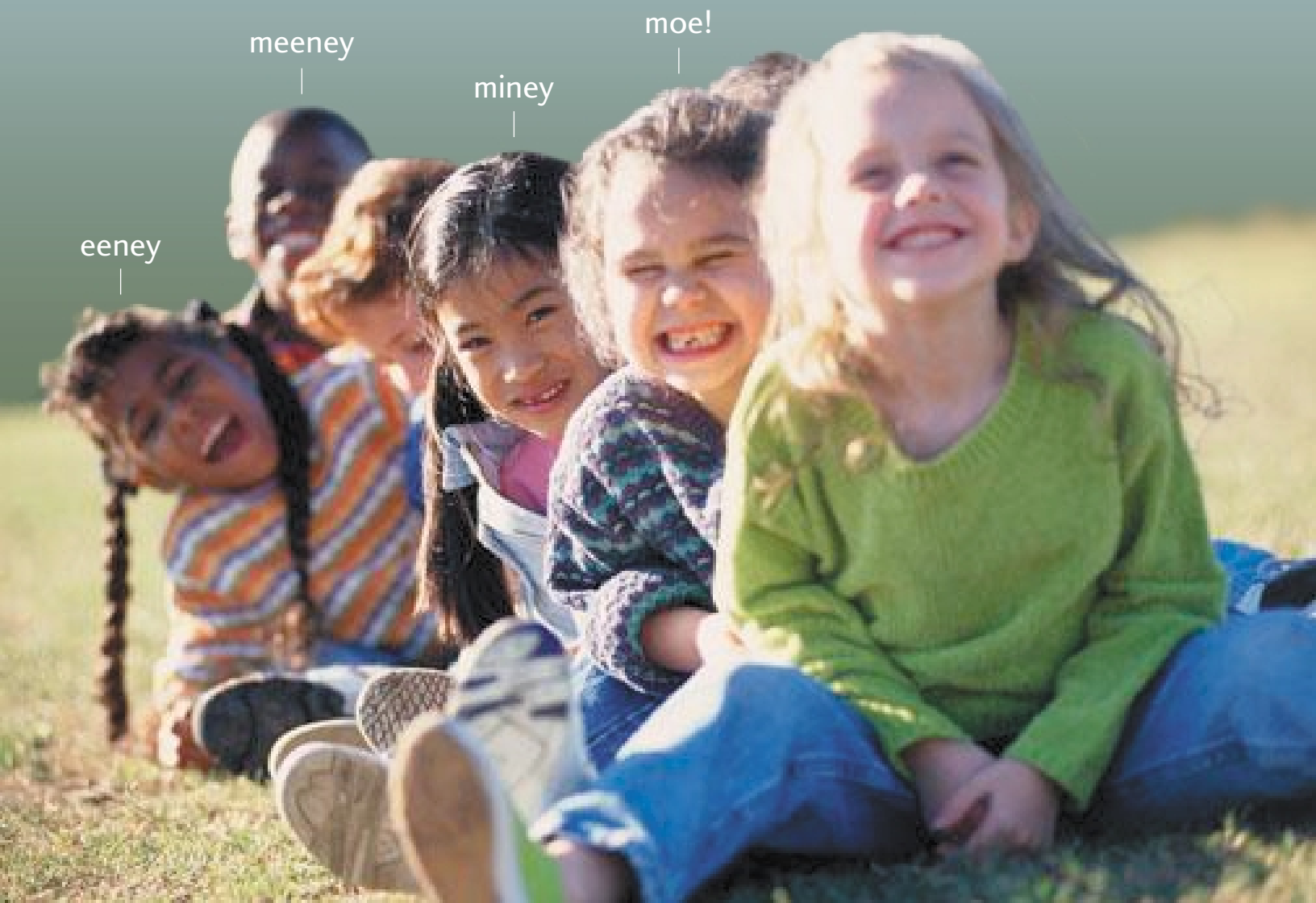


THE LOYALTY REPORT

Make identifying your profitable customers and building lasting relationships as easy as child's play...



CUSTOMER
INSIGHT GROUP, INC.



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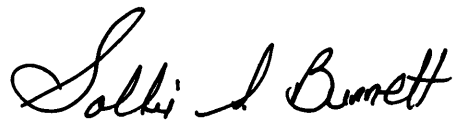
EXECUTIVE SUMMARY

Every day you hear about a new loyalty program. Another company chasing after the elusive pot of gold at the end of the loyalty-marketing rainbow. Gartner research estimates that U.S. companies spend more than \$1.2 billion a year on loyalty programs. According to Jupiter Research close to 75 percent of consumers in the U.S. now belong to at least one loyalty program, and an estimated one third have two or more loyalty cards — but how well do they work? That depends on who you ask.

