E-Loyalty: Your Secret Weapon on the Web

by Frederick F. Reichheld and Phil Schefter

Harvard Business Review

Reprint R00410

Harvard Business Review

JULY – AUGUST 2000

Reprint Number

E-Loyalty

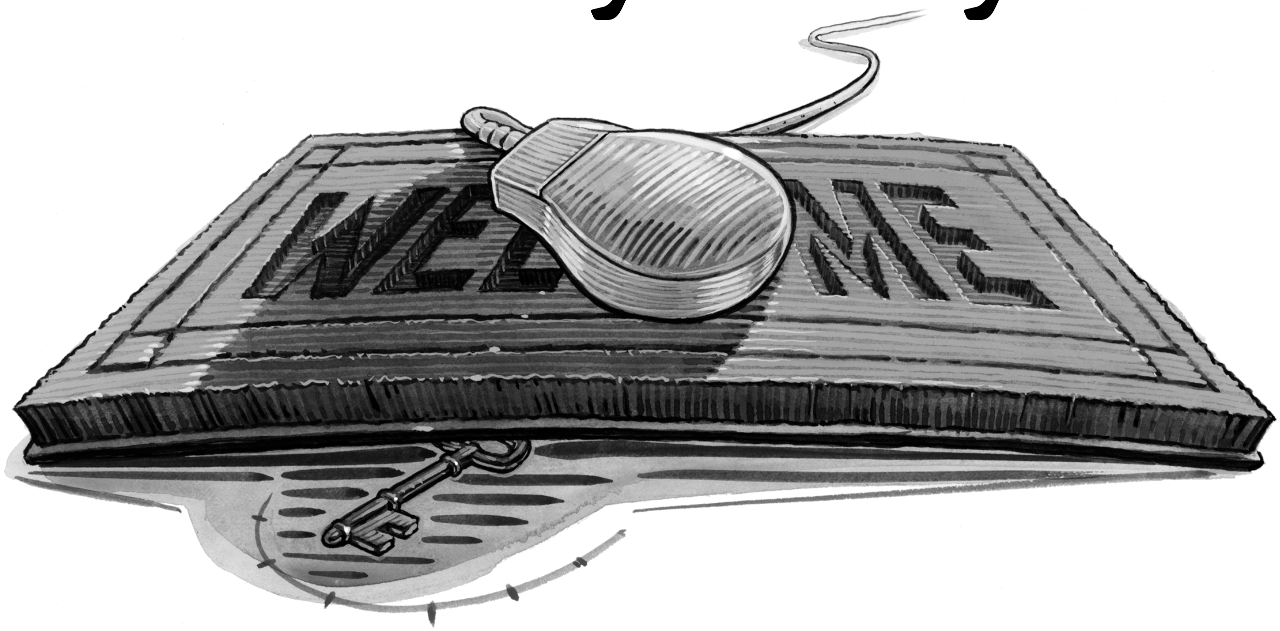


ILLUSTRATION BY DOUGLAS JONES

Your Secret Weapon on the Web

In the rush to build Internet businesses, many executives concentrate all their attention on attracting customers rather than retaining them. That's a mistake. The unique economics of e-business make customer loyalty more important than ever.

by Frederick F. Reichheld and Phil Schefter

LOYALTY MAY NOT BE THE FIRST idea that pops into your head when you think about electronic commerce. After all, what relevance could such a quaint, old-fashioned notion hold for a world in which customers defect at the click of a mouse and impersonal shopping bots scour databases for ever better deals? What good is a small-town virtue amid the faceless anonymity of the Internet's global marketplace? Loyalty must be on a fast track toward extinction, right?

Not at all. Chief executives at the cutting edge of e-commerce – from Dell Computer's Michael Dell to eBay's Meg Whitman, from Vanguard's Jack Brennan to Grainger's Richard Keyser – care deeply about customer retention and consider it vital to the success of their on-line operations. They know that loyalty is an economic necessity: acquiring customers on the Internet is enormously expensive, and unless those customers stick around and make lots of repeat purchases over the years, profits will remain elusive. They also know it's a competitive necessity: in every industry, some company will figure out how to harness the potential of the Web to create exceptional value for customers, and that company is going to lock in many profitable relationships at the expense of slow-footed rivals. Without the glue of loyalty, even the best-designed e-business model will collapse.

