

The Loyalty Rulebook 2001SM

By Dennis L. Duffy

CHAPTER 1 How It All Started

There is a worldwide trend towards loyalty marketing. Companies in just about every industry have a loyalty program in place for some segment of their customer base, or they have a committee or team investigating loyalty.

The reason for this trend is fairly simple; intense competition and little or no growth in the total base of potential customers. That's why there are countless loyalty programs in industries such as travel, retail, telecommunications, and credit card marketing. But there's more. Automotive manufacturers, restaurant chains, sports franchises, and even golf courses are evaluating or adopting loyalty strategies and programs.

I've had experience coaching dozens of companies on loyalty strategies, and I've discovered that many waste time jumping directly into tactics without considering the business objectives they seek to achieve. I can't tell you how many times I've been in a room with a group of marketers trying to figure out how many points to award per-dollar-spent or how often to mail a newsletter and a statement. But before getting into objectives and tactics, it's essential to set some ground rules about terminology.

Definition

Whatever you call it -- loyalty marketing, customer relationship management (CRM), retention marketing, frequency marketing, one-to-one marketing; I'll go out on a limb here, and at the risk of becoming a lightning rod for controversy, I'll say they're all pretty much the same.

I've heard arguments that they're not and I've read hair-splitting written descriptions of the differences, but I think they all set out to do the same thing: keep customers longer and increase share-of-customer.

For this workbook, I've selected *loyalty marketing* as the most appropriate term to use because I think it does the best job of describing the overall objective. Marketers seek to build relationships with customers to improve retention, and ultimately to increase the likelihood that they'll become more loyal; this increases share-of-customer.

Many of the other terms that people use are a way to achieve loyalty – a means to an end. Customer relationship management (CRM) is one of the most popular

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terms, used many ways, to describe the creation of an infrastructure within a company that is conducive to customer loyalty. But it's not an end in itself; it's a means to an end. The end is loyalty.

The Road to Advocacy

There is a hierarchy that helps explain the evolution we seek to create through loyalty marketing. Marketers convert prospects to customers using advertising and other acquisition tactics. Marketers then convert customers to collaborators by developing relationships through communication and superior products and services. Collaborators are less likely to quietly defect from a brand and will, instead, complain and help fix problems because they feel like they're involved. Ultimately, marketers hope to convert collaborators to advocates who become vocal ambassadors and word-of-mouth salespeople.

While advocacy is ultimate aim of a loyalty strategy, there's a fundamental consideration you can't overlook: to successfully employ a loyalty strategy, you must have a good product, a competitive price, and good service. Loyalty programs become tie-breakers when everything else is equal. Unless there is a tie between your brand and another, through the eyes of the customer, you're wasting your time on loyalty and should focus on fixing what's broken.

Evolution

Let's take a look at some of the history behind loyalty programs. Before launching a loyalty initiative at your company, it's important to understand the source and evolution of loyalty programs.

It all began in the airline business with the development of the typical, promotional currency-based (*miles, points, etc.*) frequent flyer program. Before long, all airlines had a frequent flyer program and eventually, virtually all companies in the travel business had launched or were partners in a loyalty program.

The rationale behind the development of the airline loyalty programs was simple. The airline brands faced virtual parity in the recently deregulated industry and needed a tie-breaker to influence traveler's choices. These programs did not influence demand for travel, but they did influence the traveler's choice of carrier and as a result, helped some carriers improve share-of-customer.

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These promotional currency-based programs now pervade the travel industry and they've become quite common in two other industries: credit cards and telecommunications.

There are some key similarities in how this has been used:

- **Virtual parity.** There's little or no difference in price and service. No competitor has strong product differentiation.
- **Low-involvement decision.** Consumers don't spend a lot of time making choices in these categories and once the choice is made, it is typically not repeated for some period of time. For instance, once I select a long distance carrier, I'll stay with that carrier, at least for a while. Once I choose a credit card, I carry it and use it, at least for a while.
- **Intense competition among a relatively short list of strong competitors.** When there are no new customers, the only way to get customers is steal them from your competition. Customers need a reason to say "no" when your competitor attempts to lure them away.