Talk to marketers at Air Miles Travel Company, Target Corporation, Tesco Corporation, Harrah's Entertainment Inc., eBay Inc. and a handful of others and they'll say that their loyalty programs are key to new revenue growth. Armed with a 360 degree view of customers, they put customer interests first, personalize the shopping experience, and convey messages that bolster the customer's affinity with the brand. At day's end, they address not just purchasing behaviors but the fundamental drivers of customer loyalty. They succeed despite tough economic times and cutthroat markets. *But the majority of companies are still struggling to get it right.*

Delivering on the one-to-one promise is not a one-time exercise. It's an ongoing pursuit that is continuously measured and refined. Our experience with clients in a variety of industries has shown that there are ten critical success factors to cultivating profitable customer relationships.

We share these with you as key benchmarks to any successful loyalty marketing program.



Sallie S. Burnett
President
Customer Insight Group, Inc.



ABOUT THE AUTHOR:

Sallie Burnett leads the strategic marketing field with 16 years' experience in strategic marketing, sales management and customer relationship management.

As the founder of Customer Insight Group, she helps her clients utilize customer information to develop customer-centric strategies that drive bottom-line success.

Renown for her out-of-the-box thinking and wealth of experience, she's helped many of the nation's top companies cultivate actionable opportunities throughout the customer-value relationship to better align sales, service and marketing while generating the greatest return on investment based on the voice and value of the customer.

CUSTOMER INSIGHT GROUP:

Customer Insight Group is a strategic marketing company that uses customer information to help its clients build successful and profitable long-term relationships with each and every customer.

It provides marketing strategy, customer research, data analysis, program development, implementation and refinement of customer-centric programs including: loyalty, retention, win-back, and new customer acquisition.

BUILDING CUSTOMER LOYALTY

What is customer loyalty?

Loyalty — it's one of those intangible concepts that ultimately has a different meaning depending on the type of relationship and the circumstances surrounding it. If a customer has a limited number of companies to purchase from, they may purchase from your company by default with minimal loyalty. In comparison, if a person chooses your company from a large list of companies and has a very satisfying experience, they may have a greater affinity and loyalty to you. In this case, customers showing an emotional attachment to your company can define loyalty. Research shows that those customers who demonstrate a preference shown through repeat buying behavior, referrals or a personal connection or bond with a brand/company over time will spend greater share with the company.

Perhaps the best way to understand the principles of loyalty is to first agree that loyalty in business is not a solitary relationship where a consumer will do business with only one company. Instead, loyalty is more about a customer choosing to favor a select number of companies to which they will do business. Loyalty occurs at many levels. You want your customers to have a satisfying experience that brings them back to buy regularly. Your customer should feel that they can trust your company and that your company will meet their needs. And ideally, your customers will sing your praises by saying, "That's my company" or "If you're looking for XYZ product, this is the company to get it."

Testing the Loyalty Waters

Fostering customer relationships takes time, consistency and a strategy to nurture and capture individual preferences and habits. To assess your progress, you may measure the intensity of the customer bond through:

- > **Customer repeat buying behavior**
- > **Customer referrals to friends and colleagues**
- > **Customer emotional commitment to the relationship**
- > **Customer satisfaction**
- > **Customer spending more over time (LTV)**

Your customer relationships are your enterprise's primary asset. Retention of valuable customers is the hallmark of success for your company.

Why is loyalty important?

A company's retention rate is the gateway to the future and the foremost predictor of strategic success. Rest assured that the odds are stacked in your favor. According to the Customer Service Institute, 65 percent of a company's business comes from existing customers, and it costs five times as much to attract a new customer than to keep an existing one satisfied. A study by Marketing Metrics found the average company has a 60 to 70 percent probability of selling again to existing customers and a 20 to 40 percent probability of successfully selling to lapse customers. That's greater than the probability of selling to a new prospect, 5 to 20 percent.

