

Is Consumer Loyalty a Myth?

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Introduction

The statement “best customers are loyal ones” sounds almost like a gospel today. Companies increasingly spend enormous amounts on loyalty initiatives. Reinartz et al. (2002) reports that the top 16 European retailers collectively spent over a \$1 billion on loyalty programmes in 2000. It may seem in this situation, that challenging existence of consumer loyalty is almost impossible. The empirical research argues though that the implications of loyalty initiatives are varied, and do not necessarily foster commitment among customers. This paper aims to analyse what customer loyalty really is, and why it is important to consider. Specifically it will try to address the reasons for considering loyalty a myth. To do that, the first part will analyse loyalty in a wider context of meanings. Further, the paper will view loyalty in the light of some misconceptions of traditional approach. Finally, the implications for marketers along with recent trends in research will be discussed.

What does loyalty mean?

Indeed, the vast majority of marketers seem to acknowledge “loyalty” as a crucial aspect for company’s performance. According to Reinartz et al. (2002), loyal customers often act as word-of-mouth marketers for companies. Dowling et al. (1997) point at the assumption that loyal customers are less price-sensitive and spend more, when committed to a specific brand/company. Moreover, there is a fundamental belief among marketers that it is cheaper to market to existing loyal customers, than to acquire new ones. Reichheld (1996) particularly reports that bringing in a new customer is 5 times as costly. Despite this unanimous conviction, that loyalty affects company performance, there are continuous debates around the nature of loyalty. Specifically, it is not very clear what exactly loyalty means, how it drives company’s profits, if it does at all, and what in turn, drives this act of commitment. The very first issue that catches attention is the actual definition of loyalty. The common practice among market players implies that an action of repeated purchase of the same product/service or from the same supplier is already potentially a consumer loyalty. According to a more academic approach by Oliver (1999), consumer loyalty is “a deeply held commitment to rebuy ... a preferred

product/service consistently in the future”¹. It is therefore ambiguous whether a repeated purchase or retention can be fully regarded as customer loyalty, or whether a deeper sense like emotional commitment or even devotion should be considered as such. For example, can we consider a routine act of buying bread at the corner shop an act of loyalty to the brand/shop, or is it subject to mere convenience? Indeed, as reported by Seiders et al. (2005), convenience and habit play a major role in determining behaviour in the context. The theory seems to address this ambiguity of meanings by segmenting loyalty into different categories. Broadly, two main categories are traditionally separated: behavioural loyalty indicating the observed action, and attitudinal loyalty, referring to perceptions towards the product/service. Further, some authors refer to other types of loyalty such as polygamous or multiple loyalty, habitual loyalty, price and situational loyalty, emotional loyalty, etc. By doing so the researchers imply, that loyalty is a rather complex mechanism and has various levels. It is worth to note that these levels are often presented in a hierarchical order, where the top level is considered to be the emotional/attitudinal based preference for certain products/services. As Kumar et al. (2006) argue, the customers who are just behaviourally loyal, are inclined to cease the relationship at earliest available opportunity. Thus even if behavioural loyalty (or any low-in-the-hierarchy loyalty) is likely to generate positive cash flows for the company, at some point the company will need to incorporate strategic approach to gaining attitudinal loyalty in order to pursue “sustainably superior profits”². Nonetheless, the majority of companies today still seem to address just the behavioural constituent of loyalty. Accordingly, they design the loyalty schemes in ways that do not seem to work very efficiently. Meller (1993) argues that very few airlines, for example, benefit from the frequent flyer loyalty schemes. The reason might be the fact that many of them still rely on the assumptions of traditional marketing, viewing marketing as a tool to gain, rather than retain customers. It might also be the fact that the companies are simply avoiding the costly process of deeper research into the motivation behind the continuous purchase. Yet to be successful in the highly competitive markets, the companies will need to (1)

¹ Oliver, 1999, p. 36

² Reichheld, 1993, p. 73

challenge traditionally dominant misconceptions about loyalty, and (2) judge customers by more than their actions.

