



Capturing the Loyalty Opportunity: The Cost of Doing Nothing



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Executive Summary

Succeeding in business is a straightforward matter – focus on customers and amaze them with experiences that exceed their expectations. They will respond with repeat business and longer loyalty. This would seem to be a simple, common-sense guideline; particularly since an organization’s customer experience represents its core value proposition and reflects corporate health and brand strength. However, the majority of companies appear to lack any true sense of urgency for designing and executing customer experience strategies. While organizations proclaim that “the customer is king” and consistently declare their love and commitment to customers, too many either wait excessively before acting on their declarations or rely on self-serving, efficient and transactional business models, as opposed to the generous, long-term nurturing required for real relationships. A recent CMO Council survey of business to business technology buyers found that while 56% of IT vendors perceived themselves as being extremely customer centric, only 12% of customers agreed.¹

What are the real costs of delaying the implementation of customer-centric strategies? What are the consequences of not acting in accordance with customer-centric proclamations and slogans? This paper addresses these key questions.

Organizational reluctance to implement customer strategies is directly linked to the failure to understand the economics of customer relationships and the potential value associated delighting customers. Most organizations tend to associate soft value, often in the form of customer satisfaction, to successful customer strategies. They fail to measure the financial opportunities and consequences associated with their customer experiences.

This paper will present a revolutionary approach towards thinking about the customer experience in the context of “the cost of doing nothing.” Only by framing the urgency of customer strategy implementation around financial metrics such as product preference, portion of budget, product pricing, referrals, and relationship longevity, will companies be able to make informed decisions about their business strategies. Armed with these financial metrics, companies can justify their shift in strategic priorities, and allocate the resources for designing and implementing customer strategies. They should no longer have any reason to further delay the implementation of a customer strategy.

¹ CMO Council: *Profitability from Customer Affinity*, 2008.



Experiences in the Slow Lane

Most companies do not go into business with the intention to frustrate and annoy customers. They do not spend small fortunes on attracting customers only to provide them with sub-par or mediocre experiences that frustrate them and push them into the arms of their competitors. What companies do generally choose to focus on is developing, marketing and upgrading their products. However, as the success of these companies grows, so does market maturity, product commoditization and customer inertia. At the point when inertia settles in, companies often lose the desire to please their customers and focus more on how they can reduce costs rather than on delivering meaningful and differentiated experiences.

The challenge with convincing companies to change their strategy and refocus their priorities on the customer is two fold. Some believe that there is no reason to change their existing business models. They point to historic revenue growth, product awards, analyst reviews and sheer company size as evidence that they do not need to change in a substantive manner. Even in the face of declining revenue and increasing customer attrition, organizations often feel that their predicament is a sign of the times, a trend affecting whole industries. According to Forrester, only 38% of companies view the customer experience as playing a critical role in their competitiveness over the coming years.²

Other companies believe that they are in fact running customer-centric enterprises. They point to their strategies which emphasize the customer; the posters that highlight their dedication to customers; and some initiative aimed at improving customer service. These companies have convinced themselves that they have a customer strategy – that works! As evidence, they point to customer satisfaction surveys and transactional customer service surveys that illustrate that they have nothing to worry about – customers are happy with their products and services. Indeed, a recent study found that while 85% of IT vendors were convinced that they were getting better at responding to customer needs, only 55% of customers agreed.³

Regardless of the reason, companies face the same predicament – deteriorating customer relationships. What too many companies fail to recognize is that customer relationships are similar to relationships with friends and family – all need constant rejuvenation and care. In their absence, customer relationships, like all relationships, will deteriorate or even worse – dissolve entirely. By failing to demonstrate care for their customers through the experiences they provide, companies allow customer inertia to set in, and open the door for their customers to examine and be tempted by competitive offers in the search for new and exciting options.

