BAIN & COMPANY

Mainspring

The Value of Online Customer Loyalty

And how you can capture it

eStrategy Brief

The power of online customer loyalty

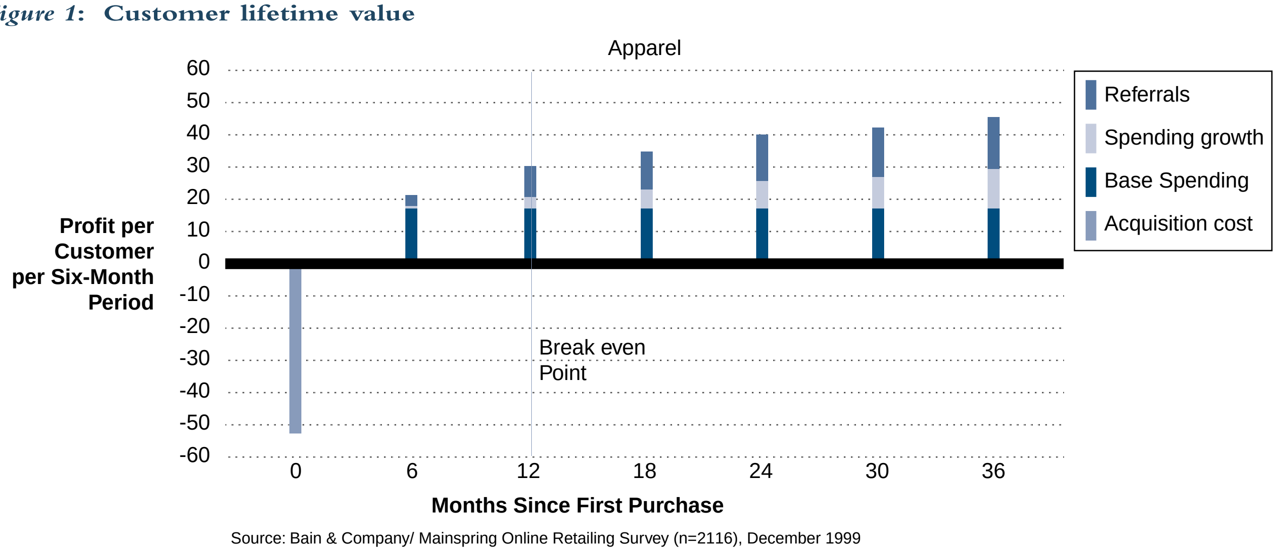
In the first years of e-commerce, it was generally accepted that customer loyalty and online shopping were mutually exclusive. The Web seemed to make customer loyalty irrelevant; at the click of a mouse, shoppers could effortlessly cover the globe in search of the lowest price, with little to hold them at one site. Yet, while it's true that online shoppers can skip easily from one site to the next, a highly loyal segment of online shoppers has emerged nonetheless, and tools such as Internet bookmarks have led to usage patterns that are loyal, almost addictive. Today, loyal shoppers visit their favorite sites far more frequently than they would any bricks-and-mortar store.

This surprising degree of customer loyalty can have an enormous impact on web-site profitability. We simulated the long-term economics of web sites in various industries, and customer loyalty proved to be a crucial factor in profitability, even more so than for offline companies. Small changes in loyalty alone, especially among the most profitable customers, can account for the long-term divergence of initially comparable online companies, with some rising to exceptional returns and others sinking to lasting unprofitability.

Why does customer loyalty have such a large impact on a site's economics? Consider the following facts, which were collected through two surveys of web shoppers conducted by Bain & Company and Mainspring[1]:

- **You won't break even on one-time shoppers.** Because customer acquisition costs in e-commerce are high, to recoup your investment you need to convince customers to return to your site time and again. For example, the average online apparel shopper in this study wasn't profitable for the retailer until he or she had shopped at the site four times. This implies that the retailer had to retain the customer for 12 months just to break even! ***(Figure 1)*** And online grocers, who spent upwards of $80 to acquire a customer, had to retain that customer for 18 months to break even. In fact, except for high-ticket items, in almost no instance can an online retailer break even on a one-time shopper.

