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Building Loyalty in Business Markets

by Das Narayandas

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Tool Kit

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Paradoxical though it may sound, the strategies that companies use in business markets often come between them and the customers they desire. Every organization knows that in order to succeed, it must acquire and retain customers, especially profitable ones. Companies start by asking the vision question: What businesses are we in? Then they segment the businesses and deploy branding strategies, communication tactics, and sales tools. That top-down approach may work well for consumer products, but in business markets, it leads companies astray, hampering their efforts to acquire and retain customers.

Business markets are very different from consumer markets. In a consumer market, large numbers of buyers have similar wants, transactions are usually small in value, products can be mass-produced, consumers’ perceptions determine products’ value, and companies focus on managing brands. In addition, the selling process is brief, retailing strategies play a vital role, and sales efforts are focused on end users. A business market, by contrast, has fewer customers, and transactions tend to be larger. Customers often need a customized product or price, the usage of the product or service determines its value, and brands mean very little to customers. Moreover, selling is a long and complex process, retailing isn’t a factor, and the target of the sales pitch may not be the product’s end user.

Still, companies tend to apply consumer marketing solutions to business markets willy-nilly, with poor results. For example, the classic consumer marketing approach of segmenting people by characteristics or behavior, and communicating the product features that matter to each segment, doesn’t work in business settings. That’s because in business markets, a given customer will use a vendor’s products in numerous different applications. Also, industrial commodities (think of cement, for instance, or soda ash) aren’t easily differentiated by their features. Customers are interested only in the money they can save by buying from one vendor instead of another.

Another textbook strategy in consumer
marketing is to group people with similar needs, so that a company can reach out to them through advertising and other forms of mass communication. That, too, fails to work in business markets because each customer uses machines and materials differently, often specifying distinct characteristics for them. Almost every customer needs a customized product, quantity, or price. In fact, each segment effectively consists of one customer. Such “segments of one” render marketwide selling tactics expensive and ineffectual; instead, firms must communicate directly to each customer the value they deliver. Thus, companies in business markets must use an approach that is based on benefits (“Here's how our product or service can help solve your specific problems”) rather than features (“Here's how our product is superior”).

Managing individual customers is tough, but it has become an imperative in business markets today. In many industries, suppliers have no choice but to focus on the few large customers that survived the wave of mergers and acquisitions in the 1990s. In addition, vendors have zeroed in on a few midsize buyers that are the profit bulges in their customer bases. And as competition has intensified in business markets, customers have demanded more services and support. Suppliers can deliver those services only if they understand what each customer wants. Besides, technological advances have reduced companies' costs of collecting and analyzing data on each customer. Despite executives' fears about the additional costs, my research shows that companies benefit by entering into long-term, individual relationships with most customers in business markets.

Clearly, marketers need to think—and sell—in terms of the benefits they provide customers or the customer problems they solve. I have been researching business markets for more than 14 years. I find that most marketers are so busy figuring out how their companies can create value that they don't pay attention to communicating the benefits their companies deliver to customers. Marketers rarely even think about the different types of benefits their companies offer and are often unable to convey the value of benefits to the executives who want them. I also find that companies often don't focus on developing individual relationships so that each customer becomes more loyal. That's a mistake, because in business markets, loyalty offers companies several advantages. In the following pages, I will show how companies can communicate benefits effectively to acquire customers and to develop loyal customers over time.

### A Typology of Benefits

Companies rarely, if ever, take the trouble to communicate to prospective customers all the economic, technical, service, and social benefits they provide. Most sellers simply assume that buyers grasp the value of products and services. That's a reasonable assumption, but it's dead wrong. My studies show that business buyers don't keep track of all the products and services they get and that they cannot quantify the value of many benefits. For instance, Arrow Electronics started coordinating parts of customers' supply chains and offering engineering design services in the late 1980s. A decade later, the electronic-components distributor was shocked to find that companies regularly using those services weren't aware that they were provided by Arrow. Similarly, a medical instruments manufacturer found from annual surveys that not one of the executives who worked for its customers was aware of all the services that the company provided his or her organization. In fact, buyers don't use some services that suppliers routinely provide, and they stop using others if vendors charge for them. When Owens & Minor, a medical supplies distributor, made customers pay for each service instead of charging them for a bundle, it discovered that hospitals quickly learned to do without many services.