Over the past two years, we have been studying e-loyalty with our colleagues at Bain & Company. We have analyzed the strategies and practices of many leading Internet companies, evaluated the designs and workings of their Web sites, and surveyed thousands of their customers. What we've uncovered may come as a surprise. Contrary to the common view that Web customers are fickle by nature and will flock to the next new idea, the Web is actually a very sticky space in both the business-to-consumer and the business-to-business spheres. Most of today's on-line customers exhibit a clear proclivity toward loyalty, and Web technologies, used correctly, reinforce that inherent loyalty. If executives don't quickly gain the loyalty of their most profitable existing customers and acquire the right new customers, they will face a dismal future catering to the whims of only the most price-sensitive buyers.

Price does not rule the Web; trust does.

We've heard new-economy pundits argue that the Internet has overturned all the old rules of business. But when it comes to customer loyalty, the old rules are as vital as ever. Loyalty is still about earning the trust of the right kinds of customers – customers for whom you can deliver such a consistently superior experience that they will want to do all their business with you. The Web does, however, raise new questions and open new opportunities: it places the old rules in a new context. Our goal in this article is to describe that context and its implications.

Frederick F. Reichheld *is a director emeritus of Bain & Company and a Bain Fellow. He is the author of* The Loyalty Effect *(Harvard Business School Press, 1996) and the forthcoming* Building Loyalty in the Age of the Internet *(Harvard Business School Press, 2001).*

Phil Schefter *is a vice president in Bain's Boston office and a leader in the firm's e-commerce practice.*

The Economics of E-Loyalty

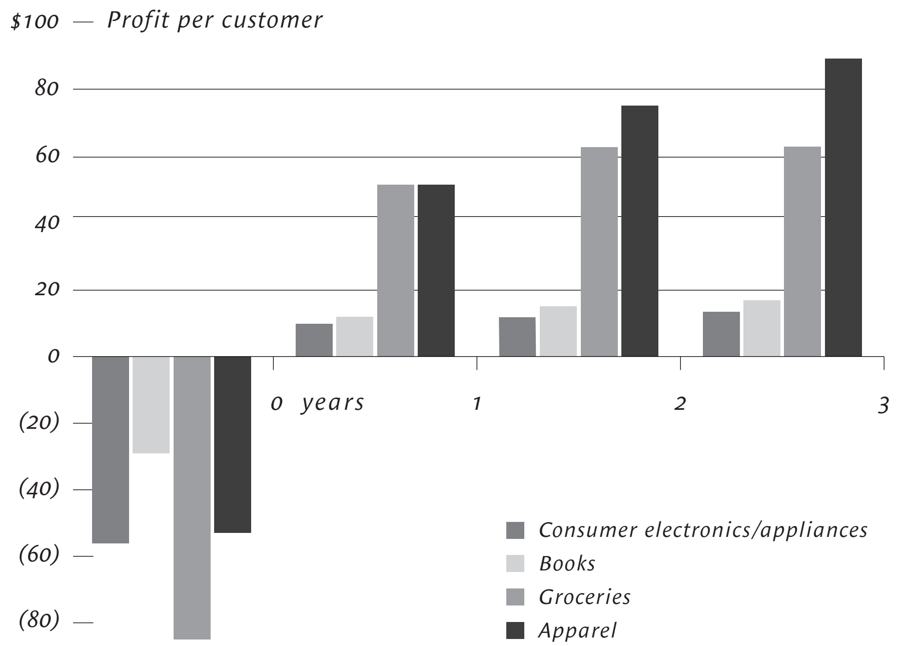
Ten years ago, Bain & Company, working with Earl Sasser of Harvard Business School, analyzed the costs and revenues derived from serving customers over their entire purchasing life cycle, and we published the results in this magazine. (See "Zero Defections: Quality Comes to Services" in the September–October 1990 issue.) We showed that in industry after industry, the high cost of acquiring customers renders many customer relationships unprofitable during their early years. Only in later years, when the cost of serving loyal customers falls and the volume of their purchases rises, do relationships generate big returns. The bottom line: increasing customer retention rates by 5% increases profits by 25% to 95%. Those numbers startled many executives, and the article set off a rush to craft retention strategies, many of which continue to pay large dividends.