***Figure 1:* Customer lifetime value**

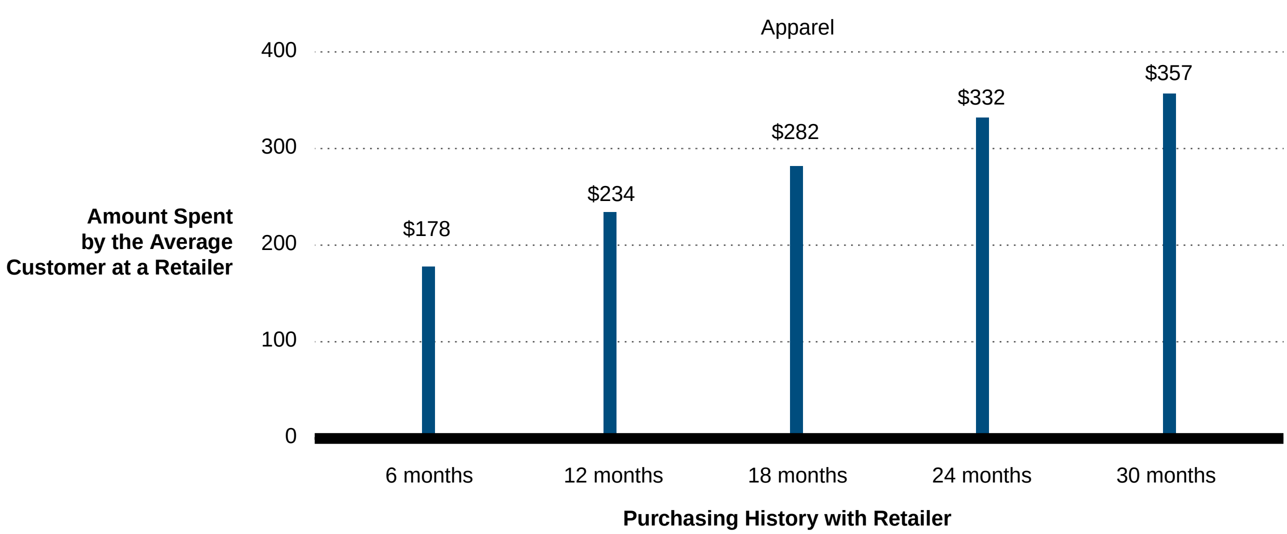


[1] *Two surveys of web shoppers were conducted. The first, conducted by Bain, surveyed 522 web shoppers at ten popular Internet retailers. The second, a joint effort by Bain and Mainspring, surveyed 2,116 online shoppers in three e-tailer categories: groceries, consumer electronics and appliances.*

- **Repeat purchasers spend more and generate larger transactions.** In our study, the longer their relationship with an online retailer, the *more* customers spent in a given period of time. In apparel, the average repeat customer spent 67 percent more in months 31–36 of his or her shopping relationship than in months zero–to–six. ***(Figure 2)*** And in groceries, customers spent 23 percent more in months 31–36 than in months zero–to–six. Higher spending levels were due in part to more frequent shopping and in part to larger transactions. For instance, in apparel, a shopper's fifth purchase was 40 percent larger than the first, and the tenth purchase was nearly 80 percent larger than the first. This aids retailer profitability, because in e–commerce, where transaction costs are largely fixed, larger transactions equal more *profitable* transactions.

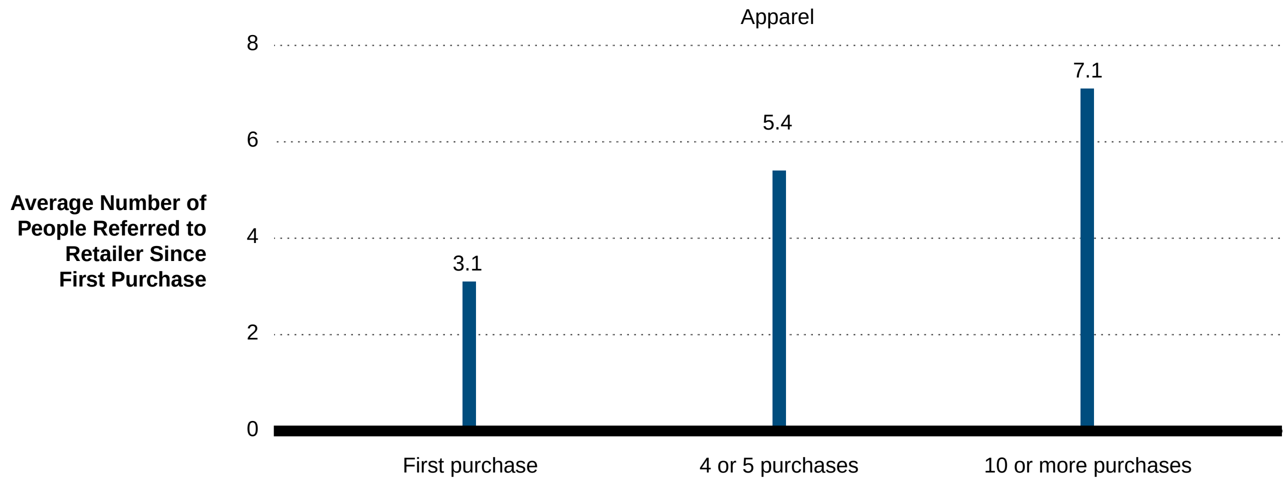
- **Repeat customers refer more people and bring in more business.** Word of mouth is the single most effective and economical way online retailers grow their sites. And loyalty, it turns out, can be a key lever for referrals. On average, an apparel shopper referred three people each to an online retailer's site after their first purchase there. After ten purchases, that same shopper had referred seven people to the site. ***(Figure 3)*** For consumer electronics and appliances, initial referrals were just over four, while total referrals after ten purchases were 13. The dollar impact of these referrals can be significant: over three years, customers referred by online grocery shoppers spent an additional 75 percent of what the original shopper spent. For both electronics and apparel, this number was over 50 percent.