The Profitability of Customer Experiences

The necessity of delivering great customer experiences is an issue of profitability, sustainability and long-term growth. A recent study found only 49.5% of executives agreeing that their respective companies deliver a unique and beneficial product to customers. Furthermore, only 56% of executives claimed that their products or services were worth the price they charge.⁴ As product commoditization across many industries increases, companies will need to deliver competitively differentiating experiences to capture and retain customer loyalty, and ensure sustainable top line growth.

² Forrester: *Q4 2006 Customer Experience Peer Research Panel Survey*.

³ CMO Council: *Profitability from Customer Affinity*, 2008.

⁴ Strativity Group: *Global Customer Experience Management Study*, 2007.



How Do You Convince Management?

How to convince management and obtain organizational buy-in and support represents one of the greatest stumbling blocks to customer strategy design and implementation. Customer experience professionals ask this question frequently at seminars and workshops as they struggle to obtain an expression of leadership support (through budget allocations), and a real sense of urgency. While many senior executives talk the talk, few walk the walk with respect to strategic focus, time commitment and resource allocations. Their apathetic approach is primarily a function of a “let’s not rock the boat” mentality.” They see no reason to “rush” a new strategy with other, more “pressing” priorities.

Since few executives know economics of relationships data, overcoming unhelpful senior executives can be addressed by presenting them with this information. A recent study found that 70.8% of executives did not know their organizations’ average annual customer value while 49.7% did not know their annual customer retention rates.⁵ Once senior executives internalize that customer experience strategies can improve these (and related) metrics, lower costs and drive revenue, gaining their buy in and support becomes a more realistic and simple endeavor.

Organizations generally believe that customer experience strategies are rooted in altruism. Others perceive such strategies to be little more than an attempt to boost customer satisfaction, which they perceive to be important, but hardly a necessity. CEOs believe that the board, shareholders and analysts are interested in cost reduction, product margins, net income and revenue growth more than they care about customer experiences. After all, when was the last time a Wall Street analyst asked a CEO about customer satisfaction or loyalty? In contrast, customer centric organizations recognize that delighting customers is a business strategy rooted in sound financial metrics. They understand that there is a direct correlation with exceeding customer expectations and generating more revenue and profit.

The Five P’s

Customer experience strategies drive loyalty that will positively impact five key financial metrics:

- **Preference of Company or Product** – Involves product or service-related purchases by new customers.
- **Portion of Overall Customer Budget** – involves gaining a larger portion of the customer’s total budget. As long as there are competitors, customers may share their budget among several vendors, indicating that they lack a company or product preference. When customers provide a single vendor with a greater share over competing vendors, it is a clear sign of loyalty.
- **Premium Price** – is about the ability to charge a higher price. It signifies that the product is perceived by customers as superior, differentiated, and, most of all, worth their business. By managing to obtain a premium price, the customer bypasses the discount alternative and reaffirms his conviction in the value delivered by the premium priced product.
- **Promotion of Company or Product** – involves providing referrals to friends and peers, as well as a willingness to support the product publicly. Public support may include endorsements or press interviews, but is usually limited to sharing opinions through blogs, social networks, and forums (public and private).
- **Permanence of Overall Relationship Longevity** – is the ultimate measure. As a customers stays with a vendor longer, the relationship becomes deeper, stronger and more meaningful. These relationships will yield more profitable business, referrals and insight.

⁵ Strativity Group: *Global Customer Experience Management Study*, 2007.



The strategic and financial benefits of constantly delighting customers should drive an increased sense of urgency around designing and implementing a customer strategy. The Five P's are driven by customer actions, not intentions, and should be the catalyst to obtain leadership's attention, support and resources.

The combination of all 5 P's represents a true picture of the benefits and consequences of implementing or not implementing a customer experience strategy.

Introducing Return on Nothing Loyalty Model

The Return on Nothing (RON) Loyalty Model assesses the full costs of not implementing customer experience strategies (or initiatives), and continuing "business as usual." Utilizing this model will assist companies with understanding how they should prioritize initiatives by determining their relative costs and benefits. In this way, organizations will be able to make intelligent decisions, prioritize initiatives effectively and allocate resources according to the financial impact that each initiative will have on the organization.