When we applied the same methodology to analyzing customer life-cycle economics in several e-commerce sectors – including books, apparel, groceries, and consumer electronics – we found classic loyalty economics at work. In fact, the general pattern – early losses, followed by rising profits – is actually exaggerated on the Internet. (See the exhibit "Customer Life-Cycle Economics in E-Commerce.") At the beginning of a relationship, the outlays needed to acquire a customer are often considerably higher in e-commerce than in traditional retail channels. In apparel e-tailing, for example, new customers cost 20% to 40% more for pure-play Internet companies than for traditional retailers with both physical and on-line stores. That means that the losses in the early stages of relationships are larger.

In future years, though, profit growth accelerates at an even faster rate. In apparel e-tailing, repeat customers spend more than twice as much in months 24–30 of their relationships than they do in the first six months. And since it is relatively easy for Web stores to extend their range of products, they can sell more and more kinds of goods to loyal customers, broadening as well as deepening relationships over time. The evidence indicates, in fact, that Web customers tend to consolidate their purchases with one primary supplier, to the extent that purchasing from the supplier's site becomes part of their daily routine. This phenomenon is particularly apparent in the business-to-business sector. For example, W.W. Grainger, the largest industrial supply company in the United States, discovered that longtime customers, whose volume of purchases through Grainger's traditional branches had stabilized, increased their purchases substantially when they began using Grainger's Web site. Sales to these customers increased at triple the rate of similar customers who used only the physical outlets.

In addition to purchasing more, loyal customers also frequently refer new customers to a supplier, providing another rich source of profits. Referrals are lucrative in traditional commerce as well but, again, the Internet amplifies the effect, since word of mouse spreads even faster than word of mouth. On-line customers can, for example, use e-mail to broadcast a recommendation for a favorite Web site to dozens of friends and family members. Many e-tailers are now automating the referral process, letting customers send recommendations to acquaintances while still at the e-tailers' sites. Because referred customers cost so little to acquire, they begin to generate profits much earlier in their life cycles.

Customer Life-Cycle Economics in E-Commerce



Source: Bain & Company and Mainspring

EBay is one e-commerce leader that is reaping the economic benefits of referrals from loyal customers. More than half its customers are referrals. "If you just do the math off our quarterly financial filings," CEO Meg Whitman recently told the *Wall Street Journal,* "you see that we're spending less than $10 to acquire each new customer. The reason is that we are being driven by word of mouth." EBay has even found that the costs of supporting referred customers are considerably lower than for those brought in through advertising or other marketing efforts. Referred customers tend to use the people who referred them for advice and guidance rather than calling eBay's technical support desk. In effect, loyal customers not only take over the function of advertising and sales, they even staff the company's help desk – for free!

The combination of all these economic factors means that the value of loyalty is often greater on the Internet than in the physical world. For all companies doing business on the Web, the implication is clear: you cannot generate superior long-term profits unless you achieve superior customer loyalty.

A Matter of Trust

To gain the loyalty of customers, you must first gain their trust. That's always been the case, but on the Web, where business is conducted at a distance and risks and uncertainties are magnified, it's truer than ever. On-line, customers can't look a sales clerk in the eye, can't size up the physical space of a store or office, and can't see and touch products. They have to rely on images and promises, and if they don't trust the company presenting those images and promises, they'll shop elsewhere. In fact, when we asked Web shoppers to name the attributes of e-tailers that were most important in earning their business, the number one answer was "a Web site I know and trust." All other attributes, including lowest cost and broadest selection, lagged far behind. Price does not rule the Web; trust does.

When customers do trust an on-line vendor, they are much more likely to share personal information. That information enables the company to form a more intimate relationship with customers, offering products and services tailored to their individual preferences, which in turn increases trust and strengthens loyalty. Such a virtuous circle can quickly translate into a durable advantage over competitors.

