

Loyalty:

A Prescription for Cutting Costs

Marketers shouldn't ignore the benefits of building trust.

**By Fred Reichheld
and Christine Detrick**

In the current downturn, many companies are tightening their belts, but too many are missing their biggest opportunity to keep costs down. Building loyal relationships with customers and other stakeholders can go a long way toward cost reduction. This article examines how retaining your current customers can help you save money.

For those of you who might ask how loyal relationships can translate into cost savings, consider the cost of serving a long-standing customer vs. the cost of courting one. Across a wide range of businesses, customers generate increasing profits each year they stay with a company. In financial services, for example, a 5% increase in customer retention produces more than a 25% increase in profit. That's because return customers tend to buy more from a company over time. As they do, your operating costs to serve them decline. In addition, return customers refer others to your company. And they'll also often pay a premium

to continue to do business with you rather than switch to a competitor with whom they're neither familiar nor comfortable. Of course, not every customer has potential to be profitable and long-standing. Cost-effectiveness dictates that you segment clients to identify the subset that holds this potential, so you can target your investment in relationship-building.

For example, take the case of Vanguard, a mutual fund industry cost leader. Vanguard's expense ratio—total costs as a proportion of assets under management—is just 0.26%, compared with an industry average of 1.4%. One of the reasons is that the company's CEO, Jack Brennan, like his predecessor John Bogle, is committed to customer retention. And Brennan's particular passion is selecting the right kind of customers up front—the kind with high potential for long-term relationships with the firm.

For example, a few years back, Vanguard rejected an institutional investor that tried to invest \$40 million in a fund because Vanguard suspected that the customer would soon churn the investment, creating extra costs for all the existing customers. The customer complained publicly to the *Wall Street Journal*, but Brennan supported the decision. In fact, he used the incident as an opportunity to underscore the need to be selective about customers, as well as to keep customer interests foremost.

Loyalty leaders also reduce costs by building trusting relationships with employees and associates. Consider the quick-service restaurant chain, Chick-fil-A, and its relationship with owner-operators. This company has so effectively fostered loyalty among its franchisees that many of them have remained with the company for 20 to 25 years, and some of them for even longer. Chick-fil-A's high profit-sharing standards and tough operator selection process help keep operator retention as high as 95% per year on average. That's a big saving on the cost of finding new franchisees.

Loyal associates nurture relationships with valuable clients. Despite a company policy of remaining closed on Sundays, Chick-fil-A's on-street restaurants deliver higher sales per square foot than McDonald's. The company generates enough cash to grow the chain without outside investment, while providing about \$1 million per year in college scholarships for its restaurant employees as well as supporting several charities.

Almost every stakeholder in your company (including customers, employees, suppliers, distributors, and channel partners) is a potential cost-reduction crusader. If you facilitate a supplier's operations by being flexible about delivery times, for example, that supplier might be more willing to be flexible for your special need. And over time, as you build trust, that supplier will likely be loyal to you even if one of your competitors offers a more attractive short-term contract. You'll both save on switching costs and, if you're attentive, you'll maximize the efficiency of your transactions as your relationship matures.

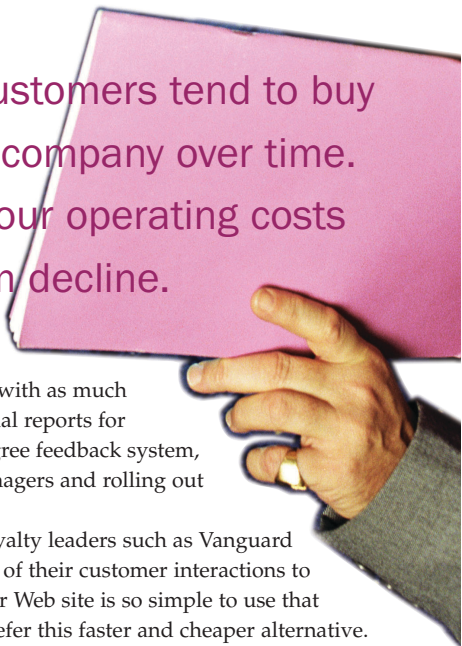
The Secrets of Loyalty Leaders

The companies that best understand cost savings through loyalty take very deliberate steps. A few you might consider:

Modify customer-acquisition incentives. Reward your sales teams and marketing channels for acquiring customers that stick around. Consider commission or bonus reductions if customers defect before 18 months.

Reallocate marketing investments. Systematically rank all of your customer acquisition campaigns on the basis of their yield of loyal customers. Shift resources toward programs that attract the richest mix of loyal customers. (Many firms today are wasting half their marketing expenses on disloyal customers who will never stick around long enough to pay back the acquisition investment.)

Identify ways to help under-performers. Develop annual relationship report cards on suppliers and dealers (and cus-



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tomers and employees) with as much care as you give to annual reports for investors. Test a 360-degree feedback system, starting with senior managers and rolling out to all employees.

Use the Internet. Loyalty leaders such as Vanguard have shifted almost half of their customer interactions to the Web. Make sure your Web site is so simple to use that many customers will prefer this faster and cheaper alternative.

These are just some of the ways to help utilize loyalty to your advantage. No company is immune to the pressures of the market, but companies that focus on building loyal relationships that by their very nature keep costs to a minimum are far better positioned to remain strong in the face of market turbulence. ■

About the Authors

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