When I work with companies, I find it's useful for executives to think about a product's value by grouping its benefits into four categories:

- **Tangible financial benefits** have value that sellers can communicate and buyers can verify. For example, Volvo can use standard measures like horsepower and torque to prove that its truck engines are more powerful than competitors', and fleet owners can calculate the money they will save by using Volvo engines to haul greater loads or to move loads faster. Industrial marketers often highlight tangible financial benefits because prospects grasp their value easily and can verify claims before purchasing products. However, if one vendor can offer such benefits, so can rivals. That kind of com-

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petition inevitably leads to price wars.

**Nontangible financial benefits** are those with value that sellers can convey but buyers cannot easily validate. For instance, when SalesSoft, an early entrant in the sales software market, told potential customers that it could estimate the additional revenues they would generate by using its software suite, most prospects were skeptical about the claims. Such situations pose a challenge to marketers, particularly because nontangible financial benefits are an effective way of differentiating industrial products.

Companies can convince prospects of the value of nontangible financial benefits in several indirect ways. They can use research from independent agencies to overcome prospects’ skepticism. Alternatively, suppliers can conduct pilot projects at potential customers’ facilities. Siebel Systems, for instance, started out in the early 1990s by doing everything it could to get prospects to agree to pilot projects. The company realized that once buyers estimated the savings from those projects, they found it easy to make purchase decisions. Vendors can also offer customers money-back guarantees or penalty payments if products don’t perform as well as advertised. However, customers demand large sums as compensation, and marketers find it difficult to provide credible guarantees in business markets. For instance, when a leasing company offered $100 rebates if it didn’t process orders within a specified time period, customers weren’t impressed. They wanted the firm to reimburse them any money they lost because of processing delays, a promise the leasing company could not afford to make.

Whenever possible, vendor companies should change the game’s rules by proposing pay-for-performance contracts. In my experience, that’s the most effective way for companies to get the value of benefits across to customers. For instance, a manufacturer of wire harnesses (essentially, bundles of wires with connectors) was for years unable to get airlines to pay higher prices, even though its products were more reliable than competitors’. Eventually, the vendor asked customers to pay a part of the savings that accrued from the products’ longer life and a portion of the additional revenues that came from keeping planes aloft for more hours. The airlines agreed because they could track the relative durability of wire harnesses and estimate the monetary impact. Since then, the vendor has generated higher revenues from existing customers every year.

**Tangible nonfinancial benefits** have value that is difficult for sellers to quantify, even though buyers perceive it. For instance, no one was ever fired for buying IBM, as the adage goes, but Big Blue can’t quantify in financial terms what that level of comfort means for customers. Tangible nonfinancial benefits, such as corporate reputations, global scale, and innovation capabilities, take time and money to create, but in commodity markets, they often influence firms’ choices. Buyers reward companies that offer this genre of benefits by paying premium prices for products or by specifying, in requests for quotations, benefits that are offered only by those companies. In fact, specialty manufacturer Raychem focuses its marketing efforts to ensure that customers mention its products in RFQs.

**Nontangible nonfinancial benefits** have value that both sellers and buyers are unable to quantify, especially in monetary terms. Since they must be experienced to be appreciated, such benefits play a more critical role when companies try to retain buyers than during the customer acquisition process. For example, many vendors go beyond the letter of contracts and do such things as deliver supplies on holidays to keep customers’ production lines going. V. Kasturi Rangan of Harvard Business School and I have found that benefits like these keep buyers loyal; customers have no way of knowing if new vendors will offer similar levels of service (see, for instance, our July 2004 *Journal of Marketing* article “Building and Sustaining Buyer-Seller Relationships in Mature Industrial Markets”). In fact, nontangible nonfinancial benefits often bind buyers to troubled sellers. In the 1990s, Lucent Technologies found that many customers bought its switching systems even though it didn’t offer the latest technology. Because of the relationships that the company had built over the years, customers were willing to give Lucent a chance to catch up with rivals.

If suppliers don’t want to lose loyal customers, they must learn to tell them about the nontangible nonfinancial benefits they provide. For example, the specialty chemicals division of a global oil company routinely informs customers about the services it has delivered.
I find that most marketers are so busy figuring out how their companies can create value that they don't pay attention to communicating the benefits their companies deliver to customers.