There are two more characteristics, shared by the travel and telecommunications industries that help make the promotional currency approach economically viable:

- **High fixed- and low variable-costs.** Each industry has substantial investment in infrastructure and within a relevant range, the variable-cost of delivering an incremental unit of product is insignificant. When an airline sells one more seat on a flight, the incremental profit percentage is substantial. When a long distance company carries one more phone call over the existing network, the incremental profit percentage is substantial.
- **Idle capacity.** The cost of "giving away" free product is small because of the high fixed- and low variable-cost structure. One can make the argument that free flights and free phone usage displace paid consumption and represent an opportunity cost. Without a doubt there is some displacement of revenue, but the impact of improved retention and of increased share-of-customer more than offsets the displacement.

Many companies have copied the promotional currency model for customer loyalty because most everyone in business has seen the powerful impact in the

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travel industry and, to a lesser extent, in the telecommunications and credit card industries.

Economics

Before blindly mimicking what's been done, consider the extent to which your business economics match up to these industries. Many companies have considered a traditional loyalty approach only to discover (after weeks of work and a few too many task-force meetings) that they have a real cost of product and it costs real money to give free merchandise away. As a result, in industries with different economics (such as retailing), one of two things happens in the planning process:

1. You discover that it will require an unrealistically high lift in sales just to break even (because you're not just rewarding incremental business -- you're rewarding all business).
2. You decide to adopt a minuscule but affordable funding rate that works well in your models but will be viewed by your customers as meaningless when they realize they have the chance to earn \$1.72 per year.

I'm not saying that the promotional currency model is wrong. Designed properly it can be a very effective way to achieve loyalty-marketing objectives. There are new approaches to customer loyalty that require more thinking and innovation and less of a direct parallel to the travel industry. Even the promotional currency model, which works well in travel, telecommunications, and credit cards, needs a breath of fresh air with innovations around earning and redemption options.

Summary

The concept of addressing customer loyalty is a sound one. But don't think it's easy. If it's too easy, it's probably not worth doing because it's going to be meaningless to your customers or easily copied by your competitors.

CHAPTER 2 Approaches to Loyalty Marketing

There are many approaches to structuring customer loyalty programs. Some programs become biased towards the traditional promotional currency structure because it has been made so popular and obvious by travel companies, credit card issuers, and telecommunications companies. Whether a program has a promotional currency structure designed to reward customers, or a series of soft benefits designed to excite customers, there are some important decisions to be made early on in the planning process.

Will your program be announced to the public or will it be clandestine?

A publicly announced program sets a clear expectation in the minds of your customers. If it's announced, customers believe that the program is available to everyone and will be available on an ongoing basis. It's difficult to test anything in an announced program because any changes you decide to make after the test period may be unpopular with customers.

An announced program is also difficult to measure in a traditional direct marketing sense. Pure measurement of a traditional direct marketing program involves holding out a random control group that is consistent in composition to your test group. If you announce your program, you'll compromise measurement and probably skew customer involvement towards those who already like your brand and are less likely to defect in the first place.

A clandestine program, on the other hand, is communicated to a group of customers privately, usually through the mail. You select the customers and you also establish the control group. In this situation, it's best to avoid giving your program a "club-like" theme. Customers have been "clubbed" to death to a large degree and it's possible and more desirable to create an atmosphere of exclusivity and special service without labeling your program as a club.

The successful implementation of a clandestine approach relies heavily on creative positioning and execution. You should focus on your special relationship with the customer, the extra services you can deliver, and if possible, some tangible benefits, but avoid creating the perception that you'll continue this in perpetuity. You'll manage expectations while recognizing your customers.

If you have a mechanism in place to track the behavior of your customers, a clandestine approach also supports more thorough measurement through the establishment of a control group. Telecommunications companies, retailers with

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a private label credit card, and catalog companies have mechanisms in place to track customer behavior. If your business does not have a pure tracking mechanism available, you can conduct a sample tracking study using phone surveys to measure changes in customer behavior and attitude. While this is not as good as pure behavior tracking, it's better than nothing.