Common misconceptions about loyalty

Loyalty is a direct result of satisfaction. This claim by Heskett et al. (1994) results from the established relationship of the Satisfaction-Loyalty-Profit chain (SPC). The model assumes that higher level of satisfaction leads to greater retention or loyalty. Hence marketers should concentrate their efforts on improving product/service attributes, which mediated by satisfaction, will end in loyalty. The first issue with this approach is the fact that unclear definitions of loyalty seem to create a bias within the model. Particularly, retention and loyalty are used interchangeably, implying that they should be taken as one. What we can observe in practice though, is the fact that not every repurchase is a clear sign of customer commitment. The term repurchase intention, suggested by Zeithaml et al. (2001), might actually be more suitable in terms of a better link with satisfaction. Secondly, the link between loyalty and satisfaction highly depends on the structure of the industry, where the firm operates. It has been reported by Jones et al. (1995) that the industries with high level of competition create many substitutes and low switching costs within brands/products, and customer retention here is more common. Whereas in non-competitive environment the opposite trend can be reported. Thirdly, the empirical research reports that between 65% and 85% of customers who defect, say, that they are satisfied with their former supplier (Reichheld 1993). Hence the traditional view that loyalty arises from satisfaction is rather ambiguous and needs further research.

Loyalty leads to increased profitability. As previously stated, this is the most common belief among both academics and executives. The latter witness that a 5% increase in retention grows the company's profits by 60% by the fifth year (Reichheld 1993). In fact, without accepting that loyalty creates profits, it would probably make little sense to consider loyalty at all. The question here is the risk of taking this statement blindly, ignoring various limitations of it. Specifically, there are two popular frameworks in support of the "loyalty-profitability" link. The "80-20 rule" states, that 80 percent of firm's profitability comes from the 20 percent of the customers. The rule particularly

assumes that these 20 percent are the few loyal customers. It can be concluded then, that slightly increasing loyalty will lead to a greater margin of profitability. A similar approach, which is customer profitability pyramid, is suggested by Zeithaml et al. (2001), who segments customers according to four tiers of profitability, assuming again that the most loyal customers are the most profitable ones. In practice, however, this is not always the case. The “best” 20 percent or the platinum tier is likely to be the competitor’s most profitable customers as well (Dowling et al. 1997). In addition, the link between loyalty and profitability weakens because of the mediating role of costs. Despite, widely held beliefs about cost efficiency of loyal customers, the research conducted by Reinartz et al. (2002) revealed, that loyal customers are actually more expensive to serve and expect to pay lower prices than the rest. Finally, it should be acknowledged that the popular effect of diminishing returns in economics, works here too. This means that marginal retention comes at increasing cost, and increasing retention might eventually be counter-effective (Kumar et al. 2006).

Loyalty can be equally stimulated in all consumers. Traditionally, transaction-based approach has considered marketing a one-way process, where customers are individually unimportant, and their role is passive. It seems to be consistent then to assume, that consumers respond to loyalty initiatives, or otherwise loyalty programmes, in a similar way. However, extensive empirical studies report existence of various moderating factors in the effectiveness of loyalty programmes, individual characteristics being one of them (Liu 2007). Here is where relational marketing steps in, to insure that customer relationship is managed and the retention of idiosyncratic consumers is enhanced. Indeed, the practice shows that consumers act differently, depending, among others, on a wide range of individual characteristics. In some extreme approaches it is even assumed that certain customers never stay loyal to one company (Reichheld 1993). In other situations, so called “polygamous loyalty”, i.e. loyalty for multiple products/services has a place to be. One widely used framework to address the nature of different consumers, introduced by Payne (2000), is the loyalty ladder. The ladder includes seven different natures of customers (ranging from suspects to partners) and their subsequent levels of loyalty. The framework implies that there is a need for managers to investigate in the characteristics of

their consumers to be able to distinguish the most suitable ones among them. Generally, studies report moderating factors to repurchase intentions such as age, customer involvement and income levels. It was discovered for example, that low-involvement customers perceive higher satisfaction and register significantly higher repurchase intentions (Seiders et al. 2005). This apparently corresponds to the Relationship Life Cycle Model, where as the relationship with the customer matures over time, there is inevitable decline in cooperation, hence repurchase intentions. These results might challenge existing perceptions that the longer the customer stays with the company, the more revenue can be generated. It should also be noted, that customers are not homogenous in their value expectations as well. Some customers may cost far more to retain than they are actually worth (West et al. 2006).