***Figure 2*: Spending growth impact**



Source: Bain & Company/ Mainspring Online Retailing Survey (n=2116), December 1999

Figure 3: **Referral impact**



Source: Bain & Company/ Mainspring Online Retailing Survey (n=2116), December 1999

- **Loyal customers will buy other products from you.** Across the board, web shoppers expressed willingness to buy different types of products from their online retailers of choice. For example, almost 70 percent of Gap Online customers said they would consider buying furniture from the Gap. And 63 percent of online grocery shoppers would buy toiletries and OTC drugs from their online grocers. Repeat purchasing not only builds trust (so a customer will more likely consider purchasing other products), it also provides more cross-selling opportunities.

All these facts add up to a simple sum: customer loyalty on the Internet is a key driver of long-term profitability. Loyal online customers, just like offline ones, spend more, refer more people, and are more willing to expand their purchasing into new categories. As a result, they are more profitable than one-time shoppers. Online retailers who succeed in building customer loyalty will ultimately be more profitable than online competitors who focus only on transactional metrics such as number of visitors, number of shoppers, eyeballs, and so forth.

So what drives e-loyalty, and how can you improve it?

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***Figure 4*: Repeat purchase drivers**

Groceries	Consumer Electronics / Appliances	Apparel
• Fees are reasonable	• Offers lower prices than competitors	• Delivers in the correct time/ place
• Purchase is simple to execute	• Real-time in-stock information	• Money-back guarantee
• Easy access to customer service	• Sells the brands/products I am interested in	• Can find the products easily on the site
• Order delivered correctly	• Online customer service	• Offers lower prices than competitors

Source: Bain & Company/ Mainspring Online Retailing Survey (n=2116), December 1999

Key factors in building online customer loyalty

When asked, online shoppers said they returned to web sites that met their needs in four areas—order fulfillment, price, customer service, and web-site functionality. The impact these factors had on retaining customers is shown in ***Figure 4***.[2]

Order fulfillment and dependability

In both apparel and groceries, our analysis shows that improvements in order fulfillment and dependability can have a large impact on customer loyalty. Improving customer satisfaction scores on order fulfillment by 0.5 (on a scale of one to five) can increase implied customer retention rates by over two percent, a significant amount given the survey's average implied retention rate for all web sites of 86 percent.[3] For grocers, this translates to a 13 percent rise in long-term net present value.

Why are fulfillment and dependability such important issues? Because satisfaction in these areas is not a given on the Internet. A surprising number of customers told us that they did not receive exactly what they thought they had ordered, they were not made aware of the total price when they placed their orders, product delivery was late or poor, and return policy and service commitments were not met. Companies in the physical world expend enormous resources developing world-class capabilities in these areas. Why should it be easier, or less costly, on the Internet? The Internet's clear benchmark in this area is Amazon.com, whose customers show the highest levels of satisfaction on order fulfillment and dependability.

