CHAPTER ONE

Blinded by Delight: The Truth about Customer Loyalty

I[1] was sitting in my office when the phone rang. David Perkins, a product manager for Genentech whom I had met a few months earlier after a talk I gave at a customer loyalty forum, greeted me. David managed Protropin, a synthetic human growth hormone. Protropin effectively prevented severe growth retardation of individuals with genetic growth hormone deficiency (GHd). Pediatricians used this miracle drug, introduced by Genentech in 1985, to treat roughly 1,000 children born each year with GHd.

Biotechnology, the use of biological systems—or living organisms—to make or develop products, has served humanity since the dawn of civilization. Beer, bread, and the kosher dill pickle all exemplify biotechnological products. However, the development of gene-splicing technology in the 1970s moved biotechnology to the forefront of a movement that revolutionized medical practice. Genentech won an early victory in that revolution by developing a method for synthesizing insulin. Synthetic insulin production proved more cost-efficient and more reliable as an alternative to the traditional method of extracting insulin from the pancreata of slaughtered animals.

Profits from licensing the manufacture of synthetic insulin to Eli Lilly and Company enabled Genentech to bring their first biotech drug to market: Protropin. Until the introduction of Protropin, all medically useful human growth hormone had come from cadavers. Protropin enabled Genentech to corner the market on human growth hormone almost immediately.

David did not sound good on the phone. Protropin had run into trouble.

Due to the wording in a licensing agreement, the market for Protropin had opened to competition long before Genentech's patent on Protropin expired. Genentech's market share ebbed as competing pharma companies took advantage of the lapse. At the time David called me, Protropin's share of market had plummeted from monopoly to 43 percent.

David had received an ultimatum: Improve market share or the company would exit the market and redeploy their assets. David feared he might become one of the redeployed assets. He told me that he felt my approach to generating customer loyalty might give Genentech a shot at recovering market share. He reasoned that since no chemical distinction existed between Protropin and its generic competitors, Genentech needed to find ways to distinguish itself in the realm of customer service.

David and I began to work on generating customer loyalty for Protropin. Within a year, Protropin's market share improved by 13 percent. This turnaround especially impressed senior management since it followed six years of steady decline. Revenues from Protropin, which had flattened in an expanding market, began to grow at 10 percent a year. Genentech once again secured its place as a leader in the biotechnology industry. David eventually got redeployed within Genentech, but on the coattails of a rising star, rather than one going in the opposite direction.

How did Protropin's turnaround happen? I'll tell you at the end of this chapter. But first, I want to give you an overview of what it means to generate loyalty in customers.

Satisfaction: Necessary but Insufficient

It has taken me 20 years to wade through all the myths, misperceptions, and misunderstandings about what constitutes and what creates customer loyalty. Let me define what I mean by customer loyalty. Here is a simple, easy to observe definition of customer loyalty:

> Loyal customers consistently give your business preference over all other competitors.

While a lot of complexity exists around predicting human behavior, it helps to have a clear definition of what customer loyalty actually means. Loyal customers will go out of their way to trade with your company in preference to trading with any other similar business. If a customer shows no particular preference for trading with you over your competitors, you cannot consider that customer loyal.

I have come to three conclusions about what it takes to make loyal customers. I reached these conclusions as a result of work I have done helping scores of companies understand how customer satisfaction translates into customer loyalty.

First conclusion: A strong causal link exists between high customer satisfaction and customer loyalty. Individuals who rate themselves as Highly Satisfied Customers on our customer satisfaction surveys become demonstrably loyal customers. What 20 years of research has taught me is that *only* Highly

Satisfied Customers become loyal in any measurable way. Highly Satisfied Customers exhibit much higher frequency of use, higher ticket price averages, and more frequent repurchase intent than do other kinds of customers. Highly Satisfied Customers drive a business's success. Satisfied customers, while important to a business's overall turnover, remain free agents when it comes to purchasing and repurchasing behavior.

