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Managing your most loyal customer relationships

John Larson [a], Bernard J. Jaworski [b,*], Jack Larson [c]

[a] *John Larson & Company, Pasadena, CA, U.S.A.*
[b] *Claremont Graduate University, 150 E. Tenth Street, Claremont, CA 91711, U.S.A.*
[c] *Larson & Company, Pasadena, CA, U.S.A.*

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Abstract Conventional wisdom regarding customer relationships suggests that a company should strive to deepen the loyalty of its customer base. While multiple approaches have been suggested, each approach advocates moving a subset of the customer base from one level of affinity (e.g., neither satisfied nor dissatisfied) to a higher one (e.g., satisfied). While seemingly appropriate, this approach assumes that moving customers up to higher categories is important and should be the focus of a firm's efforts. Instead, we recommend an approach that involves focusing a firm's resources disproportionately on its most satisfied customers. This approach provides two major benefits relative to conventional approaches. First, it focuses a firm's resources on a narrow segment of customers. Hence, it requires significantly less financial outlay and associated financial risk than any approach that is aimed at all or even a majority of customers. Second, as we demonstrate, the financial benefit from leveraging high satisfaction levels among a subset of the current customer base significantly exceeds the financial benefit of other strategies (e.g., moving customers up from neutral to satisfied). We present the results from two case studies that illustrate our main points and provide useful examples of how to leverage a firm's highly satisfied customers.

1. The conventional view of customer relationships

Conventional wisdom regarding customer relationships suggests that a company should strive to deepen the loyalty of its customer base (Evanschitzky et al., 2012; Kandampully et al., 2015). There is ample evidence over the past

* Corresponding author
E-mail addresses: john@jlarsonandco.com (J. Larson), bernie.jaworski@cgu.edu (B.J. Jaworski), jack@jlarsonandco.com (J. Larson)

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thirty years that loyal customers are generally the most profitable (Reichheld et al., 2000). Indeed, to go one step further, most firms focus their attention on stratifying their customer base—and on offering them different levels of service in return for different levels of loyalty.[1] For example, an Executive Platinum flier on American Airlines receives very different customer service from an AAdvantage Gold club member.

The general logic of loyalty pyramids is that the firm needs to understand customer needs at each level of the pyramid (e.g., platinum versus gold tiers) and provide service to match each level, thereby extracting profit commensurate with the service level (Zeithaml et al., 2001). This basic logic is true for both consumer markets and business markets, although the means by which firms create and sustain customer value require a different approach in business-to-business markets (Narayandas, 2005). In particular, it has been noted that business markets are more complex and present opportunities not found in retail markets (Narayandas, 2005). Nevertheless, the prevailing view is that these customers represent a portfolio that needs to be managed (e.g., by keeping the customer at the current level, moving them up the pyramid, or moving them down).

2. Three general strategies to strengthen client relationships

Given the existence of these pyramids, there have been three general strategies suggested in the literature to manage the portfolio of customers. In this section, we examine each approach, provide its underlying logic, and cite relevant literature. We conclude the section with a critique of these approaches.

2.1. Approach 1: Manage customer defections

The first approach is focused on customer defections (Neslin et al., 2006; Nunes & Dreze, 2006; Page et al., 1996). Some very well-respected companies focus on preventing customer defections at all costs. For example, in the U.S. the churn rate for customers in the credit card industry is about 20% per year (Gerdeman, 2013). Hence, credit card companies expend a great deal of effort to reduce customer defections. Between customer surveys and monitoring trends such as significant declines in monthly sales or bank balances, they focus on identifying potential defectors and, through some intense code-red efforts, do whatever it takes to keep them on board. It is not atypical for firms to escalate their concessions when a customer signals that they are ready to defect (Reichheld, 1996a). Code-red tactics are common within particular sectors—mobile phones, cable TV services, and branch banking, to name a few.

Interestingly, even satisfied or very satisfied customers often defect (Reichheld, 1996b). Here research has indicated that there are two key measures of satisfaction: satisfaction level and satisfaction strength (Chandrashekaran et al., 2006). This work indicates that satisfaction strength plays a central role in translating stated satisfaction into loyalty (Chandrashekaran et al., 2006). Hence, from a managerial perspective, this work suggests that to prevent defections, firms should prioritize both level and strength of satisfaction.