[2] *In the joint Bain/Mainspring survey, we guaged the importance of various web site performance dimensions in drawing customers back to the web site; measured customers' satisfaction with specific web sites along these dimensions; and asked customers how likely they were to return to those web sites in the future. Using this information in a multivariate regression, we calculated the potential impact of each dimension on customer retention.*

[3] *The implied retention rate was calculated for each web site based on the likelihood of its customers' returning to that site. "Definitely will return" implied a 100 percent retention for that customer; "probably will" = 70 percent; "might or might not" = 50 percent; "probably or definitely not" = 10 percent. These results were then aggregated for all the customers of each web site to yield an implied retention rate by site.*

Providing a fair price

Price is a key factor in both choosing a retailer and generating repeat sales. But, as we discovered, "price" means different things in different industries. In consumer electronics and appliances, "offers lower prices than competitors" was the most important reason for choosing and returning to an online retailer. In apparel, however, beating competitors on price wasn't even in the top five criteria in terms of influencing choice, and placed only fourth in influencing repeat sales. In addition, although over 95 percent of customers we surveyed say they comparison shop, most are actually comparing offline and online prices.

So, what's the message for the online retailer? Simply put, for most industries it's important to provide customers a fair—but not necessarily the lowest—price. You ***do*** need to meet or beat the offline price, but just as in the bricks-and-mortar world, you needn't have the absolute lowest price as long as you provide a good deal, and in fact you can make up for higher prices by providing exceptional customer service, reliability, and selection. Once again, Amazon.com proves this point. Although their books were on average $1.60 more expensive than those of the former Books.com (now bought and folded into BarnesandNoble.com), few Amazon.com customers were lured away from what they knew to be a reliable and timely service by promises of lower prices.

Customer service

Our research shows that improvements in customer service can have a significant impact on customer loyalty. In groceries, a one point improvement in customer service satisfaction (on a scale of one to five) yielded a five percent increase in implied retention rates. And in consumer electronics, the same improvement yielded over a two percent increase in retention rates.

Customer service doesn't necessarily mean complex service features such as click-to-call or expensive integration of customer information. What it does mean is answering questions and solving problems quickly, whether person-to-person or via self-service.

Crutchfield, for example, is a bricks-and-mortar retailer of electronics that has recently established an online presence. It does an excellent job of providing customers the information they need to make an informed purchase, giving them not only fundamental information about products online (i.e., "A radar detector is..."), but also a fully-staffed, 24-hour toll-free customer service number. They even provide links to the manufacturers of the products they sell.

As a result, Crutchfield's customer service satisfaction rating is well above average versus the other sites we tested (4.25 out of five for Crutchfield versus 3.70 on average). And while customer retention cannot be solely attributed to high scores on customer service, Crutchfield's web site does enjoy an implied customer retention rate of 92 percent, six percent above the survey average of 86 percent.

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Web-site functionality

Thirty percent of customers leave sites because they can't find what they are looking for, and even for those who do start a shopping basket, the abandonment rate is 66 percent![4] In other words, *the majority* of people who would like to buy online are prevented from doing so because they either can't find the product they want, or they find the transaction process too complex.

Easily located products, a simple order process, and access to real-time inventory information are what draw customers back to a web site. And functionality improvements in these areas can yield significant gains in customer retention. In groceries, raising site functionality satisfaction scores[5] by 0.5 yielded nearly a three percent increase in implied customer retention rates.

Once again, physical retailers invest heavily in simplifying the transaction process. Consider the amounts spent on merchandising and product placement in a bricks-and-mortar retailer, or the large number of check-out counters, all equipped with UPC scanners, at a grocery store. Shoppers expect, rightly, that online retailers will do their part to fully leverage the Internet's enormous potential to make shopping more convenient and to make their lives simpler.

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Monday morning, 8:00 A.M.: What can you do?

Clearly customer retention can have a big impact on the profitability of online retailers. So how do you actually improve customer retention? Areas of leverage will differ for each company, but there are some steps that all online retailers can take:

- **Treat customers as assets, not transactions.** The conventional battleground for online retailers has been drawn around transactions and scale, and most e-commerce metrics like-hits, click-throughs, visitors, and so on-reflect, this mentality. But improving customer loyalty requires a fundamental shift in mind-set. Customers are not transactions, they are people, and capturing their long-term business requires earning their trust and consistently providing them real value and convenience.
- **Measure customer retention and customer satisfaction along key retention drivers.** It's hard to improve something you don't measure. Start by understanding which of your customers are repeat versus one-time shoppers. Then, through customer research, identify the factors, such as customer service and order fulfillment, that are important to your customers, and measure satisfaction along these dimensions. What do you do well? What do you do poorly? Why are your loyal customers loyal? How can you leverage your best attributes to turn every shopper into a loyal shopper and to attract *more* loyal customers?