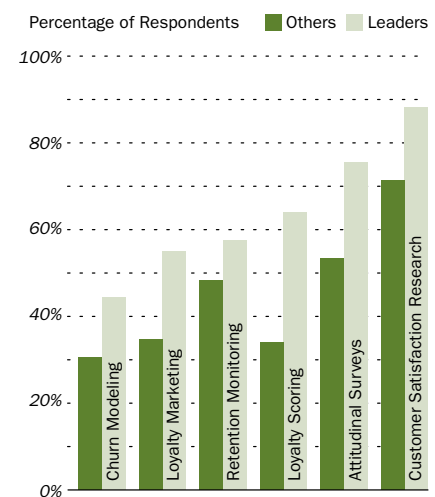
Losing a customer on the other hand, is even more expensive. According to studies by the Technical Assistance Research Programs Institute, 91 percent of unhappy customers will never buy again from a company that has displeased them and will also voice their dissatisfaction to at least seven other people.

In fact, a Gartner study revealed that more than 75 percent of 600 enterprises surveyed rated customer loyalty as more important than sales to new customers (See Exhibit 1.) A recent CRMGuru survey of business leaders found that 80 percent felt that loyalty was either "extremely important" or "very important" to top management. Of those same respondents only 45 percent rated their businesses' efforts at managing customer loyalty as "good" or "excellent".

Growth rate soars for those with an adept hand at loyalty. Frederick

EXHIBIT 1: STATUS OF LOYALTY PROGRAMS

Currently Implemented or Planned in the Next 12 Months



(Source: *The Loyalty Connection*, Bob Thompson)

10 CRITICAL SUCCESS FACTORS

Reichheld, author of *The Loyalty Effect* and *Loyalty Rules*, found that loyalty leaders grow on average more than twice as fast as the industry average across a wide variety of industries.

While we know that mastering the art and science of loyalty marketing is well worth our time, executing it effectively still proves to be a challenge for most companies. The first step is to narrow in on the key factors to successful loyalty marketing.

1. Loyalty Is Not a Silver Bullet

A loyalty program is not a silver bullet to solve a company's core weakness such as shoddy products, poor customer service, non-competitive prices, nonintegrated distribution channels or lack of communication with customers. Instead, a loyalty program should be thought of as a part of your integrated customer relationship marketing program — one that helps you to proactively manage the customer life cycle. The customer life cycle refers to the progression

EXHIBIT 2: LOYALTY PROGRESSION

Customer Life Cycle Stages



of steps your customer goes through when considering, purchasing, using and maintaining loyalty to a product, service or company (See Exhibit 2.) The importance of managing the customer relationship throughout the life cycle increases when your customers make their needs, preferences, and interests known to you, which you can then adapt your products and services to meet more of your customer's needs. This helps you meet your goals to keep customers satisfied, increase growth, decrease defection, and optimize customer lifetime value.

2. Create a Shared Internal Vision

To create a customer-centric organization, the vision has to be clear and embraced by all within. Companies that have successfully implemented customer loyalty programs have created ways to reinforce the goals with employees.

- > **Over-invest** in coordination with and across all functions. Work closely with the various stakeholder groups regarding the program objectives, strategies, areas of departmental impact and associated expenditures.
- > **Encourage employees to participate in the program.** Employees become advocates when they experience firsthand the value in the program.
- > **Create high-level positions with the sole purpose of leveraging customer data** across the organization and to serve as the customer advocate. Consider titles like Chief Customer Experience Officer or Integrated Customer

Relationship Manager.

- > **Encourage employees to think like a customer.** Ask your front-line employees what they think might improve customer loyalty. Take their feedback, evaluate the financial viability of implementing the best ideas and recognize the employees' contribution to the company's success.
- > **Incorporate customer focus into training and hiring.** Recognize and reward employees that uphold the customer service philosophy of the organization.

3. Set Realistic Goals and Objectives

In general, loyalty programs are often developed with good intentions, but unclear objectives. This can sabotage your program from the start. A program cannot be mass and exclusive, loaded with benefits and cheap. Take a critical look at your primary business objectives.