2.2. Approach 2: Move customers up a level

The second approach focuses on moving customers up to the next level of satisfaction (Pitta et al., 2006). Companies that follow this approach strive to strengthen their customer relationships by moving satisfied customers up to highly satisfied. For example, Starbucks calculated that whereas a satisfied customer generated $210 per year, a highly satisfied customer generated $328 per year. As a result, Starbucks focuses a good deal of its marketing campaign on this migration (Moon & Quelch, 2006).

A key focus of the study by Zeithaml et al. (2001) was on turning gold customers into platinum customers. Here the authors offered a number of strategies, including becoming a full-service provider, outsourcing of nonessential customer functions, increasing brand impact by brand line extensions, creating structural bonds, and offering service guarantees to move customers up the pyramid (Zeithaml et al., 2001).

2.3. Approach 3: Bimodal strategy

The third approach is to adopt a bimodal strategy. Here the firm's goal is to increase the number of truly loyal customers (promoters) while simultaneously striving to minimize any detractors (Reichheld et al., 2000). This is the strategy often pursued by firms that are committed to the Net Promoter Score (NPS) metric. The general logic of

[1] See, for example, various expressions of the customer-loyalty pyramid or loyalty classifications, such as Evanschitzky et al. (2012), Reinartz and Kumar (2002), and Zeithaml et al. (2001).

NPS is that one needs to manage both ends of the promoter continuum (i.e., promoters and detractors). American Express and Apple are two of the many companies that use NPS.[2]

Interestingly, there is considerable debate in the literature on the value of the NPS approach. Early empirical work suggested that specific NPS measures could be tied directly to revenue growth (Marketing Week, 2006; Reichheld et al., 2000). But there is also evidence that Reichheld's (2003) assertion of the clear superiority of the NPS approach is suspect (Keiningham et al., 2007; Reinartz & Kumar, 2002). Nevertheless, the NPS approach is widely deployed and is part of the stable of management metrics used to judge customer loyalty.[3]

2.4. Limitations of the three approaches

In each of the above examples, the approach is basically the same: Firms focus on moving customers from one level of affinity to a higher one. While seemingly appropriate, this strategy of promoting all categories of customers has three fundamental drawbacks. First, from psychologists' research on biases, we know that customers anchor judgments on a particular belief system (Kahneman, 2013). This anchoring process makes it difficult to switch a person's mindset without significant evidence to the contrary. The more deeply rooted their belief system, the harder it is to change their perspective (Ahuwalia, 2000). Second, it can be extremely difficult and time-consuming to move customers from categories of satisfaction (Keiningham et al., 2014). Third, not all groups of customers are equally valuable to a firm (Thomas et al., 2004). For example, for one mail-order company, customers who were expensive to acquire but easy to retain produced 40% of the firm's profits, whereas customers who were expensive both to acquire and to retain produced 25% of the profits (Thomas et al., 2004).

3. A different approach: Focus on highly satisfied customers

Given these three challenges, we have devised an approach that notably does not involve changing the mindset of all or even a majority of customers. Rather, it involves focusing resources on a narrow band of very satisfied customers. This approach provides two major benefits relative to the three given above:

- It requires less resources. One of the core lessons in competitive strategy is the need to focus resources and make choices and tradeoffs (Porter, 1996). So rather than spread resources across the entire range of customers, our approach focuses narrowly on an attractive customer segment.

- As we will demonstrate, the financial benefit from leveraging high satisfaction levels among a subset of a customer base significantly exceeds the financial benefit derived from trying to increase it among all or even a few other customer subsets.

In what follows, we first present a simple model of customer loyalty. Then we present the results from two different case studies that illustrate our main points and provide useful examples of how to engage with customers to increase profitability.

3.1. A model of customer loyalty

The value of a firm is simply the net present value of the relationships it has with each of its customers (Grant & Schlesinger, 1995). This value can increase in one of five ways:

1. The company can extend the length of the relationship by retaining more of its customers for longer periods of time.

2. It can broaden the nature of the relationship by selling the customer additional products and services.

3. It can upgrade the quality of the relationship by migrating customers to higher-margin products and services or by charging a price premium for its product.

