

White Paper on Customer Loyalty Metrics

A Three-phase Maturity Model Approach

Abstract

Key metrics for customer loyalty in customer relationship management systems and balanced scorecards should follow a three-phase maturity model to be effective, as each wave of metrics builds on the success and knowledge gained in the prior phase. The initial phase comprises win-loss and customer satisfaction metrics; the second leverages knowledge about client spend, market size, acquisition, retention and cross-selling, and the third, precursors and indicators of true loyalty. The final set of key metrics will be attitudinal in large part, and will enable proactive sales and marketing approaches focused on customer loyalty and customer retention.

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March 2006



The Business Value of Customer Loyalty

Retention Growth Advantage

What if you could increase the value of an average customer 25-100 percent simply by raising customer retention or reducing attrition by five percent? Would you go after a five percent improvement in retention if you knew that *the five percent improvement alone* could double the size of your company in less than 15 years? How would you go about it?

Defections, Margin and Cash Flow

When customer defections occur both cash flow and margins are impacted. Do you know if you are losing a *key account* of high value or a low-value account where your margins are poor? What were the reasons the customer left? Tracking and managing loyalty will help you understand the reasons your customers defect, and how important they are to your bottom line.

Loyalty should not be confused with customer satisfaction. Studies⁽²⁾ have shown that customer satisfaction surveys, while useful, can be a variable predictor of future customer loyalty. Here are some facts:

- 50 percent of your “satisfied” customers and 25 percent of your “very satisfied” customers will do business with your competition.
- 60 to 80 percent of your defecting customers were probably last surveyed as “satisfied” or “very satisfied”.

Both margins and cash flow are adversely impacted by customer defections, as it can cost five to ten times more to acquire new customers than it is to retain existing customers. Most important, customer defection is a clear statement about the value your company is delivering.

Employee Loyalty and Customer Value

Every employee contact with a customer becomes a “moment of truth” which improves or degrades the customer relationship. Surveys⁽²⁾ have shown a direct correlation between employee loyalty to the company, and customer loyalty. Here are some key points:

- Only 24 percent of employees were truly loyal, committed to the company and planning to stay with the business at least two more years.
- 72 percent of employees were not planning to stay, or were not committed to the employer (i.e., they felt trapped.)

Loyal employees are a major source of customer referrals. This is especially true in business consulting, professional services and consumer service businesses. Loyal employees are also better selectors of new customers, leading to greater long-term customer value to the business. Lower employee turnover also reduces hiring and training costs, frees up investment dollars and improves margins.

A Phased Approach to Tracking and Managing Customer Loyalty

Building customer loyalty requires that you know your customers and your business. The starting point (or first phase) is to gather knowledge at the transactional level, which includes information from engagements, contracts, customers and competitors. The second phase is to analyze and leverage this transactional information. The third phase is to examine customer attitudes and loyalty (i.e., emotional loyalty) with a focus on predictors for customer loyalty.

Maturity Model for Customer Loyalty Metrics

Phase 1 – Transactional Loyalty
(Win-Loss, Customer Satisfaction & Competitive Pressure)

Phase 2 – Opportunity Index and Value Index

Phase 3 – Emotional Loyalty
(Attitudes and Predictors for Customer Loyalty)

Where to Get Started

Knowledge about customer value is derived from interaction / transaction history, which may be stored in a customer relationship management (CRM) system that offers a unified / single view of the customer. If your organization currently does not have a CRM system, you can extract data from back-office applications and input from different parts of the organization.

This process requires collecting, cleansing, enhancing, massaging and analyzing the data, and can often be done with a small relational database, especially if the initial work is completed by a small group or project team. Some of this work may well be discarded as you learn more about your customers, so it is important to avoid over-investing to get started.

Initial data extracts for customers, contracts, products/services, orders/engagements and bookings should be obtained and fed into a relational database for manipulation. If you have multiple sources for these data feeds, then you will want to create temporary “master lists” for customers and products/services before continuing.

Customer revenue is often realized over time, following an order or a signed license agreement of a signed engagement contract. Both the total value of the order/engagement and the revenue per quarter are useful in analysis when developing customer value indexes, so consider spreading revenue over time for up-front payments, but also retain the total transaction amount.