Linking Benefits to Decision Makers

Marketers find it difficult to communicate benefits to customers because, often, the buying decisions in companies are made not by individuals but by groups of managers. When purchases affect the entire organization and involve large financial outlays, several functions and executives are involved in the process. I have seen six-function, 40-member purchase committees in many corporations. Moreover, the manufacturing plants of a multilocation business may use the same materials or machines, but each will have special requirements. Vendors must first woo the headquarters' buying group and later focus on factories' purchase committees. But few marketers are comfortable with multilevel processes and decisions by committee.

The key to success in such situations is keeping in mind that each member of a buying group is usually interested in only one benefit or, at most, a few benefits. For example, when a manufacturer debates the purchase of new machining centers, the factory head mainly wants to know how much time will be required for the vendor to install the machines and train operators. The maintenance manager will focus on the vendor's service contracts. The procurement manager will be interested in prices. As for the top executives on the team, the CEO will only want to know how the purchase will affect the business's bottom line; the COO will be concerned about the switch to a new manufacturing process; and the CFO will harp on the deal's financial terms. Since most marketers don't track the needs and concerns of each member of the buying team, they don't communicate the benefits to the team members who want them.

To help companies manage that communication process, I developed a simple set of devices, the benefit stack and the decision-maker stack. The vendor lists all the benefits it offers, placing the most important at the base of a stack. This exercise, I find, facilitates marketers' understanding of the relative importance of the benefits. The supplier then creates a stack of decision makers and places it beside the benefit stack. If possible, the supplier also lists the main concerns, motivations, and power bases of each member of the purchase committee. By linking the two stacks, the vendor can systematically tackle each decision maker's concerns and communicate how it will meet his or her specific needs. Marketers must also brief each buyer about the concerns of the other people in the stack, as well as the solutions the vendor proposes, so that the entire committee gets the full picture. (See the exhibit "The Benefit Stack and the Decision-Maker Stack").

The concept is simple but effective. In 1996, the $2.5 billion Kone introduced an elevator system in Germany that was superior to other products in three ways. The MonoSpace was more energy efficient, its motor didn't have to be housed in a rooftop structure, and its installation and maintenance costs were much lower. However, Kone had traditionally been a low-end player and had marketed its products only to contractors. Since the performance of the top five elevator systems in the market had been roughly the same before Kone launched the MonoSpace, price had been the sole differentiator.

Kone wanted to charge a premium for the MonoSpace and decided to study the market...
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• TOOLS

The Benefit Stack and the Decision-Maker Stack

You can effectively communicate the value of your offerings by linking the benefits to the executives who desire them. You must make each manager aware of all the benefits you’ve offered others, because in business markets, purchase decisions are often made jointly. (For illustration, only some of the links are shown.)

Levels of Loyalty

Retaining customers in business markets isn’t just about keeping them in the fold; companies must also develop relationships with customers and grow their loyalty over time. Unfortunately, more than 80% of companies use satisfaction scores to monitor customer loyalty. That doesn’t work, because there is very little correlation between satisfaction and loyalty in business markets. Besides, customer satisfaction scores measure how well vendors have done in the past but aren’t reliable indicators of future customer behavior.

A few businesses, having realized the limitations of satisfaction scores as a proxy for loyalty, use composite measures such as a combination of satisfaction scores, recommendations, and repurchase ratings. Other firms look at the revenues they generate from the same customer over time or the word-of-mouth recommendations that customers provide. Those metrics are a distinct improvement over satisfaction scores alone, but they don’t give vendors a complete picture of customer relationships. Nor do they let companies compare the rewards from loyalty with the costs of managing customers.

Companies can decide how much time and money they should expend on customer relationships with the help of what I call loyalty ladders. (See the exhibit “The Loyalty Ladder.”)
Managers define loyalty as a commitment to continue buying a product or service, whatever the circumstances. In business markets, the gains from loyalty go well beyond repurchase. Loyal customers display a number of other behavioral characteristics as well, usually in the following sequence. They:

Grow the Relationship. The customer will want to buy more products or services at this stage and expand the scope of its relationship with the vendor. It costs very little to serve the customer, because the supplier has already incurred customer acquisition costs.

Provide word-of-mouth endorsement. The customer is likely to promote the company by talking about it positively. The vendor incurs lower costs for acquiring new customers.

Resist competitors’ blandishments. By this time, the customer is less likely to switch to rivals, even if their products are superior, because it expects that the preferred vendor will develop similar products. It costs the vendor very little to retain the customer.

Pay premiums. A customer this loyal may be willing to pay higher prices for the vendor’s products and services.