4. It can streamline the relationship by lowering its cost to serve the customer.

5. It can leverage the relationship by getting the customer to recommended new customers to the company.

These behaviors are the five ways that a company can take advantage of its strong relationship with customers. Interestingly, we tend to think of the benefits of customer loyalty mostly in terms of

[2] http://www.netpromotersystem.com/about/companies-using-nps.aspx

[3] See Fisher and Kordupleski (2019) for a recent critical review.

Behaviors 1 (e.g., "Would you come back to Restaurant A again?") and 5 (e.g., "Would you recommend Restaurant A to your friends?"). That having been said, the other three dimensions can be substantial drivers of profitability (Grant & Schlesinger, 1995). For example, data provided by the Centers for Medicare and Medicaid Services indicate that hospitals with the greatest percentage of highly satisfied patients had disease-adjusted average costs to serve that were 4.5% lower than hospitals at the lower end of the patient-satisfaction spectrum.[4]

Not surprisingly, the higher their level of satisfaction, the more often customers exhibit these five behaviors. Indeed, evidence suggests that satisfied customers tend to exhibit more of these behaviors than customers at other levels of satisfaction (Kandampully et al., 2015).[5]

There is an explanation for the substantial differences in behavioral intent between highly satisfied and satisfied customers. Highly satisfied customers have developed a trust-based relationship with the firm, something satisfied customers do not share (Choi & La, 2013; Reichheld et al., 2000). As a general rule, highly satisfied customers are confident that they will have a great experience every time they deal with the firm, and in those rare cases when they do not, they have absolutely no doubt that the firm will take whatever steps are necessary to immediately rectify the situation (Syzmanski & Henard, 2001). On the other hand, less satisfied customers often report inconsistency—sometimes they have a very good experience, and other times they do not.[6]

In contrast to this conventional wisdom and the relevant academic literature noted above, our core hypothesis is that it is more profitable to engage in sales-inducing behavioral interactions with highly satisfied customers than it is to migrate customers (e.g., from satisfied to highly satisfied). We now turn to our two studies.

4. Research methods and findings

4.1. Case study 1: Cosmetic surgery

4.1.1. Sample

In the first study, we examined physicians' satisfaction with a firm that makes medical devices used in cosmetic surgery. The questionnaire covered a range of topics related to various aspects of the relationship between this device manufacturer and medical practices (e.g., product performance, the frequency of sales calls, and the level of clinical support for the practice).

4.1.2. Data collection

We collected a little over 300 completed interviews. Recognizing that there are many ways to measure and scale customer satisfaction (Peterson & Wilson, 1992), we employed the widely used 5-point satisfaction scale, where 5 = highly satisfied, 4 = satisfied, and 1 = highly dissatisfied. We also used conventional measures for the other key metrics, such as recommendation intent (e.g., highly likely, somewhat likely, and unlikely). After we completed our interviews, the firm provided year-to-date sales (January through October) for each practice that we surveyed. Combining these two data sets enabled us to match the satisfaction data with the firm's sales data.

4.1.3. Analysis

With these two data sets combined, we then computed sales per practice for each level of satisfaction. Sales to practices in which the physicians said they were satisfied overall with the firm averaged $35,200 through the first 10 months of the year. At practices where the physicians were highly satisfied, sales were $54,700 (over 55% higher).

As noted above, the survey covered a series of interactions between the firm and the physician practices they served. We conducted a series of follow-up analyses to determine whether there was a way for the firm to capitalize on this trust they had earned from their most loyal customers. More specifically, we studied a series of interactions between this company and the physician practices they served that had the potential to increase sales to highly satisfied physicians beyond the $54,700 average.

After analyzing a series of interactions, we identified two specific behaviors that significantly increased sales to already highly satisfied customers:

- When the account manager observed the highly satisfied physician perform a procedure in the operating room at least once a quarter, average sales to the practice increased by $9,300 to $64,000.