Additionally, factors such as convenience, initial usage levels and product types have been reported to play a strong moderating role for loyalty (Dowling et al. 1997, Liu 2007, Seiders et al. 2005). Surprisingly, loyalty programmes are found to be more effective with low initial usage levels by customers. Low-involvement products, accordingly, do not seem to stimulate loyalty, since the customers are not very interested in developing a relationship there. And obviously, the more convenient the experience, the higher loyalty was detected.

What these results indicate is that differences in customer characteristics, as well as situational and relational factors make considerable corrections to the context of loyalty discussions. Customers may be shopping at the nearest supermarket because it is closer, or because the price is suitable or just because they are not curious enough to try other shops. Equally it can be the case, that the supermarket has built a certain relationship with the customers, who end up having feelings for it. Apparently, the loyalty that is a level beyond simple behavioural characteristics is the one that might potentially be the most lasting and profitable. Hence, marketers should consider these findings when designing and implementing their loyalty initiatives.

How to make loyalty real?

According to Dowling et al. (1997) most of the existing loyalty programmes provide customers with benefits at high costs, but ultimately fail to increase brands' value and

positioning. The problem, as it seems, is that most of these initiatives are designed to affect actions of customers, mostly in a short-term perspective, and do not address the underlying motivation of customers' commitment to buy. In this sense, the assumption that loyalty is not a myth should be backed up by a thoughtful and directed to deeper needs of customers loyalty programmes. And if true loyalty is commitment, then question is how to effectively get that commitment.

Kotler (2003) suggests that there are two ways to increase customer loyalty: create high switching barriers, i.e. cost of preferring another supplier, or deliver exceptional levels of customer satisfaction. According to Davies and Chun 2003, loyalty ultimately starts from how employees see their company, which is, in turn, the key to improving how customers perceive it. Thus increasing employee loyalty leads to improved customer loyalty. Firms can also increase loyalty by providing their customers with specific knowledge about how they work. According to Bell and Eisingerich (2007), customers are more likely to spend for the firm that they are acquainted with, than to invest in unknown products/processes. Although Levitt (1980) argues, that better-informed customers are more capable of shopping around, thus switching to competitors' products, he apparently refers to general expertise about the market. Whereas, the firms should concentrate on educating for firm-specific knowledge. The latter, indeed, has chances to lead to lower mobility amongst the customers.

Latest thinking attempts to go beyond established models of customer relationship management (CRM). A model, proposed by Watson (2004), steps further to maintain interaction with customers. The approach emphasizes the effectiveness of loyalty programmes, in case the customer has an opportunity to manage his/her information database, in order to provide the company with the most appropriate one. In other words, when the customer actively interacts with suppliers, the latter have the opportunity to develop effective loyalty initiatives.

Bell (2002) goes beyond sustaining a good relationship with customers, and suggests the term "love" should be included in the context of discussion. The author implies that it is crucial to make the customers love the company, suggesting seven practical steps to do that. Even though the steps can vary and companies might want to discuss the utility of either one, the key takeaway is realising, that emotional ties of the customers with the

firm, will inflame a zealous commitment. Customer love makes a powerful shift towards care, forgiveness, defending the company to others and helpful feedback for the company. In fact, this is a level of devotion that goes beyond traditional meaning of loyalty. Bell (2002) points out that it is that level of devotion, which makes customers gleefully, pay three dollars for cup of Starbucks coffee, even though the price might seem to be exaggerated.

The last, but not the least, it is important that firms consider the cost aspect of CRM and loyalty programmes in particular. Obviously, a high loyalty rate is very desirable, but increasing the marginal retention comes at increasing cost, as already mentioned. Thus, firms should conduct a careful cost-benefit analysis before exercising any scenario discussed above.

Conclusion

The traditional approach to studying customer retention does not seem to support the existence of loyalty, at least of the one that generates profits. Rather, a variety of arguments implies on the need to look deeper into the phenomenon of consumer loyalty. This means that the nature of customers, types of products, structure of the market, situational and other factors have to contribute to the way loyalty is perceived. Companies, that want to build a sustainable competitive advantage, should realise that they deal with a multidimensional construct, beyond simple behavioural actions, and should keep that in mind when designing their loyalty initiatives. Now, is consumer loyalty a myth? Probably not, if we extend our knowledge about consumers to a wider context of personal, situational and relational characteristics.

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