In most cases, a clandestine approach is most effective during the testing and evaluation period. Some industries require making a leap of faith right into an announced program that becomes integrated in all advertising and communication. It essentially becomes an integral part of the brand. Unfortunately, once a program is announced this way, you lose the ability to effectively measure it.

Will you provide soft benefits or hard benefits?

This is a big fork in the road when it comes to loyalty programs. Few companies can afford to give away tangible and meaningful awards and benefits, so you should get this consideration out of the way quickly. Travel companies, telecommunication companies, and credit card issuers offer hard benefits because they can, and because it's becoming a cost of doing business. Few other companies can afford it in the long run (although a hard benefits approach makes a good, limited time promotion).

But don't just assume you can dream up some free soft benefits that will make a difference to your customer. Explore the possibilities early on in the planning process and make sure that you can, in fact, afford to do anything. Sometimes, simple but relevant communication several times over the course of a year can make a measurable difference.

Will enrollment be automatic or voluntary?

This is a key consideration for an announced program. Some marketers are tempted to take all customers and send them a "welcome" message and fold them all into a program right away. But many customers just aren't going to pay attention to your announcement. Experience shows that roughly two-thirds of customers that are technically enrolled in an automatic program are clueless about its existence.

Customers that must "raise their hand" and voluntarily enroll in a program are much more inclined to engage in the program and participate, and are therefore more likely to modify their behavior as a result.

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There are various shades of gray in between the pure automatic enrollment and the pure voluntary enrollment. It's possible to invite customers to join through the mail and provide an easy "opt-in" mechanism. Another option is to announce an automatic enrollment and provide a simple "opt-out" mechanism.

This whole business of enrolling customers with opt-in and opt-out strategies becomes increasingly important when you're using e-mail to facilitate the communication. You must make sure that you're respecting all the appropriate guidelines for permission based e-mail in all that you do.

The bottom line is this: voluntary enrollment programs will grow slowly but will have members who are more involved; automatic enrollment programs will grow quickly, but will demonstrate limited member involvement.

Will redemption be voluntary or automatic?

This is an important consideration for promotional currency programs. If customers have the option to voluntarily redeem their currency whenever it's convenient, you're less inclined to realize incremental spending at redemption time. Customers will often wait until the time is right for them, and they'll redeem and displace what would have been a paid sale.

Automatic redemption, on the other hand, can be structured to drive incremental sales at the time of redemption. This is essentially a balance of what's best for the customer and what's best for the brand. It's important to consider a balance between the two, because if you develop a program that's great for the customer and bad for you, you're going to regret it. If you develop a program that's great for you but a virtual yawn for the customer, it will fail miserably.

Here's an example of how to make automatic redemption work:

Let's say you're a retailer with an average time between customer visits of 45 days. When a customer reaches a redemption threshold, you mail a certificate, as good as cash, for \$25. To ensure that you're encouraging incremental behavior, you should put a 30-day expiration on the certificate. On average, you'll reduce the time period between visits and drive incremental business over the long run.

Summary

Use the preceding key questions as a checklist if you're contemplating a loyalty program. You can establish a heated discussion within your own organization which is probably a healthy thing to do at this point. Better now than after you've launched.

CHAPTER 3 Typical Approaches by Industry

While I'm not an advocate of "shooting from the hip" and prescribing a solution before understanding the problem, I do have some notions about the most effective loyalty marketing approaches under certain circumstances. Situations drive your selection.

Remember that loyalty marketing is, in essence, a tie-breaker when all other things are equal. Loyalty marketing is not a silver bullet that will solve all your problems. It's not a substitute for a good product, it's not an acquisition tool, and it won't overcome a price disadvantage.

I'll explore the most appropriate approaches in the following industries: retail, credit cards, telecommunications, and business-to-business.