- For those highly satisfied physicians who also said that their account manager conducted

[4] https://www.medicare.gov/hospitalcompare

[5] One implication is that that firms should not bundle highly satisfied and satisfied customers into one generic group, as has been previously suggested (e.g., Morgan & Rego, 2006).

[6] See Syzmanski and Henard (2001) for a meta-analysis of the link between satisfaction and outcome variables.

an annual account review with them, sales increased again—this time by $15,000, to a total of $79,000 (Fig. 1).

4.1.4. Discussion

The key point is that the increase in moving a satisfied physician up to highly satisfied ($54,700 − $35,200 = $19,500) is less than the gain that comes from elevating a highly satisfied physician (a 5 on a 5-point satisfaction scale) to what we term a Mega-5 ($79,000 − $54,700 = $24,300). Importantly, a Mega-5 is not a customer who moves from being highly satisfied to being exceptionally satisfied. Rather, a Mega-5 is defined as a highly satisfied customer who engages in two or three pivotal behavioral interactions with the firm that, in turn, increase sales. In this case study, the two behavioral interactions were: (1) The account manager observed a surgical procedure with a physician once a quarter, and (2) the account manager conducted an annual review with the physician. These behavioral interactions are of course industry- and firm-specific.

A skeptic might look at the results from our first case study and pose the following question: How do we know that the sales behaviors that you have identified actually drive account revenues? Another explanation for the results could be that these behaviors were directed toward larger practices, and that practice size accounts for the higher sales volumes in our data.

4.2. Case study 2: Controlling for account potential

4.2.1. Sample

With this observation in mind, we conducted a second study with a medical-device firm to specifically address this issue. This firm sold a device used by hospitals in a specific surgical procedure. There is an almost one-to-one relationship between hospital demand for this medical device and the number of this surgical procedure that the hospital performs.

4.2.2. Data collection

As in Case Study 1, we began with a series of practitioner interviews. In this case we interviewed nurses because they were intimately involved in the decision to select the particular brand of medical device. Here we used the same 5-point customer-satisfaction scale as in the first study as we surveyed various types of interactions between the firm and the nurses. We also again matched satisfaction data with sales data. In addition to these data sets, however, we also obtained estimates of the annual number of surgical procedures requiring this type of device performed by every hospital the firm served. We found these estimates to be excellent predictors of the firm's sales to each account and thus employed them as accurate proxies for account potential.

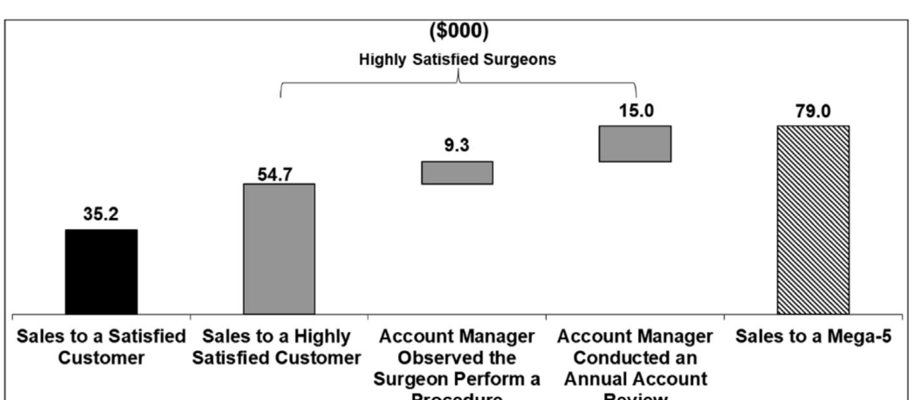
4.2.3. Analysis

The firm chose to measure sales at each hospital on a unit basis. Hence our analysis was based on unit sales. At hospitals where the nurses we interviewed said they were satisfied with our client, annual sales in 2017 averaged 6,500 units. At hospitals where nurses were highly satisfied, sales averaged 14,100 units.

Given this finding, we estimated a regression equation in which the dependent variable was annual unit sales to each hospital where the nurse reported being highly satisfied, and with three independent variables:

1. The firm's estimate of the total number of

Figure 1. Impact of selected account-management activities on increasing sales to highly satisfied surgeons



surgeries using their type of device at a given hospital;

2. The number of times in a month that the responding nurse at the hospital was contacted by their account manager; and

3. Whether or not the account manager had done a formulary review at the hospital in the last quarter (a dummy variable).

