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Lucrative Loyalty: Know Your Customers' Lifetime Value

A conversation with Tim Keiningham, Senior Vice President and Head Consultant

Q. After the success of the provocative book Loyalty Myths, *what do you see as the most important trend in loyalty right now?*

Tim: *Loyalty Myths* quashed the notion that loyal customers are profitable customers, and that was a bitter pill for many people to swallow. Once they actually recognized that there are customers that are unprofitable, customers that break even, and customers that make the company money, the newest trend has become this identification of customer profitability: And not just current customer profitability, but customer lifetime value. Past profitability may or may not be a good predictor of future profitability, depending on the industry you're in. I don't mean lifetime value in the sense of forever either, but in a managerial lifetime, say three to five years.

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Q. Tell me more about customer lifetime value.

Tim: There are many different ways to measure customer lifetime value. It's still a very new concept. Academic literature says the lifetime value of a customer is over the individual's lifetime. But that's hard to predict.

What we're talking about is how customers purchase from us, what it costs us to bring them in, and what it costs us to keep them. It's the net value of the customer, but over a reasonable time horizon. We look at the revenue stream versus cost and determine the value of the customer over the next three, four, or five years, so we have an idea of who to focus on and which customers a company cannot afford to lose.

Q. And how do you advise companies to incorporate customer lifetime value into their businesses?

Tim: Lifetime value is one component for segmenting customers. We usually segment customers by demographic and psychographic characteristics, but the share of business is probably the ultimate behavioral measure of loyalty. We now know that most customers in most categories hold – for lack of a better word – polygamous loyalty. They're loyal to a group of brands. What we'd like to know is where customers are in terms of their profitability.

Imagine creating a two-by-two grid with customer profitability on the y-axis, and customers' share of wallet on the x-axis. We'd see that many customers are unprofitable, but that many unprofitable customers are also giving the company a low share of their business. Are they unprofitable because they're giving a low share of their business? Is it possible to make them more profitable simply by having them consolidate more of their purchases with the company? What are the attitudinal components that help us make them want to consolidate more of their business with the company? Companies need to make sure that all of their marketing activities – all of their activities that also enhance the relationship with the customer – are based on these measures. That is, sustaining profitability while satisfying customer needs and wants.

Q. Can you give us an example of a success story?

Tim: A large financial services company we work with segmented their customers by their relationships, and offered them services based on the revenue they provided. But we showed them how many of their highest share customers were unprofitable. So, it's not strictly a loyalty issue anymore. The marketing question is not about enhancing the relationship, because the customer is already giving the client a ton of business, it is about enhancing the profitability.

Since it was a business-to-business environment, our advice was quite clear: Either find a way to make the customer pay more for the services, or demonstrate to the customer that they need to be served a different way; that is, a more cost-effective way. The company's solution was to meet with their customers face-to-face, and tell them that despite the amount of business they were doing, the company was losing money by servicing them. They were told either they'd have to pay more for certain components of their service or the client was going to have to drop them from their service. The customers almost uniformly said they didn't want certain "extra" services. But three months later, almost all of them decided they had to have those services and that they were willing to pay for them.

Not only did it enhance the profitability, but it also demonstrated the value of the services to the customer. The company's customer satisfaction and loyalty scores went up, because even though their customers were paying more, they also knew that they were getting more.

Q. What makes Ipsos Loyalty unique?

Tim: There are a lot of things that make Ipsos Loyalty unique. Our combination of leading-edge thinking with practical, real-world-tested applications is the most significant factor. Ipsos is clearly driving much of the new ideas in the field, both in academia and in practice. Another thing that's unique about us is that our senior management is hands-on; we're interested in finding solutions, and our management team is involved in all aspects of the project. Finally, we're truly a global firm. If you want a global solution, there are only a few firms that can do this well and apply the loyalty strategies across countries and across cultures; Ipsos is one of the very few that can do this well.

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