Retail

Let's consider the retailing industry first. I've seen a number of retail loyalty programs come and go in recent years. Consumers make their retail buying decisions based upon service and their price/value perception of the merchandise. In most cases, retailers believe they're in a near-parity situation -- even when they're really not. This is especially true in apparel retailing, where consumer taste plays a large role in choice. The best loyalty program in the world won't do a bit of good if you don't have the right merchandise.

In many categories of retailing, the best loyalty approach offers a combination of promotional currency, soft benefits and communication.

The promotional currency structure should have relatively low earning thresholds and automatic redemption.

The soft benefits should relate to the consumer's experience with the retail brand. Good soft benefits include special merchandise previews and special shopping hours. Evaluating the hidden assets of your retail brand may discover other soft benefits. The hidden assets represent the things that you offer that few customers actually know about.

All communication should seek to leverage the passion that the consumer has for the retail brand. Through soft benefits and communication, you can reinforce the

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shopping experience and promote the special services available to members on an ongoing basis.

The promotional currency model may be employed in retailing for a limited time period (to measure the impact with the option to stop or extend the earning component).

Credit Cards

Let's take a look at credit cards, where there's intense competition and little product differentiation -- not to mention the fact that a credit card choice is essentially a low-involvement decision. Here, the promotional currency model has become the standard ("earn free stuff - merchandise, miles, etc. - for doing what you've always done").

The opportunity for a breakthrough in the credit card business relates to redemption options and innovative partnership opportunities that accelerate consumer earning rates and offer perks that money can't buy. In the future, look for programs that more closely involve merchants, providing new marketing options for them while adding interesting twists that help break the tie for consumers.

Telecommunications

In the telecommunications business, the only constant is change. I'm not sure any telecommunications company will be able to embrace a long-term loyalty approach over the next few years because the nature of competition is changing so dramatically.

Older, established telecommunication companies will work harder to keep customers as their monopolistic control disappears. Here, the most effective approaches will involve improved levels of service, communication that focuses on educating consumers about product benefits, and some six- to twelve-month promotional currency or rebate programs.

New telecommunication companies will use aggressive tactics to acquire new customers from these older, more established companies. And many of the new, agile competitors will likely introduce innovative promotional currency programs to keep the new customers they've worked hard to win over.

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In the wireless arena, we're going to see a continuous flow of retail promotion and noise to "steal" customers away from other providers. Gradually we'll see a consolidation in the industry that might create the illusion of stability necessary to create a framework for cultivating real loyalty.

In both cases, promotional currency programs and rebate programs will create an economic cost of defection that will create a reluctance, in the mind of the consumer, to change carriers.

On the business side, look for telecommunications companies to work hard at becoming real partners with their customers by providing education-based communication that helps small- to mid-sized businesses run better by focusing on the efficient maximization of true product benefits.

Business-To-Business

Finally, let's consider loyalty marketing in business-to-business situations. I touched on this a little under the telecommunications category. The approach of employing communication to create a partnership applies in many business-to-business situations. Business customers make more rationale economic decisions than consumers do, so loyalty approaches have been more frustrating for marketers in search of the single business-to-business solution.

Business customers merely see promotional currency approaches as disguised discounts. To make "apples-to-apples" comparisons, the people responsible for making corporate purchasing decisions translate promotional currency and rebate programs into the appropriate discounts. For that reason, you'll see more businesses beginning to focus on understanding customer dissatisfaction and defection while boosting service levels and customer communication to improve retention.

Summary

Regardless of your industry, carefully consider the reasons for customer defection before contemplating a loyalty approach. In some cases, I've counseled clients to focus on getting the product, service, and price right before considering what might be seen as a superficial marketing tactic. But if your house is in order and if you're really in a near-parity situation, a carefully planned loyalty strategy can break the tie.

CHAPTER 4 The Promotional Currency Model Explored

While the promotional currency model does not make sense in all situations, it does have considerable merit (much like the basic airline frequent flyer model).

First, consider some elementary background on the model. Customers (or “members”) earn a promotional currency based on some behavior. Members can then redeem their earned currency at certain levels or intervals for free or discounted goods and services. It sounds simple and it is.

If you’re exploring a promotional currency program in your company, follow some of my guidelines and you’ll avoid many problems down the road.