Amazon.com, for example, has come to dominate the on-line book market by creating the most reliable and trustworthy Web site in the business. Millions of customers feel comfortable letting Amazon store their names, addresses, and credit card numbers in its ordering system. The resulting convenience – customers can make repeat purchases with just one click – has become a critical competitive edge. It's one of the biggest reasons customers keep coming back – to buy not just books but also CDs, videos, hardware, and myriad other products. If customers didn't trust Amazon, if they feared that their credit card numbers might be compromised or that they might be deluged with a torrent of spam, they would never share their personal information, and the company would quickly lose its privileged position. The company understands the value of trust very well. In 1999, when the media revealed that Amazon was accepting compensation from publishers for its purportedly independent book reviews, it reversed course immediately. It realized it was putting its most important asset at risk.

Another exemplary company that uses trust as the foundation for loyalty is the Vanguard Group. The fastest growing mutual fund company over the past decade, with more than $500 billion in assets currently under management, Vanguard has poured more than $100 million into the development of its Web site. Unlike many of its competitors, Vanguard doesn't use the site to hype its products. Rather, it uses its on-line presence to inform and educate its customers – even when that means leading them *away* from a purchase. When you click through Vanguard's pages, you are often warned against investing in certain funds. You may, for example, receive a message advising you that one fund is approaching its dividend distribution date and suggesting that you postpone investments to avoid incurring tax liabilities. Or you may see certain funds flagged because their recent performance has been particularly strong. The descriptions of such high-fliers usually bear a note of caution from CEO Jack Brennan warning that recent returns may not be sustainable in the future. That's quite a contrast from most fund companies, which lure investors by aggressively promoting the returns of hot funds.

Vanguard understands that building trust leads to more enduring relationships – and more profits – while a quick sale may simply leave a customer feeling cheated. Says Brennan: "Trust is our number one asset at Vanguard. We recognize you can't buy trust with advertising or salesmanship; you have to earn it – by always acting in the best interests of customers. We didn't design our Web site to sell more products and services. We designed it to educate our customers and provide better and more timely information and advice so they can make better decisions."

Vanguard goes against the grain of common Web strategy in another way: it makes it difficult for customers to access its site. Account holders must first apply for a password, which, instead of being delivered immediately via e-mail, is mailed from headquarters to ensure confidentiality. Then, to actually enter the site, customers have to upgrade to a 128-bit browser that is compatible with the sophisticated encryption technology Vanguard created to guard account information. Downloading the browser can take an hour or more. "Sure, the 128-bit encryption security requirement can be a hassle," says Brennan, "but we believe it is the right way to protect our customers' assets." The strategy is paying off. Vanguard's site already accounts for 40% of the company's interactions with customers and, for all its quirkiness, has received numerous honors, including the Webby Award for site design.

In addition to generously rewarding trust, the Internet opens new opportunities to build trust. Everyone knows, for example, that communities flourish on the Web. Less understood is how the trust built up in such communities can be transferred to the companies that host them. Again, eBay provides a great example. In the past, fears about reliability and fraud prevented the exchange of used merchandise among strangers from developing into a big business. But eBay used the unique capabilities of the Web to establish and enforce rules of engagement. Buyers and sellers rate each other after every transaction, and the ratings are posted on the site; every member's reputation thus becomes public record. EBay further reduces customers' risks by automatically insuring the first $200 of each transaction, thus insulating sellers from unscrupulous buyers, and it will hold money in electronic escrow until the buyer is satisfied with the merchandise received. In a sense, eBay is using the Internet to bring small-town rules of trust to the most challenging of markets – a global network of strangers. And it is reaping the rewards of its members' loyalty.