Second conclusion: High customer satisfaction has little to do with delight. Rather, high customer satisfaction results from dependably delivering what customers expect. Dependability reduces the perceived risks of transaction for customers who deal with your business when they compare their experiences with you to experiences they have with similar businesses.

We tend to think of "risk" in terms of severe bodily harm or peril. In the commercial world, however, every transaction holds the risk of potential dissatisfaction. Risk simply translates into the potential for disappointment:

- Will the product I purchase deliver the benefits I want?
- Will I be able to complete the transaction in the time I've allotted?
- If I buy the wrong product, will they take it back?
- Can I count on someone to help me find the product I want to buy?
- Will someone show me how to use this product, or will I end up having to figure it out by myself?

All commercial transactions are fraught with transactional and performance risks. There are no exceptions. One can generate a very long list of things that might cause a customer to become less than satisfied with any kind of commercial transaction. Transactional risks represent the commercial equivalent of a high-wire act. A misstep can result in a very shaky experience. Or a misstep can result in a cataclysmic outcome.

Businesses that generate customer loyalty stamp out the risks most likely to affect customers by providing customers with complete surety that they can predict the outcome of every single transaction. While companies sometimes confuse heroic efforts to deliver customer benefits with behavior that creates customer loyalty, heroism does not translate into loyalty. Tales of heroism sound good in retelling. But heroism proves difficult to achieve from day to day. Loyalty comes from customers who consistently experience satisfaction from everyday interactions between buyer and seller.

Third conclusion: Consistently reducing risk for buyers requires an institutional imperative. Companies do not earn customer loyalty as a result of any one initiative, any one program, or any one act. Fancy product features alone do not bestow loyalty. Loyalty programs do not capture loyalty. CEOs do not engender customer loyalty, regardless of their charisma quotient.

Neither Apple, Starbucks, nor the McDonald's Corporation grew fanatically loyal customers merely because the iPod has great functionality, your tenth Venti Macchiato comes free, or they serve french fries that are a challenge to stop eating. Companies can only earn loyalty over time by consistently delivering what matters most to their customers: satisfaction. Apple, Starbucks, and McDonald's have made delivering consistent customer satisfaction their institutional imperatives—if not their religions—from product conceptualization through buyer enjoyment.

Once you accept the principles of what makes customers loyal, the prescription for measuring, generating, and profiting from customer loyalty becomes straightforward. You need to discover where satisfied customers perceive risk in their relationships with your company. You then need to objectively, systematically, and energetically get rid of each and every one of those risks. Make no exceptions. Take out all the customer-perceived risks.

Building customer loyalty demands the elimination of all perceived transaction-related risks. Notice that I did not say, "reduce." I said—and I meant—"eliminate."

If you want to generate customer loyalty, you must align your entire organization to totally, completely, utterly get rid of the risks customers perceive in doing business with your enterprise. You need to wipe out the chances that satisfied customers ever experience disappointment with what you do or what you sell. No exceptions.

Mere Satisfaction Does Not Matter

The relationship between satisfaction and loyalty is not linear. If you do not generate Highly Satisfied Customers, you cannot generate customer loyalty. Most business people find this a difficult reality to embrace. Perhaps one can accept it at a cognitive level. But at a gut level, it just seems *wrong*.

Please understand: Satisfied customers may not harbor any particularly negative feelings or actual ill will toward your business. But the purchasing behaviors of satisfied customers do not differ enough from customers who express indifference to your products and services to warrant any distinction. In this respect, the occasional undercooked pizza can become nearly as toxic for a commercial relationship as the pizza that gives you the trots. No pizza-eating customer who receives either slice will ever return to that pizza shop.

I will explain how this phenomenon applies across a broad spectrum of businesses through case studies presented in the chapters that follow. However, until you identify the link between customer satisfaction and consistency of experience in your own business, you will most likely cling to your doubts. I therefore encourage you to use the customer surveys you conduct to test our theory.