It is important to note that RON does not measure customer perceptions and intentions, or focus on common customer metrics such as customer satisfaction, willingness to purchase or willingness to recommend, since they have no measurable impact on an organization's top or bottom line. RON does measure customer actions such as actual customer purchases, referrals and relationship longevity, with the aim of providing managers and executives with a tool to make the financial case for prioritizing a customer experience strategy.

In the context of customer experience strategies, the RON Loyalty Model illustrates the business impact of not implementing customer experience strategies through economics of relationship metrics such as relationship longevity and portion of budget. RON incorporates both "business at risk" (existing revenue streams that may be lost if the customer experience is not improved) and "business at growth" (additional revenue that may be captured as a result of customer experience improvements). The inability to deploy customer experience strategies in a timely manner may impact the organization through business at risk or business at growth.

RON = Business at Risk + Business at Growth

Business at risk is the sum total of all existing revenue streams that a company stands to lose by providing customers with inferior quality experiences. By neglecting to improve their existing customer experiences, many organizations face the prospect of higher customer attrition and lower customer spending, and consequently, the loss of revenue from existing revenue streams.

Business at growth is the sum total of all incremental revenue that a company stands to generate by providing customers with superior experiences. Stated otherwise, business at growth represents all additional revenue that can be generated by providing customers with high quality experiences. Alternatively, inferior customer experiences will drive customers and prospects into the arms of competitors; or will compel organizations to offer steep discounts or other costly programs in order to retain their existing customers and attract new ones.

The sum total of both business at risk and business at growth represents Return on Nothing – the amount of revenue that a company stands to lose by not providing their customers with superior experiences. The full impact of RON can be enormous given the impact to an organization's top and bottom line. The RON



Loyalty Model allows organizations to recognize the scope for potential revenue loss in the event that they continue doing “business as usual” and fail to provide customers with experiences that excite and delight.

The RON Formula – Measuring the Potential Opportunity of Customer Loyalty

Organizations attempting to measure the financial consequences of “doing business as usual” or providing poor customer experiences can use the RON Loyalty Model. It is important to note that companies should choose to focus on those elements of the model most relevant to their respective businesses. For example, some companies may not have a referral program, making calculating the number of referrals (and their associated value) impossible. In this respect, the model is intended to provide organizations with an individualized framework for determining the scope of business that they would have otherwise generated, had they provided their customers with superior quality experiences.

$$\text{Return on Nothing} = \text{Preference} + \text{Portion of Budget} + \text{Premium Pricing} + \text{Promotion} + \text{Permanence}$$

Preference

$$\text{Preference} = \frac{(\text{Number of New Customers} \times \text{Lifetime Customer Value}) - [(\text{Number of New Customers} \times (1 - \text{Percent Decline}) \times \text{Lifetime Customer Value})]}{\text{Number of New Customers}}$$

Portion of Budget

$$\text{Portion of Budget} = \frac{\text{Existing Customers} \times [\text{Entire Budget} - (\text{Entire Budget} \times \text{Existing Budget Percentage})]}{\text{Existing Customers}}$$

Premium Pricing

$$\text{Premium Pricing} = \frac{\text{Number of Customers} \times [(1 - \text{Percent Decline}) \times \text{Lifetime Customer Value} - \text{Lifetime Customer Value}]}{\text{Number of Customers}}$$

Promotion

$$\text{Promotion} = \frac{(\text{Number of Referrals} \times \text{Referral Value}) - (\text{Number of Referrals} \times (1 - \text{Percent Decline}) \times \text{Value of Referrals})}{\text{Number of Referrals}}$$

Permanence

$$\text{Permanence} = \frac{(\text{Number of Customers} \times \text{Existing Relationship Value}) - \text{Number of Customers} \times (\text{Existing Relationship Value} - \text{Revenue Lost})}{\text{Number of Customers}}$$

Key Economics of Relationship Factors

Managing customer relationships is part art, part science. The science component is driven by economics of relationship factors that illustrate the success of any customer experience strategy or initiative. Each factor such as repeat purchases or referrals is based on customer actions rather than on customer intent. In order to utilize the RON Loyalty Model, companies will need to do some homework and identify the following financial drivers.