- > **DO YOU WANT TO EXPAND MARKETING CHANNELS WITH DIRECT CAPABILITIES TO IMPROVE EFFICIENCY AND MEASURE RESULTS?**
- > **DO YOU WANT TO COLLECT DATA TO BE LEVERAGED AS A CORE BUSINESS ASSET?**
- > **DO YOU WANT TO BUILD STRONG RELATIONSHIPS WITH HIGH VALUE AND HIGH GROWTH CUSTOMER SEGMENTS?**

Successful program execution is based on working toward a primary business objective. For example, Harrah's casinos uses predictive models to treat different customers differently. David Horton, VP of loy-

ality marketing, noted in an interview with Peppers and Rogers, “By looking at the particular segments instead of the aggregate, that’s where you really drive profitability.” Harrah’s has over 25 million Total Reward members, and of those, 6 million are active. With 70 percent of the company’s revenues tracked on the card, Harrah’s loyalty program has contributed over \$100 million dollars in revenue since its inception. Each of the company’s objectives drive the features and strategic execution of their programs (See Exhibit 3.)

4. Ask Customers What They Want

There’s no better way to determine what will drive customer behavior than to go directly to the source. Ask your customers what they want, what they like and dislike. Include customer surveys on your

Web site, at point-of-sale, statement and package inserts. In addition, conduct focus groups with your best customers and potential high value customers to generate ideas that will enhance the customer experience. Investigate what really matters to your customers and what they consider worth the cost. Focus in on the features, program structures, and rewards they would add or remove if they were to (re)design your loyalty program. Analyze how these benefits contrast with existing offers/promotions. Based on your customers’ feedback, determine the business impact of the requested benefits. Is it financially viable, sustainable and does it ultimately achieve your business objectives?

Include a feedback loop — the voice of the customer — within your program communication. This is your way to regularly assess and

analyze customer needs, preferences and perceptions of current experiences. Customer feedback should provide actionable insight geared toward continuously refining the program and ensuring that the program’s customer-centric focus does not become static.

5. Know Your Customers

Look at the customer from a holistic perspective and then segment customers that are similar. Create a loyalty profile by ranking your customers by their value to your company, and then differentiate them by their customer lifecycle and needs. The profile should be a 360 degree view, combining customer relationship elements of purchase behavior, customer attitudes, satisfaction, demographics and lifestyles. The loyalty profile provides you insight that helps you establish what type of program and

EXHIBIT 3: KEY LEVERS BY COMPANY OBJECTIVE

OBJECTIVES	COMPANY	FEATURES
<i>Embrace High Value</i>	<i>Neiman Marcus American Express Centurion Card Exclusive Resorts</i>	<i>Small high value spending group Exclusive aspirational offers</i>
<i>Target Priority Segments</i>	<i>Harrah’s Entertainment Inc. Staples, Inc. Hilton Honors</i>	<i>Several important segments with differentiate needs Tailor value proposition (e.g., pricing & service levels) based on behavioral insights to better meet needs</i>
<i>Engage Mass Market</i>	<i>Target Corporation AirMiles Travel Company Safeway Discover Financial Services</i>	<i>Provide everyday extra value Strong core brand alignment Build ongoing connection point to encourage purchases and differentiate offer</i>
<i>Deliver Superior Experience</i>	<i>Amazon.com Tesco Corporation</i>	<i>Multiple touch points, channels Able to identify high value/high priority individuals to deliver superior experience across touch points</i>

rewards structure would most impact core customers. Once you've created the loyalty segments, prioritize them to focus on their potential economic impact. Avoid rewarding "free riders" — loyalty members that join your program, but give you nothing in return, and instead focus your efforts on profitable, loyal customers.

6. Attainable and Realistic Rewards

Any incentive offered within the bounds of a customer loyalty program must be realistically attainable within a reasonable time period. Typically customers expect to earn an award about seven months after joining a program. Conversely, members of retail programs expect a reward within five months. By design, a loyalty program is a balancing act between offering some low-cost, easily attainable short-term rewards that can be redeemed early in the program with more highly valued aspirational (and more costly) rewards that can be redeemed later in the program. While the short-term rewards are used to encourage enrollment and ongoing participation, the aspirational rewards serve as an incentive for your customers to consolidate purchases and award you greater share of wallet.

7. Create a Distinctive Customer Experience

While discounts are important to some customers, for others advance notice of sales, personal attention and convenience are the factors that create loyalty. Your customers are diverse, consequently your program needs to acknowledge these unique customer attitudes, behavioral drivers and needs by speaking differently to each of them. The better you understand your customers, the better you can push the most appropriate levers for the specific customer. For example, high value, more affluent customers may find personal recognition, special access and privilege of greater importance. These soft benefits are more difficult for a competitor to duplicate and are ordinarily more influential in reducing churn in your top deciles. In addition to soft benefits, successful loyalty programs use data-driven marketing techniques to deliver more personalized rewards based on the customer's value to the bottom line. A leading consumer catalog company segmented their loyalty members using three dimensions: demographics (age, gender, income, etc.), merchandise propensity (products purchased, seasonality, etc.), and relationship (customer tenure, risk, channel preferences, and profit). Based on each segment's distinctive characteristics and behaviors, the catalog then deployed a successful segment-specific strategy to personalize offers and create an enticing mix of soft and hard benefits targeted to the customer's individual interests. One of the largest banks in

the United States employs segment-specific service queuing by catering to high value bank customers with personal attention from their banker, exclusive teller lines, free ATM cards, etc.