Focusing on the Right Customers

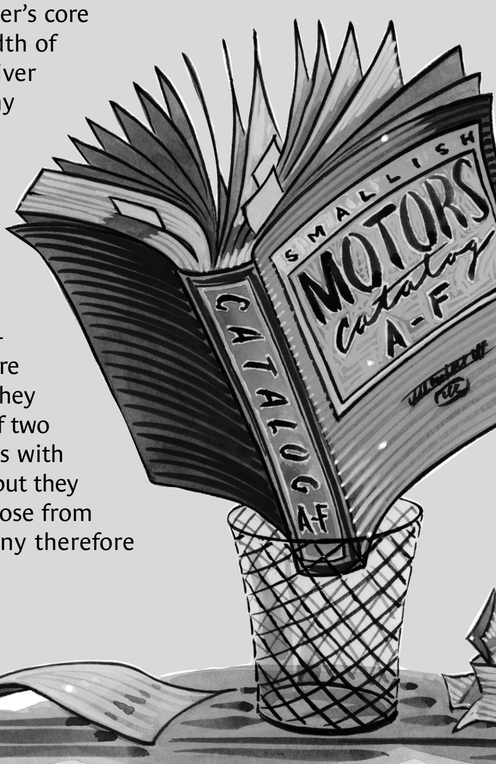
When many executives and entrepreneurs look at the Web, they see an opportunity to break free from one of the core constraints of the traditional busi-

How Grainger Helps Customers Make Sense of Complexity

The Web creates an almost infinite set of product and service possibilities, freeing companies from all sorts of traditional limitations, including location, shelf space, and the product knowledge of salespeople. But with the freedom to do more comes the temptation to do too much. Companies can present so much information and so many choices that customers are left confused and frustrated.

The business-to-business powerhouse W.W. Grainger has spent a lot of time thinking about how to help customers make sense of complex offerings – both in its physical network of branches and on its Web site. One of Grainger's core advantages is the breadth of its selection – it can deliver any product a company needs when it needs it. Totaling some 4,000 pages, Grainger's traditional paper catalog includes almost 90,000 maintenance and repair products. Many customers, however, find the catalog more than a little daunting. They like to have the choice of two or three different motors with the same power rating, but they really don't want to choose from a list of 20. The company therefore encourages customers to discuss their needs with the branch employees who can simplify the choices. And because Grainger recognizes that customers have to trust employees in order to cede power over their purchases, it carefully trains its people to act in their customers' best interests, not to simply maximize the sales commission or branch profitability.

When Grainger moved to the Web, its already staggering selection of products more than doubled. The customer who clicks onto Grainger's site will find a quarter of a million different products – the equivalent of a 10,000-page catalog. Without skillful presentation, this welter of information would be overwhelming. But Grainger has taken pains to simplify and speed product searches so customers can click onto only those options that interest them. And for thousands of its best accounts, the company has integrated customer-specific pricing on-line, which further simplifies the shopping experience. Grainger knows the Web provides infinite possibilities for new products and services, but it also knows that customers will trust only a vendor that demonstrates a deep understanding of their particular needs and that helps them navigate the various choices and trade-offs.



ness world: the need for focus. Because a Web site is accessible to any on-line customer anytime, anywhere, there is a huge temptation to try to attract as many potential buyers as possible. That temptation is reinforced by the vast up-front investments in site development and process design that companies often have to make in launching an e-business. Executives presume that these fixed costs should be amortized over as many customers as possible. So they become caught up in a frenzy of indiscriminate customer acquisition, gauging their success by the sheer number of page views, unique visitors, and sales they rack up. The fact that careful customer selection has always been a foundation of business success gets completely ignored.

A lack of focus makes building loyalty much more difficult. Customers want Web sites that are simply designed, fast to load, and easy to use, but the broader the array of customers a company attempts to serve, the more complex its site inevitably becomes. In trying to be all things to all people – to accommodate all levels of technical expertise, all service requirements, all price sensitivities, and all degrees of brand preference – it must constantly add new features and functions. As it does, its site becomes slower to load and more complicated to use. Customers flock in but, confused by what they find, they rarely return. (See the sidebar "How Grainger Helps Customers Make Sense of Complexity.")

An indiscriminate approach to customer acquisition also undermines profitability – a fact that is often overlooked in e-commerce, as investors and executives focus their attention on traffic statistics. The simple arithmetic of loyalty economics makes it clear that in most Web businesses, customers must stay on board for at least two to three years just for a company to recoup its initial acquisition investment. Yet we found that a large percentage of new customers – up to 50% in some sectors – defect before their third anniversary with an e-commerce site. Any company pursuing a strategy of grabbing customers as quickly as possible without regard to their potential for long-term relationships is in for a very bad surprise – as are its investors. (See the exhibit "The High Cost of Low Loyalty.")

