How can you create loyal customers?

Your profitability depends on the type of relationship you have with customers

This article is the second part of a discussion on the pursuit of customer loyalty; the first part discussed customer strategy and some building blocks for customer loyalty. This article considers customer profitability and customer relationships.

Customer Profitability

Customers that frequent Best Buy stores fall into two categories, according to this electronics retailer: "angels" and "devils". The angel customers are apparently less demanding than the devils, and spend more money on expensive, new technologies. Devil customers, on the other hand, seemingly buy products, apply for rebates, return the purchases, and then buy them back at returned merchandise discounts. They ask the store to honour their lowest-price pledge by finding prices quoted on the Internet. In the words of Best Buy's CEO, Brad Anderson, devil customers "can wreak enormous economic havoc." It is likely that angels and devils are to be found in retail sectors beyond home electronics and it is important for retailers to know customer profitability so the angels can receive much different treatment than the devils.

Many large retailers assess customer profitability by considering the cumulative gross margins of all customer purchases over a specified period. Such an approach is better than simply focusing on revenues but it fails to adequately describe the profitability of the customer because it omits a number of costs. For example, this calculation excludes costs associated with the time to develop sales, product returns and required discounting, financing – including late payments, outbound customer communications, the cost of time for inbound calls to help desks and support centres, and so on. The table below suggests that customer profitability should take issues such as these into account.

Calculating Customer Profitability

REVENUES
– Direct Costs
– Financing Costs
– Relationship Costs
– Communications Costs
= Customer Profitability

In addition, some retailers consider in their calculation of customer lifetime profitability, percentages for customer retention and financial hurdle rates of return (cost of capital), but, for reasons of space, this complicates the calculation and is not discussed here.

As mentioned, smaller retailers may have a qualitative appreciation of customer profitability and it is not uncommon for these retailers to already categorize customers – again, qualitatively – based on what it costs the firm to do business with each one. Some smaller firms might benefit by trying to make their cost assumptions explicit and actually calculating customer profitability for exemplars, so that decisions can be made about how much time to invest with each category and how to improve profit associated with the relationship.

Measuring Customer Relationships

Retailers measure customer relationships in a number of ways including customer satisfaction measurement, referral measurement, net promoter scores, customer value measurement, and touch-point mapping and perception measurement. Although these approaches may seem complicated, they are neither difficult to comprehend nor expensive to implement, and

The Business of Retail is part of an ongoing series of columns by **Ian Gordon**, president of Convergence Management Consultants, that explore marketing and management issues that are important to readers of *Home Style Magazine*. In this issue, we feature part two of an article outlining how retailers can maintain customer loyalty. (Part one appeared in the May/June issue.)

firms of all sizes can apply these ideas quite simply. The next issue will make suggestions for measuring these issues.

Towards Better Relationships

Customer loyalty can be developed in a planned manner and companies unhappy about current levels of customer loyalty often do not have a plan to develop this loyalty. "Without a plan", as the saying goes, "any road will get you there".

The first prerequisite of customer loyalty is to have a plan. This plan usually requires an understanding of each individual customer and, except for the smallest companies, this understanding can usually only be developed from a customer database. If this sounds like an expensive proposition, it need not be. Today, there are a number of technology solutions which are relatively inexpensive and, in some cases, technology may not be needed for retailers who already know their customers as individuals. This often applies to smaller firms.

The challenge for larger firms is to make the customer's in-store shopping experience feel at least as comfortable and memorable as buying from a smaller proprietor. This often starts with a single real-time view of the customer and training to deskill and reskill sales personnel to incorporate the technology, and it involves creating – staging – memorable experiences that will stand out in the minds of customers.

The owners/managers of many smaller stores seem to understand intuitively that their goods may not be highly differentiated and their services may not be unique, but by bringing the two together in staged experiences, customers will remember and be back. Some retailers call this combination of entertainment and retailing "entertailing" and examples include opportunities to interact with and experience products, and events tailored to customers' preferences like product and recipe demonstrations and tasting evenings. Would customers appreciate an opportunity to try out a new juicer or use new cooking tools in a staged environment?

While every customer-centric plan will be different because the objectives of each retailer obviously also differ, the following are a few questions retailers might ask of themselves as they start to rethink their approach to customer loyalty:

- What would we do differently if we charged customers to enter our stores? (You probably would not actually charge for entry, although some warehouse stores effectively do so by requiring membership, but what would you do differently if you were to do so?)
- Is the brand promise of our store understood by customers, differentiated from competitors and aligned with competent delivery?
- Can we identify our customers uniquely and in real time?
- Should we say: "the customer is always right", or only "the right customer is always right"?
- Do we know the value of each customer to the company, and do we have objectives for the value of individuals?
- Do we try to predict what each customer will want (and do our best to do so before the customer knows)?
- Does our treatment of individual customers (and employees) make each one feel special? Do they feel so special they tell their friends?
- More generally, will our customers recommend us to their friends and associates? If not, why not?
- Do we understand what our best customers want to buy, even if we don't presently carry those goods?
- Do we look after our customers with sales and service over their purchasing lifetimes or do we focus only on near-term sales?
- Do we need a loyalty program to reinforce customer behaviours or does our entire value proposition provide that reinforcement?
- Do we know when our customers might be ready to buy again? Are we positioned to sell to them at that time?
- Do we capture customers' e-mail addresses and use e-mail effectively to communicate with them?
- Do our employees have the latitude they need to serve, recognize and reward our best customers in ways that are outside of the policy manual?
- Does each of our best customers think of one of our employees as a good friend or possibly even a member of the extended family?

Successful retailers have three main positioning options: price and value (like Wal-Mart), convenience (many big-box stores offer convenience through wide selection) and relationships. It is in the third area – that of relationships – where many customers say they are underserved, and it is here that many opportunities remain for retailers to capture. A plan to create loyal customers can be developed using approaches such as those noted earlier and by thinking about the questions posed above.

For more reading:

There are a number of books on the subject of customer loyalty and relationship marketing that may be helpful. Authors who have written excellent books on related topics include Don Peppers and Martha Rogers (*Managing Customer Relationships*), Frederick Reichheld (*The Loyalty Effect*), Patricia Seybold (customers.com), David Aaker (*Building Strong Brands*) and B. Joseph Pine and James H. Gilmore (*The Experience Economy*). My book, *Relationship Marketing: How to Win the Customers You Want and Keep Them Forever*, might also be of interest. ■

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