

Illawarra Small Business Assistance

HELPFUL HINT - FOCUS ON THE CUSTOMER AS THE DRIVER OF PROFITABILITY

Growth orientated businesses maintain close focus on the customer as the driver of profitability. Selecting the right customers, managing them profitably, and retaining them through optimal allocation of resources becomes a fundamental strategy for those businesses pursuing growth in a meaningful way.

To manage and sustain profitability, proprietors need to come up with the right marketing strategies backed by the right market metrics. In this regard, the assessment of lifetime customer value (LCV) is a dynamic metric that is little understood by many fledgling entrepreneurs.

Many believe incorrectly that that long term customers tend to spend more, cost less to service, have greater propensity to generate word of mouth, and pay a premium when compared to short term customers. They think that by cultivating loyalty alone, a business can increase its overall profitability.

A key question that proprietors should seek to answer is..."Are loyal customers profitable customers"?

So, what is the link between loyalty and profitability?

Evidence shows that not all loyal customers are profitable. Often this can be as a result of the customer moving to a less expensive channel (e.g. website) when they expect lower prices, and this offsets any cost savings for the business. In a nutshell many of these loyal customers are price sensitive and expect something in return for their loyalty.

Owners are also often mistaken when they believe that by creating loyalty programs they can make their customers more behaviourally loyal, with higher profitability to follow. The link between loyalty and profitability is much more complex than often perceived.

All customers are not equally profitable and consequently, loyalty programs should ideally be designed to reward customers depending on their level of profitability.

A two tier loyalty system is a desirable strategy.

Tier 1 rewards are aimed at all customers based on their current and past purchase behaviour. It should be designed simply to reward existing clients and attract new customers and be based on total spending – rewards based in proportion to spending.

A fundamental goal at this level is to build loyalty across all customers and to collect valuable customer transaction data for behaviour analysis.

Tier 2 rewards should be forward looking; be aimed at influencing the future purchasing behaviour, be more selective and reward customers to influence their behavioural and attitudinal loyalty.

By carefully monitoring the type of purchasing, the purchase frequency, and the contribution towards profit, owners can more accurately determine the mode and frequency of marketing initiatives to drive lifetime customer values.

An important first step is to identify the most profitable customers and those who are most responsive to marketing efforts. The next step is to work out the right mix of different channel contacts for each customer – what are they responsive to? Is it email, web contacts, direct mail, telephone or face-to-face? And, how cost-effective are these contact methods? Following on from this it's necessary to determine how frequently each customer should be contacted and then to look at what other factors normally affect their buying behaviour. For example, multichannel shoppers are likely to be more active and receptive to contact providing the business with higher revenues and a longer and stronger customer relationship.

Consideration of indirect profit contribution is also essential, as customers need to be valued not only on their direct contribution but also in relation to savings in new customer development and acquisition costs as a consequence of the capture of new customers by way of referral.

There is absolutely no more important customer than the one who willingly talks positively about your business and will refer quality customers to you. It therefore becomes critical to identify whether your customers are “users”, “choosers” or “braggers” – for further insights on ways of growing “braggers”, please refer to the “Helpful Hint – Just How Powerful is Word of Mouth Marketing”.

Summary

The bottom line is that the customer matters. Developing LCV is about sustaining successful customer management strategies in the long run. Although it might be possible to keep customers happy and loyal in the short run, the greater challenge lies in achieving LCV with both growth and profits in the long run.

Key action steps are summarised:

- Adopt strategies to influence behavioural and attitudinal loyalty
- Select the right customers for future targeting
- Identify and segment customers with the highest potential for future profit
- Target customers for multi-channel shopping

- Allocate marketing resources – optimise across channels
- Pitch the right product to the right customer at the right time
- Adopt a sales matrix that includes up-selling, cross-selling and down-selling
- Prevent attrition of high value customers
- Identify customers who provide value through referrals
- Adopt viral marketing strategies

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