Collaborate. The customer believes that the feedback it provides will foster future improvements and wants to help the supplier develop new products and services.

Invest. Loyal customers often invest in their vendors. In addition to creating an exit barrier, such investments reduce vendors’ risks.

These behaviors can be thought of as rungs on a ladder, with higher positions representing higher levels of loyalty. Ladders may vary a little across sectors, but my studies show that they are the same for all customers in an industry. Companies can map the locations of customers on loyalty ladders every year by analyzing sales records, interviewing account management teams, and conducting customer surveys. For example, firms can check to see what customers bought from them in the previous year and the prices they paid for those products. By talking to salespeople, executives can learn about complaints or feedback from customers that resulted in design changes or new products. Customer surveys sometimes provide companies with early indicators of loyalty. For instance, buyers are unlikely to pay premiums for products unless they have said in customer surveys that they are “very likely” to repurchase products. Similarly, customers are usually “willing to pay a 10% premium” for products before they collaborate with vendors on developing new products.

Each successive rung is a source of higher revenues, which vendors can calculate in two ways. First, they can ask account management teams to forecast the likely increases in business as a customer moves up the ladder. My field experience suggests that such forecasts are often accurate. Second, vendors can use historical data to estimate the additional revenues they earned as customers moved up one rung. In the same way, firms can calculate, from account managers’ experience and past data, the costs of moving a customer to the next rung. That allows companies to calculate the returns on their efforts and to make decisions on how much to invest in each customer relationship in the future.

The $40 million software firm Unitech Systems did just that. It drew up a list of customers that together accounted for 80% of its annual revenues. After analyzing several years of data, the firm found a three-rung loyalty ladder in its markets: making repurchases, providing word-of-mouth recommendations, and paying premium prices. Unitech asked sales managers for information on the three parameters and used the data to place each customer on the loyalty ladder. The firm then calculated the average revenue from customers on each rung to evaluate that rung’s revenue potential and asked marketers to estimate the costs of moving customers up one or more rungs. The information allowed Unitech to classify its customers into four types, which I describe below, and to decide whether it wanted to keep them on the rungs they occupied, move them up, or reduce the time and money it spent and force some customers to move down the ladder.

Types of Customers
When companies map customers’ locations on loyalty ladders and compare the rewards of loyalty with the costs of managing customers, they usually find that they have four kinds of customers (see the exhibit “Four Kinds of Buyers”).

Commodity Buyers. Some customers force vendors to strip away all the value-added services they provide and sell them only the basic offering. They view products as commodities and are likely to switch if other suppliers offer them lower prices. In business markets, a large number of high-volume customers tend to be
in this category. In most cases, vendors shouldn't bother to educate these customers about the value-added services they offer; they should focus instead on reducing their customer service costs. Sometimes, vendors can benefit by entering into long-term contracts with commodity buyers or by pushing them into one of the other customer categories, because assured demand is important in business markets.

Underperformers. Companies that operate in industries with high fixed costs will find that their biggest customers are in this quadrant. That's because vendors often provide free services to large customers in order to retain them. For the same reason, this category includes showcase accounts that companies use to enhance their reputations. Some marketers also make the mistake of acquiring customers by offering low prices, hoping it will be possible to increase prices in the future. That never happens; companies only lose money on those customers.

Underperformers should be in customer portfolios only temporarily. At one extreme, companies can try to turn them into commodity buyers by slashing services that the customers don't need or value. At the other extreme, vendors can make these companies partners by getting them to pay for benefits that they appreciate. Suppliers can also cut costs by offering underperformers standard products and services or by serving them more cost-effectively. Similarly, since showcase customers often demand free services, vendors should guestimate the advantages of having them in their portfolios. If the costs greatly outweigh the advantages, a vendor must try to move such a customer to another category.

Finally, companies can get rid of underperformers. That requires resolve; it is never easy to walk away from big customers. A supplier of engineered components found that one of its biggest customers was planning to hold Internet-based reverse auctions to procure those components. Desperate to keep the business, the vendor dropped prices to win the auctions. Not long afterward, the vendor realized that the customer wanted the same levels of service as before. When the vendor couldn't get the customer to pay extra for the services it provided, it decided to drop the account. Firing the customer paid off: When the ex-buyer started working with new suppliers, it found that they couldn't or wouldn't provide many of the services it needed. The company had to go back to its original vendor, and the two firms negotiated a fresh agreement on the vendor's terms.