Phase 1 – Transaction Loyalty

Phase 1 is primarily to assess why the customers do business with your company and how often it loses to the competition. In gathering knowledge of its customers, your organization will want to know

- **Who are my customers?**
(Industry, turnover, employees, needs)
- **How often and how much do they buy?**
(Recency, frequency, span (how long a customer), depth (share of spend))
- **What is a “typical” engagement or sale?**
(Revenue, expense, margin, time, resources, value delivered, value to company)
- **Who is my competition?**
(Traditional competitors, new competitors, competitive intensity)
- **Why do we win?**
(Why do we lose?)

The key metrics are

- Win / Loss Rates
- Win / Loss Reason Codes
- Transaction Frequency
- Transaction Value
- Estimated Percent of Total Spend
- Competition

If your organization has a sales force automation tool or CRM system, then it has what it needs for win-loss tracking. The goal is not only to measure wins and losses, but also to understand customer buying behavior. Once you know why customers buy, it becomes easy to determine the value of each purchase criteria and a rough estimate of the value your products and services bring to the customer.

The competitive view is also highly useful – why does your competition win sometimes? Is a competitive win a permanent loss of the customer, or are customers shopping around on a regular basis? Knowing *who* your competitors are and *why* they win will enable your business to manage and grow your competitive advantage over time.

Win-Loss Process Description

Briefly, following are two approaches to win-loss analysis.

1. Simple Flags

Opportunity record comprises three fields for win-loss: Status, Reason Code & Competitor.

- **Status** is the overall opportunity status (Active, On Hold, Closed-Win, Closed-Loss). Do not confuse opportunity status with Sales Stage.

- **Reason Code** is the single primary pick for Win or Loss. The field becomes mandatory if the Status changes to Closed-Win or Closed-Loss.
- **Competitor** is a simple list of known competitors. This is an optional field.

2. Flags with a Follow-up Survey

1. Win-Loss data from opportunity records is collected in the CRM system (as described in the Simple Flags approach.)
2. Wins and losses are extracted for use in follow-up surveys.
 - Surveys can go to *internal sources* – examples would be engagement managers, account executives and relationship managers.
 OR
 - Surveys can go to *customers* – decision makers, key contacts, etc.
3. Surveys are conducted by email or via an interview questionnaire.
4. Survey results are gathered and analyzed.

Sample Reason Codes

- | | |
|-------------------------------------|--------------------------|
| • Reference / Referral | • Product Features |
| • Overall Value | • Quality & Reliability |
| • Time-to-Value (speed) | • Overall Relationship |
| • Price or Performance | • Ease of Doing Business |
| • Satisfaction with Last Engagement | • Customer Support |

The Reason Codes chosen by your organization should reflect business priorities and customer characteristics. If customer satisfaction is measured by the survey, results over time should be tracked so that current and future satisfaction scores can be compared.

Customer Data Enhancement

Various services (similar to Dun&Bradstreet or Acxiom) can be leveraged to augment customer information with details of location, annual sales, employees, overall growth rate, etc. Industry sector is especially valuable if your organization has a vertical go-to-market strategy.

Reporting on Phase 1 Transaction Loyalty Metrics

Sample trend lines and metrics for reporting on a monthly and quarterly basis include:

- Win Rate, Revenue Won
- Top 20 Wins, Top 20 Losses by Engagement / Opportunity Revenue
- Primary Win Reason Codes
- Primary Loss Reason Codes
- Top 10 Competitors and Revenue Lost to Competitors
- Average deal size

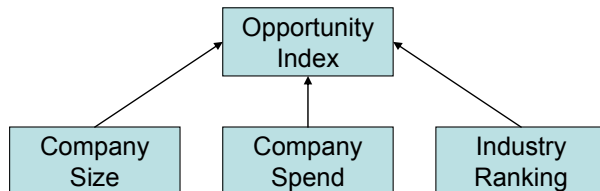
Metrics can be added that track number of transactions over time. Also, if your organization tracks estimated total customer spend on a given business problem, then you can also calculate your percentage share of that total spend.

Phase 2 – Opportunity Index and Value Index

The second phase of developing customer loyalty metrics is to determine the magnitude of the customer opportunity and value by creating Opportunity and Value Indexes; each having a unique definition appropriate for your business and customers.

Opportunity Index

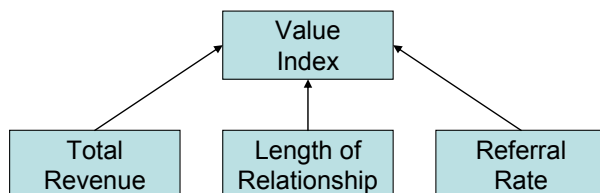
As the name suggests, the Opportunity Index is a blended value derived from several measurements. Below is a framework for thinking about the Opportunity Index.