Name Your Promotional Currency

The currency might be referred to as “points” or “miles.” I’ve seen other terms used as well. On several occasions, I’ve seen the term “credits” used. And for a golf course, I saw the term “yards” used. Some companies try communicating their currency in percentages (“you’ll earn 1% on all purchases, but on Tuesdays you’ll earn a 50% bonus or 1.5%”). This can get confusing, especially when you try to introduce a bonus (“you’ll earn 1% plus you’ll get an extra \$5.00 credit on Fridays”). I’ve also seen programs that attempt to communicate their concept without a name. Not good. For marketing purposes, it’s important to name your currency.

Select an Appropriate Unit of Measure

The unit of measure should not be too large or too small. As a rule of thumb, a promotional currency should be worth \$.01 on the redemption side of the equation. That’s large enough so that members aren’t throwing around tens- or hundreds-of-thousands of points for \$25 in value. But it’s also small enough that you can work out bonuses or partnership deals that don’t require splitting points into fractions. Let me illustrate:

Suppose you’ve decided that a 5% funding rate is appropriate for your situation. You announce that members will earn one point for every dollar spent and that each point is worth five cents. Next you make a deal with a partner company. The partner company can’t afford 5%, but they can afford 2%. It’s still a good deal for you that adds value to your relationship with your customers. Since the partner will pay you for the currency, you make a deal. Now you’ll have to tell your members they’ll earn 40% of one point for every dollar spent or one point

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for every \$2.50 spent with your partner. If the currency is worth one cent, you can tell members they'll earn five points for every dollar spent with you and two points for every dollar spent with your partner.

Select the Right Tier Structure

The use of tiers in a promotional currency program may help stimulate behavior among members. There are two basic approaches to tiers.

Here's the first approach:

| Annual Spending | SPEND MORE/EARN FASTER | |
|--------------------|----------------------------|-------|
| | Earning Rate Per Dollar | Bonus |
| First \$500 | 5 points | None |
| \$501 to \$1,000 | 5 points | 20% |
| \$1,001 to \$1,500 | 5 points | 40% |
| \$1,501 to \$2,000 | 5 points | 60% |
| Over \$2,000 | 5 points | 100% |

This approach is "the more you spend, the faster you earn." It motivates spending but does not necessarily motivate saving. Ideally, your promotional currency should represent an economic cost-of-defection for your member. If a member has a great deal of currency in the bank, that member is less likely to defect. While this tier structure provides flexibility for your members, it may not completely satisfy your retention objectives.

Here's the second approach:

| Point Balance | SAVE MORE/INCREASE VALUE | |
|---------------|--------------------------|-----------------|
| | Value | Value per point |
| 2,500 | \$25.00 | \$.0100 |
| 5,000 | \$55.00 | \$.0110 |
| 7,500 | \$90.00 | \$.0120 |
| 10,000 | \$130.00 | \$.0130 |

This approach is "the more you save, the more it's worth." It motivates both spending and saving. It creates a cost-of-defection that grows at an accelerated rate as the member's balance grows. If the redemption options are strong

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enough, this structure can be very effective at taking customers out of the market from your competitors' perspective.

Require Redemption in Fixed Units

Requiring members to redeem points in denominations that you define will virtually guarantee that they will always have a balance remaining after redeeming. Therefore, they will be reluctant to defect because there will always be something to lose. Having this structure will ensure that all of your promotional currency can never be redeemed.

Using Redemption to Drive Sales

Most promotional currency programs have several options on the redemption side. A few years back, many companies -- regardless of industry -- offered a catalog of merchandise and some travel-related options for redemption. These basic offerings evolved from the incentive and motivation business. Over time, most marketers (especially on the consumer side) found these redemption options too expensive to offer for their customer marketing programs. Today, most programs like this offer a redemption option for the marketer's own product (for instance, most retailers with promotional currency programs offer redemption in the form of gift certificates).