For each of the variables in the regression, we obtained statistically significant coefficients. By plugging into the regression equation the sample average for the number of surgeries performed (Variable 1 above), we were able to control for account potential. The results indicate that when holding account potential constant at the sample average, annual sales among hospitals at which the nurse was highly satisfied with the firm and the account manager conducted a quarterly formulary review increased by 4,000 units over the highly satisfied group, from 14,100 to 18,100. If this account manager also contacted the nurse at least twice a quarter, sales increased an additional 5,300 units, to 23,400 (see Fig. 2).

4.2.4. Discussion

Consistent with Case Study 1, the increase in sales associated with moving customers up from satisfied to highly satisfied (14,100 − 6,500 = 7,600 units) is exceeded by elevating highly satisfied customers to Mega-5 (23,400 − 14,100 = 8,300 units). Importantly, in this situation the two behavioral interactions were: (1) Conduct the formulary review of the various options for surgical devices, and (2) contact the nurse at least twice a quarter. What is so striking about these behavioral interactions is that firms don't need a laundry list of potential actions; rather, both Case Study 1 and Case Study 2 reveal that just two behavioral interactions are sufficient. The key is to look for the right behavioral interactions within the firm and industry. Our analysis reveals that different interactions were necessary for the cosmetic-device manufacturer than for the surgical-procedure manufacturer.

5. Conclusion

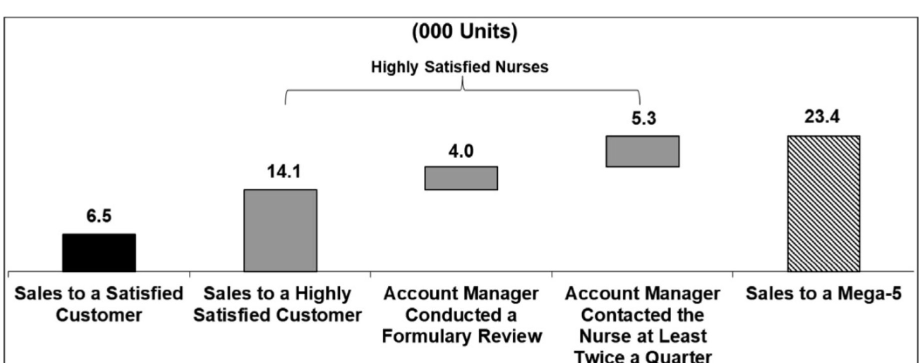
These two studies are not unique. We have seen the results described above in several similar studies we have conducted over the last few years. In each case the financial gain realized by elevating a highly satisfied customer to Mega-5 exceeded that of moving a satisfied one up to highly satisfied.

What we learned from this initial work is that Mega-5s do not materialize out of thin air. Each of the firms we studied worked specifically to create these Mega-5s. In the business-to-business sphere, for example, key sales activities that created Mega-5s included: (1) conducting quarterly or annual business reviews with the customer, (2) receiving a visit from senior management, and (3) having the sales representative contact the customer three or more times a month. In our two case studies, specific activities performed by account managers are the key in elevating a 5 to a Mega-5.

In sum, there are three compelling reasons why companies should give high priority to creating Mega-5s:

- As previously noted, the gains from shifting a 5 to Mega-5 significantly exceed those achieved by shifting a satisfied customer (a 4) to a 5.

Figure 2. Impact of selected account-management activities on increasing sales to highly satisfied nurses



- Most firms have significantly more highly satisfied customers (typically about 50% of their customer base) than satisfied ones (typically 30% of their customer base), so the playing field is significantly larger (Peterson & Wilson, 1992).

- Since the 5s by definition already have a trust-based relationship with the firm, it is easier to convert them to Mega-5s than it is to move satisfied customers up to highly satisfied. Viewed in this context, creating Mega-5s involves nothing more than taking full advantage of the strong relationship the firm already has with its highly satisfied customers.

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