Vanguard's experience reveals the wisdom of focus. It has created both strong customer loyalty and a substantial cost advantage through its highly disciplined approach to attracting customers. The company concentrates on individuals with long-term investment horizons who appreciate the low-cost, low-churn advantages of index fund investing – Vanguard's specialty; it has honed its marketing and customer acquisition activities to cater to that segment. Its relentless focus has allowed it to maintain an overwhelming cost advantage: its expenses as a percentage of average assets run at 30 basis points versus 120 for competitors. Vanguard spends, for instance, only about one-tenth of what competitors do on advertising, yet it adds new customers faster than most of them due to word-of-mouth recommendations. It also minimizes its operating complexity by investing only in those features and products that appeal to its target customers.

If a company assumes that the customers it is losing to dot-coms are motivated solely by price – and thus not worth defending – it is probably mistaken.

In moving to the Web, Vanguard has been careful not to dilute its focus; its site is tailored to the needs of its core customers. Vanguard.com's brokerage arm, for instance, does not provide the kind of sophisticated trading capabilities other on-line brokerages offer. The company made a conscious choice to forgo the business of speculators in order to cater to its traditional, more conservative clients. The typical Vanguard brokerage customer, who trades only three or four times a year, would simply be confused by the complex information screens that day traders demand.

In identifying which customers to attract – and which to avoid – the first step is to clearly assess the different categories of on-line customers. Contrary to a common perception, the majority of on-line shoppers are not out to score the absolute lowest price. The largest single segment of on-line customers, we found, are seeking convenience above all else. They want to do business with a site that makes their lives easier, and they are willing to pay more for that convenience. Price rational but not price obsessive, they also have a strong inclination toward loyalty. After all, returning to a familiar site is much more convenient than scouting out a new one. Another large group of customers are influenced primarily by brand. They, too, are looking for stable, long-term relationships. If a company assumes that the customers it is losing to dot-coms are motivated solely by price – and thus not worth defending – it is probably mistaken.

The way a site is designed and marketed has a large impact on the types of customers it attracts. Our research reveals that the mix of customer segments varies widely among Web competitors within the same market; some sites attract a rich mix of loyalty-oriented customers and others primarily attract the price butterflies who flit from site to site seeking bargains. In the grocery business, for example, 75% of one leading company's new customers are relationship-averse bargain hunters, while 75% of a direct competitor's new customers are convenience- and brand-driven shoppers.

The loyalists we surveyed found sites mostly through referrals. The butterflies, by contrast, reported that they were lured by promotional discounts and general advertising. In the grocery segment, for example, the best butterfly bait seemed to be untargeted banner ads. If a Web company is spending most of its marketing dollars on indiscriminate banner ads and on-line coupons, with little investment in building communities and promoting referrals, it is probably building long-term losses into its customer base.

Learning About Loyalty

While the Internet may seem like an anonymous space, in reality it is far easier to track customers, their purchase histories, and their preferences on-line than in a traditional business setting. Customers in bricks-and-mortar stores leave no record of their behavior unless they buy something – and even then the data are often sketchy. But in virtual stores, their shopping purchase patterns are transparent. Every move they make can be documented electronically, click by click. If a customer exits a Web site when the price screen appears, it's a fair bet that he's price-sensitive. If he jumps from page to page without ever initiating a transaction, he's probably frustrated at being unable to find what he wants.

By providing such rich data, the Internet offers companies unprecedented opportunities for getting to know their customers in depth and for customizing offerings to meet their preferences. Very few companies, however, are actually doing much to realize that potential. We found that less than 20% even track customer retention rigorously, let alone try to systematically learn from customer defection patterns. Instead, they are fixated on building their Web capacity and increasing their visitor counts, click-throughs, and on-line sales. As a result, they overlook opportunities for upselling and cross-selling and end up capturing a much smaller share of customers' overall purchases than they might have. Research shows, in fact, that the average Web site achieves less than 30% of its full sales potential with each customer.[1]

America Online is an exception. It meticulously measures customer loyalty and purchase patterns and uses that information to guide its decisions about strategy, marketing, and site design. To the casual observer, the company's approach to customer acquisition may seem like a carpet bombing of free diskettes, but the approach is based on a careful analysis of the retention rates and life-cycle economics of different customer segments. The company conducts many small-scale tests of creative customer-acquisition programs, but it invests heavily only in those that are likely to bring in customers whose long-run revenues justify their acquisition cost.

