Mismanagement of Customer Loyalty

W. Reinartz & V. Kumar
HBR, July 2002

TakeAway Points
“Mismanagement of Customer Loyalty”
W. Reinartz & V. Kumar, HBR, July 2002

• Half of loyal customers barely generate a profit

• Half of profits from opportunistic customers

• Relationship between loyalty and profitability weaker and more subtle than expected (r ~ .3)

• In general, loyal customers not lower cost, higher paying, or new business-generating
Loyal Customers

- Cost less to serve
- Buy more, pay more
- Recruit more customers

… or so it’s thought

Mismanagement of Customer Loyalty, W. Reinartz & V. Kumar, HBR, July 2002
Cost less to serve?

• Rationale:
  ...Amortize front-end acquisition costs
  ...More self-service with familiarity

• Findings
  ...Amortize over low profit sales
  ...Expect more service (reward for loyalty)
  ...Exploit processes (e.g. easy return policies)
  ...Companies keep promoting to former loyal customers who eventually become unprofitable

*Mismanagement of Customer Loyalty, W. Reinartz & V. Kumar, HBR, July 2002*
Pay higher prices?

• Rationale:
  …Switching costs offset higher prices
  …Examples: credit cards, telecom

• Reality
  …Volume discounts, loyalty specials
  …Savvy buying: recognize values
  …Survey: loyals paid ~ less

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Positive word of mouth?

• More attitudinal than behavioral

• Longevity with company not a predictor

• Often, loyalty more apparent than real … more inertia and convenience

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Managing Loyalty

• Focus on profitability, not revenues

• Event-history modeling:
  …Gear programs to likelihood of continuing purchases, not past behavior

• Loyalty Strategy Matrix:
  …Profitability vs. Longevity

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Loyalty Matrix

<table>
<thead>
<tr>
<th>Profitability</th>
<th>Longevity</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>Transactional</td>
</tr>
<tr>
<td></td>
<td>“Butterflies”</td>
</tr>
<tr>
<td></td>
<td>Pleasantly Milk Them</td>
</tr>
<tr>
<td>Low</td>
<td>“Strangers”</td>
</tr>
<tr>
<td></td>
<td>Max Profit or Avoid</td>
</tr>
</tbody>
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Adapted by KEH based on Mismanagement of Customer Loyalty, W. Reinartz & V. Kumar, HBR, July 2002