

ABSTRACT

Loyalty Myth #8:

It Costs Five Times More to Acquire a Customer than to Retain a Customer

In this excerpt from their book *Loyalty Myths*, the authors argue that any retention strategy based in whole upon this myth is a recipe for financial disappointment

Although it is difficult to determine the exact origins of this platitude, the earliest sources that we can find attribute it to research conducted by the Technical Assistance Research Project (TARP) in Washington, D.C. in the late 1980s. Around the same time, other loyalty pundits claimed exactly the same findings as their own (for example, the Customer Service Institute, Consumer Connections Corp., and ITEM Group). Soon the myth found its way into the pages of prestigious journals and books. In 1990, Total Quality Management group president Christopher Hart and Harvard professors James Heskett and W. Earl Sasser, Jr. lent the statement further credibility in their *Harvard Business Review* article “The Profitable Art of Service Recovery.” And popular business strategist Tom Peters likewise repeated the myth in his best-selling book *Thriving on Chaos*. This myth is so pervasive and so seemingly intuitive that it has stood unchallenged for 20 or more years! We, too, have published prior works repeating this fallacy. There is currently enough contrary information to bury or significantly qualify this truism, based on three major flaws.

Loyalty Myth No. 8: Debunked!

1. The fundamental financial underpinnings of the argument are either misallocated in terms of acquisition and retention, or the financial effects attributed to retention are false. The basic argument that the cost to acquire new customers is substantially greater than that to retain existing customers hinges on a stream of interrelated factors. With regard to existing customers, there is the assumption that they will: (1) increase their level of spending at an increasing rate; (2) purchase at full-margin rather than discount prices; and (3) create operating efficiencies for firms. Unfortunately, research has shown that none of these things are true. With regard to new customers, operating costs are presumed to rise as the customer has to learn the procedures of the firm, and the firm has to learn the needs of its new customer. Even if that were universally true, most firms don't go through new account setups, credit searches, etc. when a new customer walks through the door. The fallacy becomes obvious when we think about our own experiences as a new customer. What exactly was the additional cost to the companies of our purchasing from a new retailer, dining at a new restaurant, or flying with a new airline? For those industries in which there is a legitimate cost associated with sign-up, these costs are often incurred regardless of whether the consumer remains loyal to the firm. Exactly how much easier is it to purchase a new car, television, or washing machine simply by staying with the same brand?

The x-factor that makes this myth seem plausible is the costs associated with advertising and promotional expenses. While it is believable that they represent enormous expenses that would far more than exceed the costs of retaining existing customers, there is one fatal flaw with this assumption: advertising and promotion are not simply about inducing first time purchases. Much of advertising is about reinforcing brand imagery and maintaining awareness among current customers of the brand. And while some firms promotionally “price to lose” to attract new customers in the short-term, typically such promotions are enjoyed by both prospective and current customers. Therefore the breakdown of acquisition versus retention related expenses associated with advertising and promotion is likely incorrectly weighted to the acquisition side of the equation to arrive at this fallacy.

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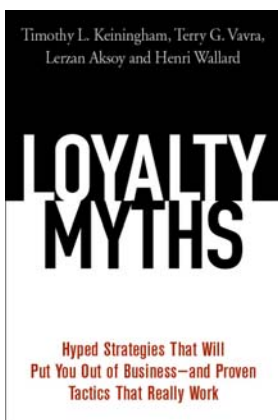
2. The assertion ignores the lifecycle of products, services, and institutions. When firms are in their introductory and growth phases allocations to acquire customers will be substantial. The customer acquisition-retention cost ratio will typically be heavily weighted to acquisition. Conversely, when products or firms are in the decline phase, allocations required to retain customers will be substantial, making the typical acquisition-retention cost ratio weighted heavily to retention. It is in the maturity phase of a product's lifecycle that the ratio of acquisition costs to retention costs can fall to either side.

3. It ignores the fact that a company's customer base is made up of broad mix of customers who vary in their costs to acquire and retain. Managerially, the problem with this myth is that it ignores the diversity of firms' customer bases in terms of the costs both to acquire and to retain customers. For most firms, customer profitability is not evenly distributed. Often the most expensive customers to retain are those who generate the most profits for the firm (Desired Customers). For obvious reasons, they are most desirable to competitors, thus are more likely to receive attractive offers from the competition. Desired Customers also often know that their relationship is significant to the firm and, consequently, they expect a higher level of service. The costs to retain these customers can be very high, but economically worthwhile to the firm.

As a result, while it seems plausible that acquisition costs are significantly higher than retention costs, as with all myths, the reality is far more complex. And while it may serve as a provocative wake-up statement to ensure that management is aware of the importance of retaining customers, supporting any retention strategy based in whole upon this myth is a recipe for financial disappointment.

In *Loyalty Myths*, business strategists and renowned authors Keiningham, Vavra, Aksoy, and Wallard reveal the ugly truth about customer loyalty: almost everything we have been told about it is wrong. Following the conventional wisdom that has been propagated about customer loyalty has, at best, led to misallocated resources; at worst, it is a recipe for financial disaster.

The pursuit of customer loyalty can be a highly profitable strategy, but not by following the myths that have developed. Our current knowledge of customer loyalty has advanced to the point of being able to identify the flaws in the conventional positions – the myths. More importantly, we can now establish and prove “loyalty truths” that we've associated with profitable customer loyalty strategies.



Praise for *Loyalty Myths*

by Keiningham, Vavra, Aksoy, and Wallard

Loyalty Myths provides great insights as to why simple answers never work in customer loyalty. The authors show with many real life examples how businesses can go wrong in adopting an unquestioned mantra of “customer loyalty is all that counts” and illustrate how it will most likely not help, but hurt your profitability. Finally, the book gives managers a guide to get started on a more comprehensive approach to customer loyalty that already whets one's appetite for the sequel to this must-read book.

Peter Jueptner,

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