Customer loyalty and customer value - 3
Charcteristics of loyalty

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Relating service quality to the bottom line
In the last article we saw how customer loss compounds over time, creating what might be the firm's largest expense - finding new customers to replace the ones it has lost. In an attempt to stop customer erosion practically all major firms measure customer satisfaction.

But then, as we noted, customer satisfaction is a necessary but not a sufficient condition of loyalty: Customers will not stay if they are dissatisfied, but satisfaction in and of itself does not guarantee loyalty.

So we move to the next step, customer loyalty. How do differences in customer perception translate into loyalty?

Differentiating captivity from choice
The standard way to measure loyalty is through customer retention. To a large extent, the two words are used interchangeably. Yet, in the previous article, we differentiated two types of retention: retention by customer choice and retention by captivity.

In simple terms, retention by choice has a positive psychological correlate - the customer wants to stay with the firm. Captive retention has no such positive psychological correlate; rather it has a negative psychological correlate i.e., other alternatives are even more painful. A customer who is unhappy with a company (e.g., their local hydro) that is a monopoly has two choices: either to be loyal to the firm and accept poor service or do without light or heat.

Unfortunately there is nothing in the customer retention data itself that would differentiate the two types of retention. For our purposes, we will define loyalty as retention by choice.

Customer loyalty leads to customer retention. While other factors such as monopoly can also lead to customer retention, our focus will be on retention as a result of intentional loyalty.

Retention as an after-the-fact measure
Customer retention is an after-the-fact measure. From a behavioural perspective, by the time a firm measures retention, it is too late - the customer has already left. This is why we need a correlate for retention which can serve as an early warning signal.

Characteristics of loyalty
Loyalty arises when a customer feels that there are special benefits in the business relationship. When such a belief is not present, the customer will value the relationship for only its immediate benefits, most likely the price.

Mutually beneficial relationship
Loyalty is strengthened when the firm recognizes the mutual benefits that accrue from customer loyalty. As a result, a firm will act to protect the relationship by acting in the interests of the customer, genuinely attempting to solve customer problems. Customers in turn protect the relationship by not defecting.

Short-term goals often cloud this mutually beneficial relationship. Non-loyal customers seek to solve their own problems and non-loyal firms seek to maximize their short-term profitability.

Loyalty refers to the relationship
Because loyalty is a psychological concept, it is frequently treated as an attribute of the customer (customer loyalty). In reality, loyalty is not specific to the customer but to the relationship between a customer and a firm.

Many firms appear to believe that loyalty flows from the customer to the firm and not vice versa. Hence the firm concentrates on customers rather than on individual relationships. They offer customer benefits as a sole means of augmenting the relationship. The drive to solve problems shared by many customers rather than the ones faced by an individual customer.

Two factors that augment loyalty

What augments client relationships and thus loyalty? Research studies repeatedly point to two factors: (1) solving problems faced by the customer, whether the customer's problem is common or unique; and (2) exceeding expectations.

Every time the firm solves a problem, customers interpret this as a special benefit, which they may not get with a competitor. When the firm solves a customer problem that is not generally shared by other customers ("non-routine problems" as Professor Parasuraman calls them), a customer is even more likely to attribute it to the special relationship they have with the firm. The customer rewards the firm by being with them longer, doing more business and bringing in new customers.

Exceeding expectations refers to receiving a level of service that is beyond what is strictly necessary. When a customer perceives that he or she has received more than what can be normally expected, the difference between what is expected and what is delivered is interpreted by the customer as the value the firm places on the relationship. This increases customer loyalty.

Who are loyal?
Although loyalty lies with the relationship and not with the customer, some types of customers tend to be more loyal than others. A study by Jain, Pinson and Malhotra identified a number of characte?ristics relating to loyalty in the banking industry (see Exhibit 1).

Exhibit 1
Characteristics of loyal and nond-loyal customes in banking industry

Non-loyal	Loyal
Deal prone	Relatively older
Innovator	Less educated
Risk taker	Less affluent
Heavy user	More blue collar
Knowledeable	
Economic considerations	Human considerations
High profit	Low profit

(Source: A.K. Jain, C. Pinson & N. Malhotra, *International Journal of Marketing*, 5.3

There is not enough published evidence to suggest that similar patterns hold for other business sectors. If they do, the challenge is clear: a firm's most profitable customers are least likely to stay, are least likely to be pacified by routine solutions to non-routine problems. There are fewer of these customers, but they contribute more to the bottom line.

Loyalty, then, is more than just a numbers game. Numbers are important but, to be truly profitable the firm needs not only a large proportion of loyal customers but a large number of defection prone customers who contribute dispro?portionately to profits.

Why customers switch
After analyzing 526 descriptions of switching behaviour in a variety of service areas ranging from restaurants to telephone services, Keaveney (1995) identified 8 basic reasons for switching (see Exhibit 2).

Exhibit 2 **Eight reasons for switching service**
Pricing Inconvenience Service failure - core Service failure - encounter Service failure - employee response Attraction by competitors Ethical problems Other problems
Source: S.M. Keaveney. customer switching behaviour in service industries: An exploratory study. *Journal of Marketing*, 1995, 59.2.

Over 80% of all switching is not related to price. More than 50% of all those who switch do so because of service failures. Service failure is a stronger reason for switching than price, inconvenience, competition, ethical and all other problems put together.

Why customers continue to defect
The reasons for customer defection should not come as a great surprise to anyone involved in customer satisfaction research. The more relevant question is, as Susan Devlin puts it, "why isn't the churn monster tamed?". She provides the answer as well: lack of sustained strategy, no data-driven decision making, no follow through or tracking of results, no competitive maturity and no access to customer intelligence (see Exhibit 3).

Exhibit 3 **Why isn't the churn monster tamed?**
No comprehensive, sustained strategy No objective, data-driven decision making No implementation follow-through/tracking No cultural alignment or competitive maturity No ready access to customer intelligence
Source: S.J. Devlin. The use of customer research and analytical methods in managing churn. American Marketing Association, Applied Research Methods Tutorial Notes, 1997.

Where do we go from here?
From our discussion so far, this much is evident:
1. Customer satisfaction is important but, in and of itself, does not lead to loyalty.

2. Loyalty results in retention, but retention does not necessarily imply loyalty.

3. This is because customer retention may come about either through choice (which has a positive psychological component) or though a lack of it (which has a negative psychological component).

4. We will be concerned only with loyalty through choice in these articles.

5. Many large organizations fail to distinguish loyalty through choice from general retention.

6. Customer retention is not simply a numbers game. The most desirable customers tend to be less loyal.

7. To stop customer defections, organizations should have a sustained strategy that should include among other things techniques of measurement, competitive intelligence, understanding of competitive 'hot-buttons', a strategy to stop the churn, an understanding of the most profitable alternative and an understanding of customer needs.

How many of these potential solutions are really achievable? Given the state of our knowledge of customer loyalty and given the radical technological changes that keep changing customer expectations, we cannot hope to achieve miracles. No perfect solution exists and the solutions we find will keep changing.

However, we know a lot more about customer loyalty than we did just a few years ago. We will not be able to achieve 'zero defections' in a competitive market, but with proper measurement techniques, commitment and strategies we can definitely slow down the churn rate, increase retention and the lifetime value of a customer.

The next few articles in this series will discuss how we can measure and build customer loyalty, thereby improving the bottom line.

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