Analyze the data. Correlate satisfaction scores with repeat business and revenues per customer. I have full confidence that you will see that your repeat business correlates highly with customers who report themselves as Highly Satisfied Customers. You will also see that there is little difference in repeat purchasing between customers who report themselves satisfied with your offerings and customers who report themselves as less than satisfied. I have yet to encounter a company whose customer base did not reconfirm this relationship. Once you see for yourself the relationship between satisfaction scores and loyalty behaviors, you will become convinced that only Highly Satisfied Customers merit treatment as loyal customers.

Loyalty Programs Do Not Generate Loyalty

Customer loyalty programs have become another common but misdirected effort to garner customer loyalty. Customer loyalty programs generally consist of incentive programs that offer customers rewards, usually in the form of redeemable points, in exchange for patronage. The most common examples are credit cards with purchasing points or airline mileage points for additional travel. One typically redeems points earned for rebates, goods and services, or anything else that qualifies under the loyalty program.

Here's our bottom line on such loyalty programs: They do not create loyalty. Further, they often lead to confusion and suspicion. So-called loyalty programs are a misappropriation of the word loyalty. Instead of calling such programs "loyalty programs," we suggest calling them "fealty programs." Fealty is what the warlords of old required of their subjects in exchange for physical protection and economic benefits.

Real customer loyalty arises from a profound belief held by Highly Satisfied Customers that the companies to which they entrust their custom will not disappoint them. In contrast, fealty programs may shift spending among comparable competitors, but they do not generate loyalty. Customers who subscribe to loyalty programs direct their trade toward companies that have made them a conditional promise. The promise looks like this: *If* you give me a certain amount of business, *then and only then* I will give you a post-transaction reward for having done so.

Grahame R. Dowling and Mark Uncles provided some convincing empirical evidence that loyalty programs do not work to generate loyalty. In their study, "Do Loyalty Programs Work?,"[2] they concluded, "Most schemes do not fundamentally alter market structure." They further concluded that the loyalty programs they studied might help to preserve share among incumbents in an industry, but that they did so by increasing the cost of marketing spending.

While Dowling and Uncles did not completely condemn loyalty programs, their research highlights a number of the pitfalls I have come to associate with such programs. The main problem with loyalty programs is that they neither increase primary demand nor do they improve marketing efficiency. In other words, loyalty programs reduce industry profits and they do little to change the distribution of customer spending.

Linking Consistent Satisfaction and Loyalty

In speculating about what makes customers loyal, you can easily make the mistake of believing you understand the relationship between how people feel and how they act. Logic dictates that increasing customer satisfaction—better feelings—should lead to increasing levels of customer loyalty—more purchasing. The more customer satisfaction increases, the more customer loyalty should increase. Build customer satisfaction and you build customer loyalty. That just seems obvious, right?

However, loyalty does not work that way. Increasing customer satisfaction does next to nothing to increase customer loyalty until *your customers become Highly Satisfied Customers*. This means you must achieve satisfaction ratings of 5 out of 5 for every factor that matters to your satisfied customers. In fact, customers who rate their satisfaction levels as 4 on a 5-point scale are not only less loyal than Highly Satisfied Customers, they are not loyal by any definition.

A colleague at the Xerox Corporation once disclosed to me that "There is a greater likelihood of someone walking in off the street to buy a paper copier than of us getting an existing 'satisfied' customer to repurchase from us."

I told him I did not believe it. My Xerox insider had the data to back up his claim. His data indicated that Xerox experienced a 15 percent likelihood that somebody who walked into a showroom would buy a copier. The likelihood that a customer who self-identified as merely satisfied would repurchase was 10 percent. Back in the day, a casual walk-in to a Xerox store showed more inclination to buy a copier than existing satisfied Xerox customers.

The data also indicated another anomaly: Highly Satisfied Customers registered an 80 percent likelihood of repurchase. Satisfied customers recorded a mere 10 percent likelihood of repurchase. That stunning difference really made me wonder what distinguishes satisfied customers from Highly Satisfied Customers. What created that huge gap in loyalty behavior?

