

## **Managing Based on Facts, Not Faith**

**Timothy Keiningham and Lerzan Aksoy**

Loyalty is the right strategy in all aspects of our economic lives: as employees, as customers, as managers, and as business owners. And by right, we mean that it tangibly maximizes value—emotional and economic. But all too often the justification for a business's loyalty strategy is shaky at best.

After hearing numerous complaints from managers that their loyalty initiatives were not living up to expectations—that their investments just weren't paying off—we conducted an extensive investigation into some of the most commonly held beliefs about customer loyalty. Shockingly, our research found that virtually everything we believe about loyalty is either a gross oversimplification or patently false.

For example, in examining the oft-repeated claim about the benefits of retaining current customers over the costs of attracting new ones, we uncovered big flaws. First, customers are presumed to grow more profitable over time. Unfortunately, the reality is that unprofitable customers tend to come in that way, and stay unprofitable. And profitable customers tend to do the same. The reason we want to believe this myth is that average profitability tends to increase with customer tenure. The problem with the implied causality, however, is that unprofitable customers tend to be much more likely to defect, meaning there are fewer of them with each successive year of customer tenure.

The big question that we as managers need to confront is “Why are such patently false promises widely accepted as true?” Why do professional managers treat certain claims as “scripture” when experience and data show otherwise? In our view, the answer has to do with both how managers relate to problems and where they seek advice. We let our own biases get in the way of genuine insights, we tend to follow gurus without questioning whether it's the right strategy for us, and we seek simple solutions to complex problems.

A loyalty strategy can be a highly profitable strategy, but not by clinging to the myths that have surrounded the idea. Typically only 20% of a firm's customers are actually profitable. And many—often most—of a company's profitable customers are not loyal. The place to begin any loyalty strategy is to determine which loyal customers are profitable and which are not.

We need to understand what differentiates Profitable Loyals from their unprofitable counterparts. Profitable loyal customers are almost always driven by differentiating aspects of our product or service offering. The key to a successful loyalty strategy is to become crystal clear as to what these are, and to focus on tangibly improving these elements.

This is the core of a financially successful and mutually beneficial loyalty strategy. While it isn't the quick fix that the myths of loyalty promise to the bottom line, it is no less

significant in its ultimate impact. And by focusing on Profitable Loyalty, the benefits actually materialize.

**About the Authors**

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