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## **Loyalty Rules!**

*The Strategic Leadership Forum speaker at the Research Breakfast on Wednesday, October 31, 2001 was Frederick Reichheld, Director Emeritus & Bain Fellow, Bain & Company Inc.*

*Reported by Bob Angel, The Gilford Group Limited*

“Loyalty is dead!” More than a decade ago this newspaper headline typified Frederick Reichheld’s introduction to the subject of loyalty (and the apparent lack of it) in business.

As a relatively new Bain consultant, Reichheld was repeatedly told that loyalty is passé. Staying more than four or five years at the same company clearly signaled limited expertise and lack of ambition. Loyalty? Forget it. Fortunately, Reichheld persevered. He soon emerged as leader of Bain’s loyalty practice and as the author of *The Loyalty Effect*, in 1996, followed by *Loyalty Rules!* in 2001. For practitioners in Client Relationship Management like me, Fred Reichheld, the foremost authority on loyalty, has paved the way for what is today known as CRM.

### **Loyalty as the common ingredient**

Reichheld addressed a sold-out crowd at the SLF’s Breakfast Research Briefing on October 31, 2001. He outlined six principles of loyalty upon which leaders build enduring businesses. He described the Loyalty Acid Test, a tool designed to monitor and diagnose the health of key relationships. And he provided numerous examples of successful organizations that formed the basis of his extensive research into loyalty. Indeed, it was his examination of the successes of several different companies that first alerted him to *loyalty as the common ingredient* – why some organizations succeed, while others fall by the wayside.

Andy Taylor, CEO of Enterprise Rent-A-Car summed it up when Reichheld asked him to what extent loyalty had helped Enterprise achieve the industry’s leading client retention rates, along with sustained growth and lower costs. “Loyalty is everything,” Taylor replied. The Vanguard Group, Nordstrom, Harley-Davidson, Chick-fil-A, USAA, State Farm Insurance, MBNA, Dell, and many others told similar stories.

As Reichheld began to perceive a common thread linking these successful companies, he developed his view of loyalty as a critical factor for success, and he initiated new research into how it may be achieved.



### **Reichheld's thesis**

Simply stated, loyalty is fuelled by leaders who recognize the enormous value of building and maintaining mutually beneficial relationships. The converse is also true. When customers, partners, or employees leave, you generally don't have their loyalty. When the focus of an organization is on building long-term relationships, then the objectives of shareholders and short term accounting profits can be met as a matter of course. Reichheld's research shows that a 5% increase in customer retention rates increases profits by 25% to 90% in the form of lower costs and superior cash flow. For example, Vanguard pays its people more, but boasts the highest loyalty and retention in the industry. It is now #2, and closing in on #1.

Reichheld described his six principles and how to put them into action:

#### **1. Play to win-win**

It's not enough that your competitors lose. Your partners must win. Jeff Bluestein, Harley-Davidson's current CEO, invited his union to participate in the selection of the site for a new plant. Bluestein could have taken advantage of a generally declining union environment, but chose instead to treat them as valued partners. As a result, the unions became firm supporters of the new plant, thus helping to meet its performance goals.

#### **2. Be picky**

The message is, "not just any customer, but only those you can build a mutually beneficial relationship with." MBNA does the math based on relationship duration and cash generated. This company's research on retention statistics has focused it on affinity marketing (for example, setting their sights on teachers as prime targets) so as to avoid short term price-sensitive customers who soon leave for another deal. In general, a price-promotion approach makes it impossible to achieve long-term loyalty.

#### **3. Keep it simple**

Small teams are critical. It is very difficult to maximize accountability or loyalty with big teams. Harley-Davidson has organized into 8 to 10-unit teams on its shop floor, to which Bluestein attributes many of Harley's productivity and quality improvements.

#### **4. Reward the right results**

"Taking your customer hostage" is not loyalty. One example of this is enticing new clients with low prices and then raising them once the customers are locked into the company. To reward the right results, Vanguard drops its pricing by one third for longtime customers. Andy Taylor of Enterprise refuses to promote any employee in the bottom half of the firm's performance rankings. This strategy delivers a very clear message as to what result is important.

#### **5. Listen hard, talk straight**

Long-term relationships require honest, two-way communications and learning. Bucking prevailing wisdom, Enterprise Rent-a-Car was candid with employees about the challenges of competing as an independent against huge new market entrants like Ford and GM. This daring approach paid off: Free and open discussions stimulated creative new strategies that eventually resulted in Enterprise outperforming all its competitors.

#### **6. Preach what you practice**

Write down your position and make sure everyone understands it. When Intuit's founder, Scott Cook, read in a newspaper that a bug had been found in Intuit's software, he was traveling to



make a speech. He quickly instructed his executive team to handle the crisis according to Intuit's core values. Because these were well known within the company, by the time Cook had finished his speech that day, Intuit had offered a new copy of the software to anyone who requested it – without proof of purchase. Later, when Microsoft offered its personal finance software for free, Intuit customer loyalty was so intense that its customers refused to switch.

### **Summing up**

Reichheld's Loyalty Acid Test (take the test yourself on-line at [www.loyaltyrules.com](http://www.loyaltyrules.com)) addresses the essential question of whether or not your organization deserves loyalty. While 87% of executives provide a "yes" answer, only 51% of their employees agree. However, the employee "yes" score rises to 75% for the leading companies. In other words, in the average company, half of the employees do not believe their organization deserves loyalty and are likely undermining profits.

Efforts to satisfy employees do not necessarily help, especially if long tenure means just staying there. In fact, longer tenure often means disillusion. Reichheld's research indicates that only 39% of long-term employees think their company tells the truth.

In an active Q & A session, Reichheld addressed the concept of loyalty in a slowing economy. Successful leaders anticipate well, and don't over-hire in good times. They make layoffs for individual performance reasons, not because the economy cools. In firms that adhere to the philosophy of small teams, poor performance cannot be hidden. Reichheld went on to explain the subtle difference between loyalty and trust. Loyalty is the right standard, then trust follows.

Reichheld views the September 11 terrorist attacks in the US as an opportunity to redefine principles. He noted a back-to-basics movement, re-examining life's priorities. In summary, he quoted Meg Whitman of eBay, declaring, "Loyalty is the primary ingredient."

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