The Opportunity Index allows your organization to gauge the potential value of non-customers and customers, and is an important component of the overall Customer Value Index. The metrics can be obtained fairly easily from third-party data sources. Other attributes may be important in calculating your unique Opportunity Index, and a simple percentage weighting of the components in the index is an easy way to get started (e.g. 25 percent on company size, 50 percent on estimated company spend, 25 percent on industry rank). Estimating the total company spend on the types of services and products you provide may require some creativity and research.

Value Index

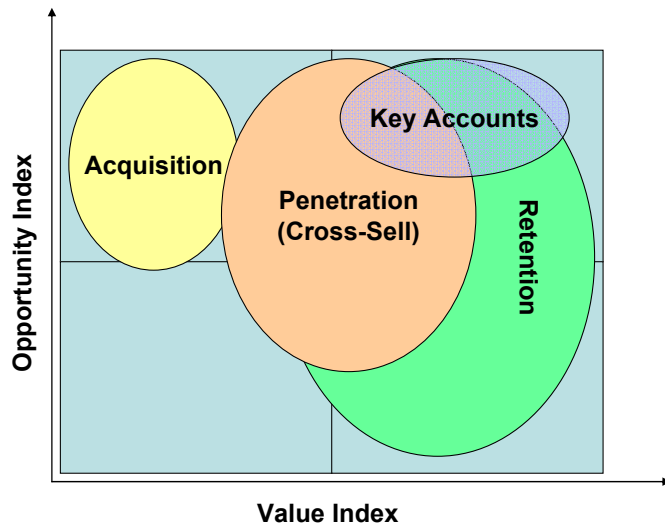
The Customer Value Index is a measure of the current value of existing customers to your business. Sample factors are provided in the following diagram.



Your company receives value from each of these areas – revenues, ongoing relationship (ease of next win), and referral rates. As with the Opportunity Index, you may have an assortment of other key inputs to how you want to include in the Value Index.

Leveraging Opportunity and Value Indexes to Target Resources and Actions

Used together, the opportunity and value numbers can be used to define target areas for specific actions of high value to your business. The next step is to examine acquisition, penetration and retention. While retention has highest synergy with customer loyalty, careful acquisition and regular cross-sell / up-sell (penetration) of your customers is also important to building high, lasting customer loyalty.



Acquisition

Acquisition offers high opportunity value (potential value, mostly with non-customers), but little to no current value (small revenue, short history, no referrals). All customer accounts should be treated as acquisition accounts.

Penetration

For most companies, the largest market opportunity lies in cross-selling to existing customers (additional services, repeat business, new offerings, etc.) Growth in revenue from cross-selling drives an increase in the Value Index.

Retention

Here we have the most valuable customers, with the top portion of the Retention and Penetration circles probably comprising the majority of the “Key Accounts”. This is not to say that retention of all customers is not important; rather, this is a statement of the primary approach to the customer.

When Phase 1 and Phase 2 have been implemented successfully, your organization will have a solid understanding of why it wins, when it loses, and to whom it loses. You will also see customer transactions in the larger context of an overall customer and market strategy around acquisition, penetration and retention where customer opportunity and value are important variables for where your organization prioritizes resources, programs and metrics.

Reporting on Phase 2 Opportunity & Value Loyalty Metrics

Sample trend lines and metrics for reporting on a monthly and quarterly basis include

- Acquisition – number and quality (opportunity size) of new wins
- Penetration – cross-sell rate, and average cross-sell size
- Retention – customers defecting, number of win-backs, number of references
- Key Account Metrics – deals, wins, losses, retention & defection, avg. deal size

Phase 3 – Emotional Loyalty

Customers who take a personal stake in your company’s success are described as being emotionally attached⁽³⁾ and offer the highest levels of loyalty. In Phase 3, your organization examines the attitudinal or emotional aspects of loyalty; early indicators of loyalty growth or erosion that requires action, and refined detail around customer value.

Key questions for this phase are

- What are the drivers of loyalty and defection?
- What are the attributes of my most loyal customers?
- What are the primary reasons why we lose business and customers?
- How can we avoid acquiring or retaining unprofitable customers?