When AOL upgraded its software from version 3 to version 4, data on customer behavior informed many of its technological decisions. For example, AOL had been carefully monitoring the root causes of calls to its customer support center, and it made improvements to the new software, such as making the help menu easier to use, that solved the problems generating a large percentage of the calls. AOL knew that handling fewer calls would reduce its support costs, but that was not its primary impetus. Its core goal was to enhance the convenience of its service – and thus strengthen its appeal to and its

hold on convenience-driven customers. The company also analyzed the drivers of customer loyalty in creating the upgrade. It had found that customers were much more likely to maintain their accounts when AOL was part of their daily routine, so it enhanced the software's calendar and scheduling functions and its stock-portfolio tracking service. As customers have increasingly used AOL to manage their day-to-day lives, the service has become much more sticky.

Dell Computer is another company that has made the measurement of customer behavior a cornerstone of its e-business strategy. The company set up a customer experience council, reporting to a corporate vice chairman, to oversee its measurement efforts and its loyalty-building programs. Senior executives from each of the company's major business lines and functions participate in the council. In a recent interview, council member and senior vice president Paul Bell explained that Dell looks to apply the same rigor to tracking customers as most companies do to tracking financial results: "Every public company tells shareholders how it's doing every quarter, but few companies have a set of metrics that measure the customer experience from month to month, quarter to quarter [as we do]."

Grainger does not view the Web as a way to reduce costs by bypassing its commissioned sales force. It pays commissions no matter which channel is used.

After studying data on customer retention, the council found three key drivers of loyalty: order fulfillment, product performance, and postsale service and support. It then identified the best summary statistic for each driver. For order fulfillment, it chose "ship to target," which measures the percentage of orders delivered to the customer on time with complete accuracy. For product performance, it picked "initial field incident rate," which measures the frequency of product problems encountered by customers. For service and support, it chose "on-time, first-time fix," which measures the percentage of problems fixed on the first visit by a service rep who arrives at the time promised.

The council set up systems to track each statistic, and the performance data are updated daily and shared with all employees. In addition, aggressive improvement targets have been established for each measure, and management bonuses are tied to their fulfillment. Dell tracks many other aspects of service performance and customer response, of course, but by focusing its organization on the three summary measures, it has simplified its goals and created a rallying point for employees. In 1999, the program achieved a 15% rate of improvement, and similar gains are expected in the future.

Another metric tracked by most loyalty leaders is the lifetime ownership cost of their products or services. Dell, for example, calculates all the costs its customers incur in shopping for, ordering, installing, operating, servicing, and disposing of computers and necessary software – whether those costs are paid to Dell or to other parties. That information guides the company's investments in new products and services; Dell places a high priority on investments that create new revenue streams for the company while reducing customers' overall ownership costs and thus strengthening their loyalty. An example of such an investment is the Dell Auction site, where customers can sell their outdated equipment. The auction benefits the customer while generating fees for Dell.

The real value of tracking measures of loyalty is that it allows companies to see beyond today's fads to the underlying drivers of business success. In studying repurchase patterns at leading Web sites, we found that the five primary determinants of loyalty don't consist of technological bells and whistles, but rather old-fashioned customer-service basics: quality customer support, on-time delivery, compelling product presentations, convenient and reasonably priced shipping and handling, and clear and trustworthy privacy policies. Of course, the drivers of loyalty will vary for each business and will evolve over time. But executives who don't set clear loyalty targets and measure their progress will inevitably drift toward weak retention performance as their organizations focus their energy in less productive areas. The long-term economic consequences of such a passive approach to e-loyalty will be dire.