A recent Deloitte *Loyalty Quest* study revealed that bank customer relationships are molded by convenience, value and service. Banks combining these three elements are more likely to acquire and retain a greater number of customers.

8. Customer Centric Organization

As once stated by Bill Gates in *Business @ The Speed of Thought (1999)*, "The best way to put distance between you and the crowd is to do an outstanding job with information. How you gather, manage, and use information will determine whether you win or lose."

Successful loyalty programs leverage customer insight to:

- > **Attract** profitable customers,
- > **Determine** allocation of resources to improve ROI,
- > **Evaluate** how individual customers react to specific promotions,
- > **Deflect** competitive challenges,
- > **Identify** trends and opportunities,
- > **Increase** customer conversion rates.

Tesco, number one in the UK grocery business, embraces its customer knowledge as a key differentiator and leverages it to deliver and tailor

its customer value proposition and loyalty program offerings. Tesco's corporate mission is to "Create value for customers to earn their lifetime loyalty." Its company values includes, "Understand the customer better than anyone," and "Share knowledge so that it can be used." Tesco's customer insight has evolved to a level where microsegments based on lifestyle have been identified and meaningful "subclubs" have been created to address specific customer needs and deliver relevant, personalized information. The Food Club appeals to consumers who are fanatical about food; Baby & Toddler Club offers parenting tips, expert advice and coupons based on the child's exact life stage; Tesco Clubcard Wine Club features coupons, wine tips and expert wine advice; Healthy Living Club provides practical healing solutions from leading experts and preferred product coupons.

9. Relevant and Consistent Communication

There are more communication channels than ever before. Depending on your business, customer touch points include mail, telephone, fax, text message, e-mail, instant messaging, Internet chat rooms, catalogs, point-of-sale, signage, Web sites, and online bulletin boards. New forays in Internet-based systems include blogs, video conferencing,

podcasts and meeting-sharing systems. Each touch point has its own cost implications and perceived benefits to your customer. In developing your customer communication plan, leverage each touch point to reinforce the value proposition and focus on what really matters to your customer — creating concise, relevant and compelling messages that build relationships based on your customers' needs. The key to success is to embed your loyalty program into the total customer experience with your company.

Optimize results from your customer interactions by first calculating each customer's current value, and then build a model to predict customer spending in the coming year. These two pieces of information can be used to understand customer spend/value migration and enable you to develop strategies to upgrade customers. In addition, by tracking when customers historically purchase, you can create a predictive model to determine when customers would be most inclined to spend in the future. This kind of modeling will enable you to deliver on the promise of one-to-one — the right message, to the right customer, at the right time.

10. Measure Success

Customer satisfaction and loyalty metrics should be prominent in performance dashboards and visible to the company's leadership, including the board. You should measure results in both

the short-term and the long-term. While short-term success is measured by evaluating the results of promotions, events and customer communication, long-term success is measured by RFV — recency, frequency and value. Recency is the measurement of when the customer last purchased. Generally it is a good indicator of potential defection. Frequency is a measure of how often a customer shops; it gauges how robust the relationship is between your customer and the company. Value indicates profitability of the customer; a decline in value can represent a decrease in transaction size and your share of wallet. Measuring value is more than looking at one transaction; instead it is a measurement of your customer's perceived value in the relationship. As Frederick Reicheld explains in *The Loyalty Effect*, "Creating value for customers builds loyalty and loyalty in turn builds growth, profits and more value." RFV provides you a actionable measure for enhancing and refining your loyalty program.

Begin Your Pursuit

The quest for loyalty is a worthy one with bottom-line rewards for those who prevail. As unique as your customers are, so will be your challenges and successes as you build and refine your program along the way. The pursuit for customer insight is not one to be taken lightly or without long-term dedication. Dig in. Dedicate for the long haul and discover the treasure of true customer loyalty.



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