Follow the 'Long Tail'

It is possible to predict how frequently a consumer will buy a product using a mathematical model known as the negative binomial distribution (NBD). The figure on the next page illustrates this type of distribution. Note how a majority of buyers buy less frequently (left side of the distribution) and, as the quantity increases, we have fewer and fewer buyers. This "long tail" distribution illustrates how consumers typically behave: a huge number of low-frequency buyers followed by a small number of high-frequency buyers.

In hundreds of studies in different countries for different products, this relationship has been found to hold. In the figure, if we define those who buy ten or more units as heavy buyers, they may account for disproportionate sales volume, some consumers buying more than fifty units. If we need to develop a marketing strategy of targeting heavy buyers, we need to understand how much heavy buyers – those who comprise the long tail – actually buy.

Figure: Negative Binomial Distribution of Consumer Purchases – An Example



Note how few heavy buyers there are (the area under the dotted line on the right side of the graph) compared to light buyers (the area under the dotted line on the left side of the graph).

Does Pareto Have the Answer?

Over one hundred years ago, the Italian economist Vilfredo Pareto noticed that 20% of the pea pods in his garden contained 80% of the peas and wondered if this relationship could be applied to economics. After doing some additional work, he observed that 80% of the land in Italy was owned by 20% of the population. Since then, this "Pareto principle" has been found to apply in many contexts, resulting in the generalization that 20% of effort yields 80% of results.

In marketing, it is often believed that 20% of our customers are responsible for 80% of our sales. Looking at the negative binomial nature of consumer buying behaviour (as illustrated in the figure on this page), we may infer that the Pareto principle may apply to buyer behaviour.

Research data show there is some evidence to support a "Pareto-like" principle rather than the Pareto principle of 20:80 as far as buyer behaviour is concerned. Gerald Goodhardt, who has done extensive research in this area for about fifty years, has come up with the following generalization based on hundreds of products: 20% of customers generally account for about 50% of sales, while the other 80% account for the remaining 50% of sales.

	Customers	Sales
Top	20%	50%
Medium	30	30
Bottom	50	20

This "Goodhardt modification" means that high-value customers are not as tightly clustered as one would expect. By concentrating on 20% of our customers, we will not cover anywhere near 80% of our sales, but only 50%. We cannot afford to ignore the 80% of our customers who account for the remaining 50% of our sales.

Light Buyers Are More Brand Loyal Than Heavy Buyers

There is another reason why we cannot ignore light buyers: light buyers tend to be more brand loyal. Consider, for example, the data on instant coffee in Exhibit 1, which shows that those who are loyal to a single brand buy substantially less of the category than heavy buyers.

This observation sounds counterintuitive. However, if we examine it more closely, it is quite logical. Light buyers of a category find a brand in the category and stay with it. If you are a light user and you are happy with your current purchase, you are likely to buy the same brand again, since it involves the least amount of risk.

Exhibit 1: Heavy Category Buyers Are Not 100% Loyal; Light Buyers Are

	Category Purchases per Buyer	
Brand	**100% Loyal**	**Less loyal***
Folgers	3.6	8.0
Maxwell House	3.8	8.6
Tasters Choice	2.9	8.1
Nescafe	2.8	9.4
Maxim	4.0	9.8
High Point	2.6	6.5
Brim	2.9	5.7

Extracted from John Bound's 2009, "User's Guide to Dirichlet" (available at marketing-bulletin.massey.ac.nz).
* The quantity bought by those who are less than 100% loyal was calculated from the data provided in John Bound's table.

But if you are a heavy user of a category, you are more likely to explore more brands, try different ones, and look for better deals. In general, it is heavy buyers who look for better prices, who can easily negotiate a better deal, and who are likely to be more informed about the alternatives and so more open to switching. They tend to be multiple brand buyers and are less loyal to a single brand.

As an analogy, consider Walmart. It tends to buy in large quantities from all its suppliers, even though it has thousands of them. You would, of course, do all you could to retain such a large buyer as a customer and keep the buyer happy. However, the fact that Walmart is a heavy buyer of your product does not mean that it is loyal to your product. It buys a lot from you because it buys a lot from all its suppliers.

Heavy buyers are less loyal to individual brands. It is the light buyers who tend to be loyal and provide the base that makes heavy buyers profitable. Ignoring light buyers is a risky marketing strategy – like building an edifice without a foundation.

Light buyers are important even when they are not hugely profitable, because they provide the foundation for profitability. They create the stability needed to make profit. Ignoring light buyers is a risky marketing strategy – like building an edifice without a foundation.

Preaching to the Converted

Even though consumers who very frequently buy our product are far fewer in number, they contribute a lot to the volume sold. For example, 5% of heavy Coke buyers could account for 25% of the total volume. But would it be worthwhile to spend your marketing dollars mostly on heavy buyers of your brand? After all, they buy your brand frequently because the category is important to them. If you are a heavy buyer of Dell, computers as a category are important to you.

Heavy buyers of your brand already know your brand, already buy your brand and, because of their "involvement" in the category, are also likely to be aware of your POS and your advertising. Most likely, they value your brand already. Spending most of your marketing dollars here is preaching to the converted. It is unlikely that a heavy user of Dell is unaware of HP and has no opinion on it. The chances are that a heavy user of a brand (hence of the category) is already familiar with and has tried other brands available in that category.

Anyone whose goal is "something higher" must expect someday to suffer vertigo.

— Milan Kundera,
The Unbearable Lightness of Being

Loyalty Follows Penetration

A common assumption is that consumers tend to be more loyal to small-niche brands than to undifferentiated mass-market brands. This is not borne out by facts. Research data show that loyalty is somewhat higher for brands with a larger market penetration than for brands with lower market penetration.