[4] *Forrester Research*

[5] *Respondents were asked to rate the site from 1 to 5 based on the statement "The purchase was simple to execute."*

- **Talk to your "defectors."** One of the best ways to improve retention is to talk to people who have used your site and then taken their business elsewhere. Through targeted e-mails you can gain insight into why people are leaving and where they are going, be it online or offline.

- **Keep tabs on competitors and other industry leaders.** Visit your competitors' web sites. Now visit your own. What are they doing that you are not? On which dimensions are you better or worse? You may also want to visit best-in-class web retailers in other product categories to see what they are doing around key drivers of retention.

- **Invest in key areas, especially where you are weak.** As the research shows, improvements in customer service, order fulfillment, price, and web-site functionality can have a large impact on customer retention rates. Hometownstores.com, for instance, added a chat support function to greet customers as they enter the site, providing a more timely resource than customer service e-mails. Within four weeks, sales grew 30 percent while e-mail volume fell from thousands to just dozens.

  Other customer service improvements that can impact retention include Frequently Asked Questions (FAQs) sections with well-organized information, knowledge bases or wizards for process completion, and quick-response e-mails. Because these are automated services, they cost less than traditional offline customer service tools (such as toll-free telephone numbers), and are more scalable as the site grows.

  The value of best-in-class fulfillment and web-site functionality can also not be overstated, as many companies found out during the 1999 Christmas season. The company that over-invests in marketing or advertising at the expense of fulfillment and basic site functionality may succeed in drawing customers to its site, only to lose them forever.

- **Make the customer's life easier.** Slick web-site design and graphical interfaces with animation do not create loyalty; eliminating complexity from the customer's life does. Online shoppers want their lives to be made simpler, with the offline world as their benchmark. This is different from just providing a site that is easy to use or visually entertaining. For example, the best online retailers allow customers to request notification when an out-of-stock item becomes available. And reminder e-mails, based on customer requests about upcoming events or new information, can also save the customer time and effort.

Most online shoppers' expectations are fairly modest: they want a good service that's secure, easy to use, and simplifies life; a fair price; reliable and timely fulfillment; and resources available to answer questions quickly and accurately. Meet these seemingly simple requirements, and you will earn the customer's loyalty. The few companies that succeed at this have a real advantage over their competitors: they have loyal, satisfied customers and a business model that, in the long run, yields superior returns.

Bain & Company:
Strategy for sustainable results

Bain is one of the world's leading global business consulting firms. Its 2,500 professionals serve major multinationals and other organizations through an integrated network of 26 offices in 18 countries. Its fact–based, "outside–in" approach is unique, and its immense experience base, developed over 27 years, covers a complete range of critical business issues in every economic sector. Bain's entire approach is based on two guiding principles:

1) working in true collaboration with clients to craft and implement customized strategies that yield significant, measurable, and sustainable results, and

2) developing processes that strengthen a client's organization and create lasting competitive advantage. The firm gauges its success solely by its clients' achievements.

Bain & Company's global e–commerce practice helps businesses achieve outstanding results in the new economy. We work with traditional companies to launch and manage online operations, and with pre–IPO clients to hone business models and accelerate to market. We also work with entrepreneurs to incubate new ideas into viable businesses, in some cases taking equity stakes through our bainlab subsidiary. Our e–commerce practice professionals work around the globe in every major industry.

Mainspring
eStrategy Consulting

Mainspring is the leading eStrategy consulting firm that focuses exclusively on developing actionable Internet strategies. It enables Fortune 1000 companies to protect, evolve, and transform their business for sustained competitive advantage by offering an integrated process of business, customer, and technology strategy planning. Its proprietary process hinges on the following activities to help guide clients effectively through eStrategy development:

- Building the Business Model
- Creating the Customer Experience
- Defining the Solution Architecture
- Commercializing the Business Plan

Working with Mainspring, companies identify, define, and formulate a portfolio of strategic Internet initiatives that are customized for their business and designed to create sustainable competitive advantage.

Mainspring's core services include eStrategy Consulting, eStrategy Direct, and the eStrategy Executive Council. These services are provided to companies in the financial services; retail and consumer goods; technology, communications, and media; and manufacturing industries. Mainspring was founded in 1996 and has offices in Cambridge, Massachusetts and New York City.

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