Remove the Negative to Create the Positive

Most customer loyalty literature accentuates the positive: customer delight. Make the customer happy. Even better, make the customer deliriously happy. Then throw in heroism, givebacks, and whatever other gimmicks you can conjure. In other words, most customer loyalty literature offers up loyalty as a product of positive affect: good, good, good vibrations. The underlying assumption is that when people feel good about you, they become loyal to you.

This sunny approach presents only part of the story, and in many ways it results in focusing on the wrong factors. It emphasizes happiness over all other factors. It's a nice theory. But it's mostly wishful thinking.

Loyalty also has a component of negative affect. Slight unhappiness leads to major gaps in loyalty. Your loyal customers feel no sense of unhappiness with you or with what they purchase from you. Further, your loyal customers perceive no possibility for becoming unhappy with you. That's a bit baffling. Yet, good psychological reasons exist for this seemingly quirky truth. We'll explain those as best we can in the pages that follow.

In statistical terms, we consistently see from customer satisfaction survey data that the presence of loyalty correlates to the absence of risk. We also see that businesspeople have trouble believing that satisfied customers are anything less than Highly Satisfied Customers who are just too shy to say it. Nobody wants to admit to inconsistency.

Admitting risk has negative connotations. Businesspeople don't like seeing their businesses as risky. Still, it comes down to this: You can add in all the positive stuff you hope will generate customer loyalty—give your customers all the love you feel it takes—but if you fail to take away the risks customers associate with your business, then you are not going to generate true customer loyalty. This book emphasizes the importance of taking out the risks that get in the way of making generally satisfied customers into avidly loyal customers. Or in other words, converting satisfied customers into Highly Satisfied Customers.

Readers of this book will probably agree with us that "loyalty is a good thing." You might also agree that it takes hard work to earn customer loyalty. Yet, only the rare businessperson will confess, "My business is fraught with risks for those customers who want to buy from me." What you need to understand is that occasional mess-ups create—in the minds of customers—the possibility that the next interaction they have with you will also become messed up. Therefore, in the minds of your customers, *your business is fraught with the risk that you will fail to deliver exactly what they want.*

Rational people steer around avoidable risks. A satisfied customer perceives risk. A Highly Satisfied Customer no longer perceives the risk of dealing with your business. Highly Satisfied Customers believe, often with evangelical fervor, that the commercial interaction—whatever form it may take—will unfold exactly as expected, and that if something goes awry the organization will do absolutely whatever it takes to make amends. Customers who make the leap from 4s to 5s on the customer satisfaction scale not only feel better about you, they also feel more loyal to you. And once achieved, loyalty greatly increases the level of customer engagement with your company. Translation: Loyal customers make you more money than casual customers.

Consistency: The Real Link between Customer Loyalty and Profitability

The relationship between satisfaction and loyalty turns out to be simple to state and complicated to achieve. Customer loyalty is a function of two sets of interacting factors:

1. How well you satisfy customer needs.
2. How consistently you eliminate the risks customers experience in dealing with your business.

We define this as a risk-free relationship. You need to understand how you can take the risk out of your business, so you can convert more satisfied customers into loyal customers. Once you understand what risks customers perceive, and you begin to take those risks out, you will not only bring more customers in, you will:

- Keep more of the customers you attract.
- Sell them more of the goods and services you offer.
- Get them to pay price premiums for your goods and services.
- Help them trade up to better products.
- Change customer behaviors to lower the cost of serving them while improving your effectiveness at doing that.
- Have customers go out of their way to patronize your business whenever they need what you provide.
- Convert customers into brand evangelists that praise your company and generate the most credible recommendations for doing business with you.

The financial implications of achieving risk-free relationships, as evidenced by realizing the benefits listed above, are more than attractive enough to merit the effort required to give your business the institutional imperative (discussed in Chapter 15) to achieve risk-free customer relationships.

We don't see any fundamental incompatibility between the popular theories of customer loyalty and our own risk-free theory. Many of the ideas for generating customer loyalty also lead to reducing risks for customers. But focusing on eliminating customer-perceived risk—fanatically and consistently—gives you the most reliable way to convert your merely satisfied customers into Highly Satisfied Customers who become loyal to your business. Those customers contribute the most to your bottom line.