Ultimately, redemption should be used to drive incremental sales. After all, the primary objective of loyalty marketing is to improve retention and increase share-of-customer. Those objectives are measured in terms of larger average sales per customer as compared to a control group. Sometimes, a gift certificate may displace a paid sale because the customer would have shopped anyway. But with careful analysis regarding a customer's average time between purchases, you can set an expiration date on a redemption gift certificate to help ensure that the sales are incremental.

For instance, if your research shows that the average time between visits to the store is 60 days, set the expiration date for 30 days and automatically trigger the award. When a customer shops and clears the necessary plateau, generate the award and mail it to the customer. Since the customer just shopped, the 30-day expiration date will ensure that if the certificate is used before the expiration, the sale can be counted as incremental.

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Some say this approach is manipulative. But if you do not build mechanisms into your loyalty program to ensure that you improve your business, you'll merely reward existing business and drive up your cost structure.

Don't Overlook the Accounting

A promotional currency program requires a 100% accurate accounting system (it looks a lot like an accounts payable system except you pay customers instead of suppliers). Don't confuse this with a marketing database. This is a behind-the-scenes accounting system with debits, credits, and an audit trail. When members earn points, you incur an expense on your income statement and set up a redemption liability on your balance sheet. Those are the fundamentals, but behind the scenes, there's a great deal of complexity. Be sure to involve some smart people in your accounting or finance department to help you assess this, and don't overlook the cost of redemption in your economic models.

Summary

The promotional currency model is not for everyone, but it's a powerful approach when applied properly. Some of the seemingly inconsequential decisions regarding unit of measure, tiers and redemption structure can make or break this approach.

CHAPTER 5 Critical Planning Considerations

OK. So you've read enough articles, attended enough conferences, and had enough internal meetings. You're threatening to do something about loyalty marketing. Now what?

Here's a checklist to use internally to help facilitate the process of exploring customer loyalty, and to help you in developing the most appropriate strategy for your company.

Objective

What are you trying to make happen that is not happening now? Many companies mobilize task forces and resources to work on customer loyalty without ever defining their objectives.

The first question to ask is this: Are you doing this to solve a problem -- or to capitalize on an opportunity?

Some companies launch loyalty initiatives because they face severe problems. For instance, in the telecommunication industry, companies with monopolies are facing some severe problems as competition opens up and customers finally have a choice for telecommunication services. Look for telecommunication companies to take dramatic steps to make loyalty marketing an integral part of everything they do (the long-distance companies have been doing just that and the regional Bell-operating companies -- RBOCs -- are ramping up).

Other companies consider loyalty approaches as a way to drive sales. They get confused about what they're trying to do and begin to apply loyalty tactics just as they would sales promotion tactics (and in some cases, a limited-time promotional currency program can work as a successful sales promotion).

Typically, objectives that lead to a commitment to loyalty marketing should have to do with improving retention and increasing share-of-customer. But before you can address retention, consider why customers defect.

Do customers defect because of a better product, or because of a better value from your competition? Do customers defect because you have an inferior product (this is a tough one to answer -- you've got to be honest)? Do customers defect because they stop buying what it is you have to sell?

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As you consider the reasons and review or conduct research, you'll find there are some reasons that can be addressed and others that cannot. Some of the issues you discover will have nothing to do with loyalty marketing -- they'll have to do with whether or not your product, service, and value proposition are competitive. Loyalty marketing efforts can only make a difference when a parity or near-parity situation exists between you and your competition.

Some objectives cannot be achieved through loyalty marketing. You may think this is obvious, but here are three key truths I've discovered in my years of consulting on loyalty marketing:

- Loyalty marketing cannot overcome a price disadvantage.
- Loyalty marketing cannot overcome a product or service deficiency.
- Loyalty marketing cannot keep a customer in your category if the customer no longer has a need or desire for your product or service.

Once you've defined an objective based on truth, run it by others in your company to get feedback. You'll get a lot of different perspectives. And you'll definitely get everybody thinking.

Business Economics

Once you've got an objective defined, it's time to explore the economics of your business. How do you make money?