1. **New customers** – The average number of new customers per year.
2. **Lifetime customer value** – the average amount of money that customers will spend over the lifetime of their relationships.
3. **Annual customer value** – the average amount of money that customers spend each year.
4. **Total annual customer budget** – the total amount of money that customers will spend on a specific category (e.g. office products, entertainment, technology).
5. **Current annual customer budget** – The portion of a customer’s total budget currently being allocated to a specific category.
6. **Customer discount rate** – the anticipated discounts that an organization anticipates giving to its customers each year (and over the lifetime of their relationships).
7. **Customer referral rate** – the number of customer-generated referrals per year (or the average number of referrals per customer).
8. **Customer relationship longevity** – the average length (number of years) of a customer relationship.
9. **Average net price of goods and services** – The price of all goods and services paid by customers.

Number of Existing Customers	
New Customers Per Year	
Customer Relationship Longevity	
Number and Value of Product / Service Discounts	
Portion of Customer Budget	
Product Price	
Number of Products Purchased	
Number and Value of Customer Referrals	
Annual Customer Value	
Lifetime Customer Value	



Financial Assumptions

In addition to the economics of relationship metrics, companies will need to make certain assumptions to determine the impact of RON. As a basis of these assumptions, organizations may opt to use available industry standards (e.g. customer attrition rate) or company-specific historical data (e.g. price erosion over a certain time period).

Organizations will need to make assumptions each of the economic of relationship factors – the **Five P's**:

- **Preference of Company or Product** – the anticipated change in the number of new customers per year.
- **Portion of Overall Customer Budget** – the anticipated change in the amount of money that customers are currently spending with an organization (as a portion of their overall budget).
- **Premium Prices** – the anticipated change in prices for all goods or services purchased by customers; as well as the customer discount rate per for all goods and services.
- **Promotion of Company or Product** – the anticipated change in the number of customer referrals about a company, brand or product.
- **Permanence of Relationship Longevity** – the anticipated change in the average length of a customer relationship.

Product Preference – change in the annual number of new customers	
Portion of Budget – change in (annual) customers' overall budgets captured by a company	
Premium Pricing – change in product prices	
Promotion – change in the annual number of customer generated referrals	
Permanence of Relationship Longevity – change in the length of customer relationships	

Once an organization has benchmarked and gathered this information, it is time to begin using the RON Loyalty Model. The loyalty model is predicated on the assumption that offering experiences of poor quality will lead to a reduction in some or all of the 5 P's – product preference, portion of budget, premium price, promotion, and permanence of relationship longevity. Stated otherwise, companies that do not offer superior customer experiences will not yield additional revenue from customers that they would have otherwise received, had they in fact delivered such experiences. Alternatively, companies stand to lose business from existing customers through attrition, price discounts, and lower spending.

Organizations should consider running multiple scenarios, each with different assumptions (conservative to aggressive), to illustrate the impact of RON to different target executives.



ABC Image In Color - A Case Study

ABC Image In Color Corporation is a regional distributor of printers and toner to small and medium-sized businesses in the Kansas City area. The company services 2000 customers who on average, remain with the company for five years. Additional facts include:

- 200 new customers per year
- \$400 is the cost of a printer. \$150 is the cost per toner
- Customers purchase 6 printers and 120 toners (24 per year) over the lifetime of their relationships
- 50 customer referrals per year
- The average lifetime value of a customer relationship is \$20,400

Assumptions

- Preference – 15% decrease in the average number of new customers
- Portion of Budget – ABC currently receives 75% of their customers total printer and toner budget
- Premium Pricing – 5% decline in product prices
- Promotion – 20% decline in number of referrals
- Permanence – Two year decline in average customer lifetime relationship

By using the RON Loyalty Model ABC Image In Color Corporation was able to calculate the potential cost of not implementing a customer experience strategy. (Note: Please refer to the RON Loyalty Model for formula descriptions).