Partners. Such customers are expensive to serve, but the returns usually justify the effort. Since partners choose not to develop in-house expertise or make investments that would reduce their need for vendors' services, they want turnkey solutions from suppliers. They view suppliers as value-adding partners and look for long-term commitments. These customers also want the latest and best products and are willing to pay premiums for them. Although they may not be involved in codeveloping new products, partners are often drivers of product innovation.

It isn't easy for companies to manage partners. For example, partners in high-tech industries often ask vendors to reduce prices because their products become commodities quickly. If vendors comply but can't subsequently reduce costs, such partners become underperformers. Similarly, as markets mature, procurement managers, rather than technical staffs, dominate purchase committees. Unless suppliers educate the new members about how they have helped reduce customers' costs in the past, they will lose their partners to the lowest bidders.

The Loyalty Ladder

Business customers display their loyalty in a predictable sequence as they move up the loyalty ladder. You can determine which rungs your customers stand on by analyzing sales records, talking to sales teams, and conducting surveys.
Most valuable customers. MVCs are as loyal as partners but often less expensive to serve. That’s because vendors have become more efficient at serving them or buyers have taken over functions that suppliers traditionally provide. For instance, some firms prefer to customize products themselves with tools provided by vendors. Similarly, the Internet enables buyers to place orders, track deliveries, print bills, and deliver payments, reducing vendors’ costs.

A company’s MVCs may be willing to pay premium prices as rewards for vendors’ past efforts. That may seem to be irrational behavior at the transaction level, but it is rational when viewed through the lens of a long-term relationship. Such customers are often willing to vouch for their vendors. In most business markets, MVCs account for less than 10% of a vendor’s revenue base, and companies cultivate them assiduously. When new rivals or technologies appear, it’s a good idea for suppliers to move such customers to the partner quadrant by offering them more benefits.

Turning Switchers into Valuable Customers

In most business markets, customers don’t show up in the shape desired by vendors. Companies can develop profitable relationships by investing time and money to migrate customers from one category to another. As the case of the $3.7 billion electrical parts distributor Wesco Distribution demonstrates, businesses need discipline to do that. When Wesco analyzed its OEM customer base, it found that most of the companies in it were commodity buyers. They shopped for the lowest price and played vendors against each other. Wesco was willing to offer low prices as well as a full range of products, but it wanted customers to make long-term purchase commitments. Few OEMs were willing to do so; they wanted to see the benefits of building a relationship with Wesco before they made any promises. Wesco took the plunge and made investments that allowed it to provide services such as inventory management and energy audits, which trimmed customers’ costs of procuring components and operating electrical systems. Naturally, Wesco’s costs rose, and since customers were still cherry-picking products from its portfolio, they became underperformers.

Most companies would have given up at this stage, but Wesco persisted with its strategy. Over the next 12 months, several customers noticed that Wesco had invested in building relationships with them and that their costs had fallen. They also realized that by integrating their procurement and supply chain processes with Wesco’s systems, they could reduce costs even further. The buyers’ focus was no longer on purchase (or product) costs, but on the costs of ownership (or procurement). Customers started buying greater volumes from Wesco, and Wesco’s costs began to drop because of scale economies, predictable demand patterns, and lower inventory costs. When the benefits became large enough, the supplier even passed on some of its savings to customers. Because

Four Kinds of Buyers

To determine whether to invest in, maintain, or divest a relationship with a customer, compare the advantages of having that buyer remain on its current rung of the loyalty ladder with the cost of moving it up and the savings from moving it down. That calculation yields four customer categories.
Wesco realized that it takes time to shift customers to a new category, the company eventually succeeded in turning a group of commodity buyers into valuable customers.

Few companies try to build relationships with individual customers, because that approach differs entirely from current practice and, more important, requires considerable discipline in planning and execution. For instance, many companies believe that because they sell solutions rather than products, they have gone beyond offering features. But most suppliers continue to base solutions on preconceived notions of customer wants instead of tailoring products and services to meet each customer’s needs and processes. As a result, they push the features of their solutions packages rather than offering benefits that customers really want. State-of-the-art customer relationship management systems focus entirely on companies’ interactions with customers; that is a step toward managing customers, but it is only a small beginning. Companies still have a long way to go before they can say they manage individual customers in business markets. The silver lining is that this approach requires neither big ad budgets nor software programs; all it demands is a return to the basics of marketing.

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