Theories linking customer loyalty with charming customers, delighting customers, fulfilling the customer's every need, and all the other "get close to the customer" theories provide a useful starting point. They do not reliably predict customer loyalty.

Fulfilling customers' needs is necessary. It is just not sufficient to generate customer loyalty. Even occasionally delighting customers is not sufficient to generate loyal customers. To make generally satisfied customers loyal, you have to remove the risk for those customers of ever having a disappointing experience. Loyalty comes when you satisfy customer needs, absolutely every time. That is the essence of what it means to provide risk-free customer experiences.

How Focusing on Taking Risk out Helped Turn Protropin Around

Let's go back to David Perkins and Protropin. How did applying the principles for generating customer loyalty apply to the dramatic reversal in sales of Protropin?

The first step involved conducting a satisfaction survey of customers. Protropin's customers, as for all prescription drugs, are physicians who prescribe drugs and the staff who work in their offices. Patients and their parents, while the beneficiaries of Protropin, do not represent the pharmaceutical company's customers. The satisfaction survey aimed at determining the physician's key needs and pain points.

The survey revealed that because the GHd treatment was very expensive—about $40,000 a year—insurers tended to take great care in approving coverage. Taking "great care" for an insurance company meant delaying payment to the physician by up to a year. However, waiting for insurance approval is not an option once a physician determines the need to treat a child with GHd. Each month's delay translates into a lesser height at maturity. Medical professionals regard delay in treating GHd as an unacceptable option.

Doctors therefore ended up fronting the money for GHd treatment for their patients until reimbursement could be approved. Delays in payment, and the possibility of payment denial, represented a tremendous customer risk for the physician. Doctors typically put themselves on the hook for an awful lot of reimbursement money that might never come. The problem faced by these physicians clearly demonstrated the rift between medical ethics and medical practice economics.

The survey data suggested that physicians who treated GHd would value assistance with interacting with insurance companies to help them through the inevitably complex treatment approval process. While the risk of nonpayment was not directly linked to anything Genentech did, it was a risk associated with the purchase of the products Genentech sold. There is a subtle point one can draw out here: The risks associated with doing business with your company need not be risks for which your company has any direct responsibility. Nonetheless, such risks impinge on the customer's sense of safety in dealing with you. Specifically, in the case of generic products, the desire to reduce the risk of late payment or nonpayment led physicians to price shop for generic drugs.

David Perkins rightly deduced that training the sales force to assist physicians with the insurance reimbursement process, as well as helping to enhance the billing expertise of medical office staff, would provide physicians with tremendous value. David set out to build a consensus within the organization for this new direction, champion the plan, and see it through. As a result of identifying and targeting the transactional risks perceived by his customers, physicians gained a new metric for differentiating human grown hormone suppliers. Protropin—chemically indistinct from the generic drug—became a much more attractive product. And Genentech became a much more successful company.

What This Book Will Show You

Throughout the remainder of this book, we share our experiences of working with organizations that have understood and applied the concept of creating a risk-free customer experience. We describe the payouts for eliminating customer-perceived risks, the process for findings those risks, and the method for determining which risks matter the most. We share our findings about what it takes to identify and eliminate perceived customer risk and to craft a risk-free customer satisfaction strategy. We provide insights derived from working with business leaders who fully embraced what it takes to create risk-free customer loyalty businesses.

The ideas presented in this book can benefit any business of any size. If you want loyal customers and you are running Exxon, GM, Google, Conagra, or Citigroup, take the risk out. If you are running a components manufacturing company in Seoul, a call center in Bangalore, an advertising agency in London, or a car repair shop in Sydney and you want loyal customers, take the risk out. If you are running an auction business on eBay from your bedroom and you want to boost customer loyalty, take the risk out. If you are running a lemonade stand on your sidewalk, take the risk out. The loyalty formula works regardless of the size of your business.

If you want customers to willingly and consistently give you their trade, eliminate the risks of doing business with you.