Consider, for example, the data presented in Exhibit 2. It shows that higher penetration brands such as Folgers, Maxwell House, and Taster's Choice have a greater percentage of 100% loyal customers (around 34%), while relatively smaller brands such as Brim, High Point, and Maxim have fewer 100% loyal customers (around 26%). Brands that have lower penetration also have fewer buyers.

Exhibit 2: Smaller Brands Have Fewer Loyal Buyers

Category Purchases per Buyer		
Brand	**100% Loyal**	**Less loyal**
Larger brands		
Folgers	36%	64%
Maxwell House	35	65
Taster's Choice	33	67
Nescafé	32	68
Smaller brands		
Maxim	26%	74%
High Point	26	74
Brim	26	74

Extracted from John Bound's 2009, "User's Guide to Dirichlet" (available at marketing-bulletin.massey.ac.nz).

Exhibit 2 once again illustrates the importance of penetration. Contrary to popular belief, niche brands actually command lower loyalty than high-penetration mass-market brands. This pattern holds for many products. We will return to this point in a later article.

Contrary to the popular belief, niche brands actually command lower loyalty than high-penetration mass-market brands. This pattern holds for many products.

Catering to the needs of high-volume buyers and keeping them happy is common sense. It is an important marketing strategy to increase our profitability. But it is shortsighted to cater to these buyers *at the expense* of the remaining, more loyal, half of our customers.

Yesterday's Moderate Buyer Can Be Today's Heavy Buyer

Another common mistake is to treat heavy users as a static group. Customers are not static. They "regress" to the mean. A heavy buyer in this quarter could be a moderate buyer in the next quarter; a non-buyer can become a buyer; a medium buyer can become a heavy buyer.

It is not so much that consumers change their mind frequently. Rather, their patterns of purchase can create this illusion. Some consumers may space their purchase occasions equally, while others may buy heavily during some periods and not at all during the subsequent period.

> Customers are not static. A heavy buyer in this quarter could be a moderate buyer in the next quarter; a non-buyer can become a buyer; a medium buyer can become a heavy buyer.

The loyalty approach concentrates on heavy buyers and does not pay sufficient attention to light buyers. The penetration approach takes a holistic view of the market. These two approaches are summarized in Exhibit 3.

Exhibit 3: Loyalty vs. Penetration

LOYALTY APPROACH	
Focus on large customers	
What the marketer believes	**What research shows**
They like us, so they buy more.	They are high category buyers. They buy more of any brand they buy.
We can make them loyal to us.	They are usually multibrand buyers. They are less loyal to a single brand.
They are highly profitable. We should concentrate only on this group.	Yes, but when they leave, it can affect our stability. This will make us too dependent on a few customers.
PENETRATION APPROACH	
Focus on total customer base	
What the marketer believes	**What research shows**
Light buyers are not loyal to us.	They are more likely to be loyal to us than heavy buyers
A large number of customers are only marginally profitable.	Individually, yes. But collectively, they provide a stable base.
It is too difficult to serve so many customers.	Most light buyers are not high maintenance. Some are, but if they leave, we are not affected.
Customer groups are static. A light buyer is a light buyer.	Customer groups are not static. A light buyer in one period may become a heavy buyer in another period.
Increasing penetration is a difficult strategy.	Yes, but more rewarding and more enduring.

Light Buyers Are Important

Light buyers provide us with stability, and yet they cannot individually threaten our stability by leaving. Their presence in large numbers increases market penetration. Market penetration in turn generates loyalty as a by-product. Given all these advantages of the market penetration approach, one would expect marketers to be keen on increasing the penetration of a brand rather than single mindedly trying to increase loyalty. Not so.

As I mentioned at the beginning of this article, of the 880 ads analysed, the strategy of increasing loyalty was 60% more frequent than the strategy of increasing the penetration. Here is the punchline: When Binet and Field tested these ads against an effectiveness criterion, ads that attempted to increase penetration were about twice as effective (a little less than 80%) as the ads that attempted to increase loyalty (a little more than 40%). Increasing long-term loyalty is considerably more difficult than it is normally presumed to be.

Loyalty is highly desirable. So I am not against any valid attempt to increase customer loyalty – high-volume buyers can contribute disproportionately to our profitability, and we need to retain them. But the attempt should not be made at the expense of increasing market penetration. Unfortunately, much of what is written and practised with respect to loyalty bears little resemblance to the reality of how loyalty actually works.

Endnotes

1. L. Binet & P. Field. "The Conflict between Accountability and Effectiveness." *Admap*, 2007 (June).
2. A. Ehrenberg. "Two Kinds of Research." *Marketing Research*, 2002: 14(2), 37–38.
3. B. Sharp. Based on the 2010 TNS panel "How Brands Grow."

Note: This series of articles is based on extensive empirical evidence. To keep the material readable, I have quoted only a few studies. I intend, in the not-too-distant future, to put on my website an extensive list of the papers and books on which this series is based. When I have done so, I will provide the link.

Dr. Chuck Chakrapani is the chief knowledge officer of Leger, The Research Intelligence Group. He is also a distinguished visiting professor at the Ted Rogers School of Management at Ryerson University, editor of the American Marketing Association's Marketing Research, *and a member of the board of directors of the Marketing Research Institute International which, in collaboration with the University of Georgia, offers the online course "Principles of Marketing Research." He is a fellow of the Royal Statistical Society as well as of MRIA and has authored over a dozen books and 500 articles on various subjects.*