Preference: $(200 * 20,400) - [200 * (1 - .15) * 20,400] = \$612,000$

ABC Image In Color Corporation stands to lose **\$612,000** each year from a 15% decline in new customer preference.

Portion of Budget: $2000 * [27,200 - (27,200 * .75)] = \$13,600,000$

ABC Image In Color Corporation is losing out on an additional **\$13,600,000** in missed revenue each year.

Premium Pricing: $2000 * [(.95 * 20,400) - 20,400] = \$2,040,000$

ABC Image In Color Corporation stands to lose **\$204,000** from referral revenue each year.

Promotion: $(50 * 20,400) * (50 * (1 - .20) * 20,400) = \$204,000$

ABC Image In Color Corporation stands to lose **\$204,000** from referral or promotion revenue each year.

Permanence: $(2000 * 20,400) - [2000 * (20,400 - \$7200)] = \$14,400,000$

ABC Image In Color Corporation stands to lose **\$14,400,000** from customers leaving after three years (rather than five years).



Total Loss

ABC Image In Color Corporation faces losses totaling \$30,856,000 from not providing superior experiences to its customers. This breaks down into \$612,000 (Permanence), \$13,600,000 (Portion of Budget), \$2,040,000 (Premium Pricing), \$204,000 (Promotion) and \$14,400,000 (Permanence).

Please note that the proposed model does not incorporate any changes to consumer spending and product pricing as a result of the economy, general market trends or competitive dynamics. Each organization will need to determine the impact of extraneous factors and apply them as they see fit. Additionally, the model is constructed so that individuals can extract those relevant components that will best illustrate the impact of RON on their respective organizations.

Summing Up

Designing and deploying a customer experience strategy can no longer be considered as a “nice to have” but should be viewed in the larger context of an organization’s long-term sustainability and overall success. Any successful customer experience strategy should focus on delivering differentiated value to customers, increasing customer loyalty and maximizing revenue. The RON Loyalty Model illustrates that the failure to implement a customer strategy comes at a cost, often, a very high cost. This cost may manifest itself through additional revenue that may have been captured or through the loss of existing revenue streams, had the experiences provided to customer been of higher quality. When considering the relative importance and prioritization of a customer strategy, organizations should use the RON Loyalty Model or conduct a similar analysis to best understand the benefits, consequences and trade offs associated with the implementation (or lack thereof) of a customer experience strategy. Only by looking at a customer experience strategy through the lens of economics of relationships, will organizations be able to place the topic of a customer experience strategy at the top of the corporate agenda, and with it, the highest sense of urgency.



About RightNow Technologies

RightNow (NASDAQ: RNOW) delivers the high-impact technology solutions and services organizations need to cost-efficiently deliver a consistently superior customer experience across their frontline service, sales and marketing touch-points. Approximately 1,800 corporations and government agencies worldwide depend on RightNow to achieve their strategic objectives and better meet the needs of those they serve. RightNow is headquartered in Bozeman, Montana. For more information, please visit www.rightnow.com.

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About Strativity Group

Strativity Group, Inc. is a global customer experience research and consulting firm which assists organizations with the creation of differentiating experiences and profitable customer relationships. Utilizing research, consulting, education and communication programs, Strativity creates and implements customer experience strategies for its clients. At the core of its methodology is the development of action plans that are used to drive organizational change.

Strativity Group, Inc. works with Global 2000 companies as well as emerging businesses around the world. Our clients include Akibia, American Management Association, AMO, Capital One, CATIC, Circle K, CA, Crown Plaza Hotels & Resorts, Dimension Data, DVTEL, FedEx, Herbalife, ICMI, Honeywell, Jacada, Lockheed Martin, Nokia, Nordea, Nortel, RightNow Technologies, Sage, SAP, Seagate Technology, Siemens, The Fund, University of Pennsylvania, Verint Systems and Wyeth.