The Big Picture

Many companies have been tempted to split their Web businesses from the rest of their operations – in hopes of cashing in on investors' enthusiasm for dot-coms or of making it easier to attract the kind of talent required to manage Web activities. In the short run, such a strategy may create benefits; over the long run, however, it is likely to erode customer loyalty. After all, when a customer does business with a company, she doesn't distinguish between a transaction on the Web and one in a physical store or branch – they are both elements of her total experience with the company. Leaders like Vanguard, Dell, and Grainger understand that loyalty is determined by the full range of their interactions with customers, and they consciously integrate their operations to produce a seamless, quality experience.

In this view, the Web becomes, to borrow a phrase from Vanguard's Jack Brennan, "a tool, not a strategy." Its unique capabilities are used to improve communications with customers, to enhance organizational learning about customers' needs and increase responsiveness, to reduce customers' transaction costs, and to enhance convenience – all of which are vital for developing strong and durable relationships. But these capabilities are not exercised in isolation. They are plugged into the full range of corporate capabilities.

When an employee of one of Dell's corporate customers needs to order a computer from Dell, for example, chances are good that one of Dell's more than 2,000 direct sales representatives has already worked face-to-face with the company's purchasing staff to hammer out pricing schedules and hardware and software configurations. The individual employee is thus free to place the order over the phone, on the Web, or through the mail, whichever is most convenient, and can subsequently draw on those channels, in any combination, to check on the order's progress or to ask questions. And when the machine arrives, it doesn't have to be routed through the company's IT help desk to have inventory tags applied or software configured – Dell has already done that. If there's a technical problem, the employee or a corporate technician can access customized diagnostic and prescriptive information on the Web or over the phone with a Dell technician. This exceptional integration of customer service is what distinguishes Dell from the competition and makes life much easier for the customer.

Grainger is another company that seamlessly integrates its Web channel with its traditional business. It has spent more than $75 million to build its highly successful Web operation, which now transacts more sales than all but a handful of other business-to-business sites. Customers clearly appreciate the site's 24-hour availability – nearly one-fourth of Grainger's Web orders come in during times when its branches are closed. But Grainger does not view the Web channel as a way to reduce costs by bypassing its commissioned sales force. Rather, it pays sales commissions no matter which channel is used. That way, the sales reps will always direct customers to the most convenient channel. Grainger's goal is to earn an ever-higher share of each customer's business – and because it never loses sight of the overall customer experience, it is succeeding. Its customers are increasing their Web purchases at more than double the rate for the overall industry.

Home Depot, which most people view as a purely bricks-and-mortar retailer, has also done an exemplary job of integrating the Web with its traditional business. Because small contractors are one of the company's most profitable segments, its Web site focuses on serving these customers better. Contractors can check the Web to see if their orders are available for pickup at the store, thus saving themselves (and store personnel) both time and aggravation. While this new Web capability does not directly generate more revenues, it does increase the value delivered to a group of highly profitable customers and thus increases the likelihood that they'll continue to buy from Home Depot. Integration strengthens loyalty.

Nothing but the Truth

In the end, loyalty is not won with technology. It is won through the delivery of a consistently superior customer experience. The Internet is a powerful tool for strengthening relationships, but the basic laws and rewards of building loyalty have not changed. By encouraging repeat purchases among a core of profitable customers, companies can initiate a spiral of economic advantages. This loyalty effect enables them to compensate their employees more generously, provide investors with superior cash flows, and reinvest more aggressively to further enhance the value delivered to customers.

What is changing is the pace at which these economic rules are playing out, and the speed with which companies must improve their products and services if they hope to keep customers loyal. Customers' tolerance for inconsistency and mediocrity is rapidly disappearing. In the past, convenient store locations, aggressive sales forces, and a general lack of information shielded companies from the penalties of providing anything less than the best product and service quality; customers were loyal by necessity, not choice. Thanks to the Internet, those shields have been dismantled. Customers can compare suppliers in real time, all the time. Building superior customer loyalty is no longer just one of many ways to boost profits. Today it is essential for survival.

1. See Sarabjit Singh Baveja, "Making the Most of Customers," *Industry Standard*, February 28, 2000.

Reprint R00410 To place an order, call 1-800-988-0886.