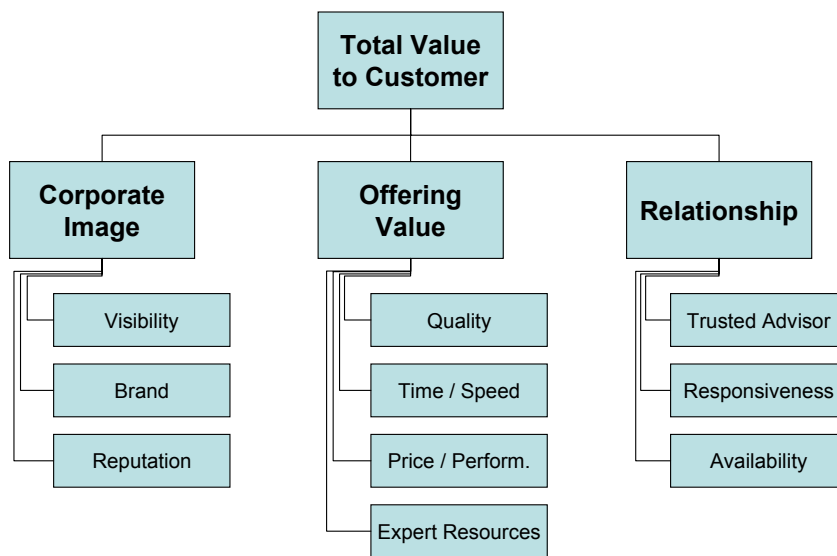
Key metrics include

- Customer Churn (Turnover) Rates
- Number of Customers in a Loyalty Segmentation Model
- Number of Customers moving *Up* the Loyalty Segmentation
- Number of Customers moving *Down* the Loyalty Segmentation

Predictors of Churn (potential for upcoming defection) include

- Speed of Approvals (for proposals and contracts)
- Management Access and Visibility (in general)
- Quantity of Customer Data (if it slows down over time)
- Short-term versus Long-term Future Project Plans and Discussions
- Reduction in Project scope
- Reduction in Customer Spend rate

Below is a generic model⁽¹⁾ for understanding total customer value.



Total Customer Value and Customer Defections

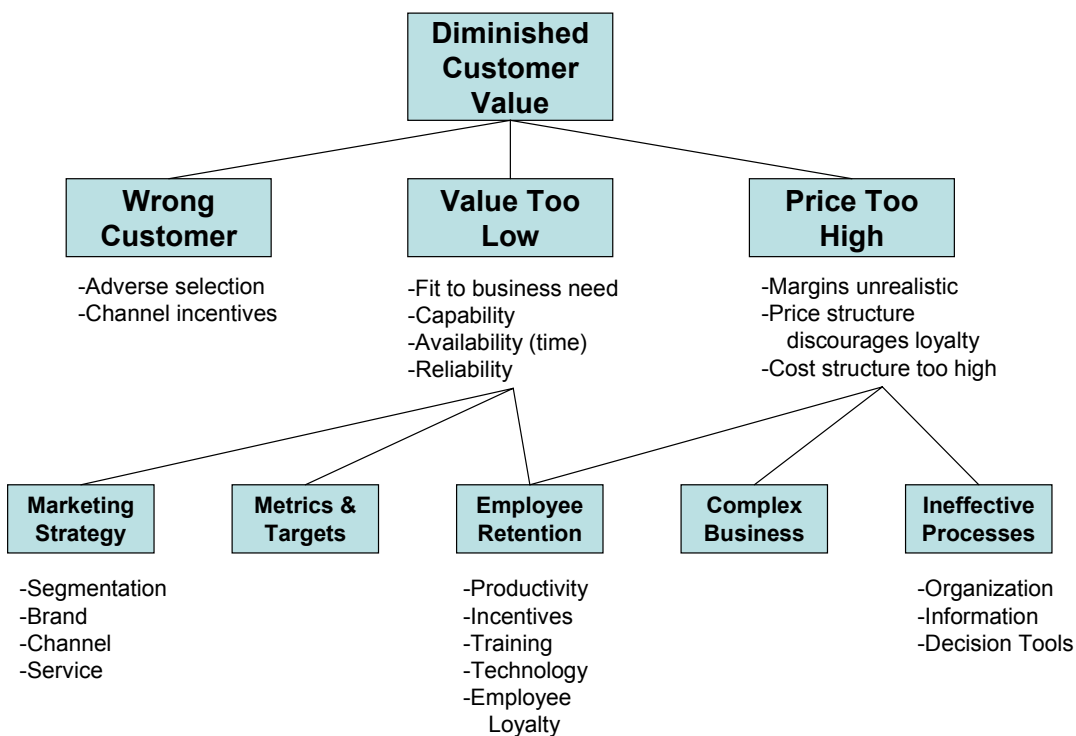
Churn is a key metric because it captures failure in two critical areas, in that a defection

- Reflects a breakdown in the Total Value Delivered to the Customer.
- Lowers Customer Value because of reduced cash flows from the customer.

The loss of the customer is an opportunity to understand the root causes of failure and implement changes or actions within the business.

Indicators of Future Churn or Defection

Segmenting your customers by value and loyalty can be very helpful in identifying and then acting on changes in customer loyalty. As a customer moves up and down the loyalty scale, they will at some point transition from one loyalty segment to another. The change in segment status can be used to trigger specific actions (marketing, sales, executive calls, etc.) which are designed to understand the root causes for the segment shift. A generic root cause analysis model⁽²⁾ is provided below.



Defection Triggers

A recent survey⁽⁴⁾ found that over 80 percent of actual defections were “triggered” by a specific event which created an emotional response, leading the customer to exit the business relationship. Over 40 percent of defecting customers cited a failure to manage the customer relationship properly, and 30 percent cited a misalignment in price and value which caused them feel they were not treated fairly.

Understanding defection triggers and the primary types of attitudes or emotional triggers which occur in your customer relationships will be highly valuable in completing your root cause analysis and predictive capabilities.

Remember that very small percentages of customers will take the time to call and complain – over 90 percent will not call and openly state the issue, giving you the opportunity to resolve the root causes in a timely manner to salvage the relationship. Consequently, additional indicators and predictors for churn or defection are necessary if you want to be proactive in retaining customer loyalty.

Loyalty Programs

Below are the results of a recent survey⁽⁴⁾ on planned loyalty program spending. Results for both leaders in loyalty management and “non-leaders” are presented. Over \$4 billion a year is spent on loyalty programs in the USA. It is essential to determine what your company will spend to maximize the loyalty and future value of your customer base.

Top loyalty program spending areas as a percentage of respondents:

Percentage of Respondents	Planned Loyalty Program Spending Areas
Over 80%	Customer satisfaction research
Over 70%	Attitudinal surveys on customer loyalty
Over 60%	Loyalty scoring and tracking
Over 55%	Retention monitoring
Over 50%	Proactive loyalty marketing programs
Over 40%	Customer churn modeling

Final Note on Loyalty Metrics and CRM Systems

A strategic and structured approach to customer relationship and loyalty management are essential to making your business strategy operational and can result in a significant competitive advantage.

Following are critical steps in building a customer relationship management system that will enable you to develop and retain customer loyalty.

- ***Invest in creating a single, shared view of the customer***
Customer visibility across all touch points, engagements and transactions is a powerful tool for your business. Efforts spent searching for data and driving consensus on action plans can be quickly turned into analysis time to create new realizations about your customer and your business performance. A single view creates the opportunity to manage the customer experience.
- ***Optimize sales and marketing efforts with customer analysis***
Segmenting your customers and non-customers, focusing your resources and tracking business outcomes can improve your margins and revenue without incurring expense growth. A “point and shoot” targeting approach in your marketing efforts will deliver significantly higher value than traditional “spray and pray” efforts which communicate a common message to everyone.
- ***Track the propensity to defect, and take targeted actions***
Tying an Opportunity Index and Customer Value Index to predictors of churn will give your business the call-to-action necessary to be proactive with loyalty. Reductions in attrition/defection will significantly improve your cash flow and margins. Happier customers will provide better and more frequent referrals and references. Customer emotional investment in your business success is like adding a sales channel every time you add a highly loyal customer.
- ***Include employee loyalty in your loyalty metrics, and tie customer loyalty to employee incentives***
Research has shown that loyal employees lead to loyal customers. Invest in metrics, surveys and incentives with your employees to understand and monitor their loyalty as one additional predictor of customer loyalty. Tying a portion of employee incentive compensation to customer loyalty metrics *while also surveying and acting* on employee loyalty action areas will create high assurance in staff that executive management is “acting and not just talking.”
- ***Take a phased approach to implementing loyalty metrics***
Understand your business and customers first (Phase 1), before creating market and customer value indexes (Phase 2), before finally implementing attitudinal and emotional loyalty predictors (Phase 3).

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