Review the facts regarding how much your customers spend, your gross margins on your product or service, your marketing costs (acquisition and current retention), and the average length of a customer relationship. Explore these issues by segments (however you segment customers). Hopefully your segmentation model reflects expected lifetime value and your strategic business model (the extent to which your customers buy what you want them to buy, rather than just buying your loss-leaders).

It's helpful to examine this data at an individual customer level (if you have that level of detail on at least some of your customers) and at an extrapolated level from sample research. Look for consistencies and discrepancies to ensure you've got a good handle on your facts.

Some questions you should seek to answer:

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- What do you know about your share-of-customer? Is your business one in which customers buy from others in your category? Or do you have the lion's share of each customer's spending because of the nature of your category?
- What is the impact of improvement in share-of-customer? Improving share-of-customer will increase your sales because customers will consolidate more of their spending with you. And selling more to customers who already buy from you is considerably easier than attracting new customers.
- What do you know about the feasibility of extending the length of the relationship you have with customers? This question requires a look back at the objective section to consider why customers defect.
- What is the impact of extending the length of your customer relationship? Customer lifetime value is an expected value that changes based upon the defection rate. If you can extend the length of your average customer relationship, you will reduce the annual defection rate and increase customer lifetime value.

Now, a reality check is in order. Before you spend too much more time developing a full-blown program, think about whether the size of the relationship between your brand and your customer is really large enough to support anything remotely resembling a loyalty strategy.

At this point, some companies find they're better served investing in sales and service to optimize their customer retention rate. But if you decide a loyalty program is for you, there are two broad approaches to loyalty marketing. The first is a promotional currency approach. The second is a communication and soft-benefits approach.

The Promotional Currency Approach

More often than not, this is the wrong way to go. It's good in certain categories with the following characteristics:

- Low-involvement decision.
- High fixed/low variable cost business.
- Significant relationship between the customer and your brand.
- Gap between real cost and perceived value of the product.
- Opportunity to "break a tie" - at least some of the time.

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- Idle capacity.

If your business has at least two of these characteristics, promotional currency may be the right way to go. To be sure, go back and review your objectives and your business economics. Even then, you won't be done. You'll run into more obstacles when you get into measurement, logistics and internal challenges. Be sure to consider using redemption in a strategic way to drive incremental transactions (automatic redemption with an expiration date).

The Communication and Soft Benefits Approach

Some programs work fine by providing limited soft benefits and focusing more on enhanced communication. Soft benefits are a "wild card" that I'll cover last. The focus of enhanced communication will vary between consumer marketing and business-to-business situations. Consumer communication should aim to leverage the passion the consumer has for your brand. Business communication, on the other hand, should try to help customers become more successful in whatever business they're in. There's much more to it than just this, but the key at this point is to give your communication strategy a mission.

Soft benefits should help make your customer feel special. This is not as easy to pull off as you might think. Make sure that whatever you come up with is as important to the customer as it is to you. Some companies try to approach partners for donated benefits. If you do this, make sure the donated benefits are worthwhile and relevant. If you have too many benefits and they're all weak, you'll frustrate and confuse your customers. You're better off to provide one or two strong soft benefits or none at all.

Once you have a general sense of the approach you plan to take, you'll have a lot to consider when you get into the logistics of developing, launching, and running your program.

Internal Challenges

You are often your own worst enemy.

Loyalty marketing is more than just a program -- it's a business strategy and it must pervade your company. If you don't have total buy-in, top to bottom, you'll struggle and eventually fail. I'm convinced that some companies will never be effective with loyalty marketing until they go through some wholesale

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changes in their leadership ranks. To succeed, the whole issue of customer retention must be accepted as an important topic within your company.

I suggest defining your objective and drafting a preliminary overview document about potential approaches for your company first. Circulate the document internally with superiors, peers, and subordinates. Get some reactions. See if you're on track and have some potential. If it's obvious you have too many internal challenges, you'll drive yourself crazy trying to do this. Getting early buy-in will help create a sense of teamwork and help your initiative get off the ground and succeed.

Measurement

How will you measure what you do?

Go back to your objective and remind yourself of what you originally set out to do. This should answer what performance criteria you'll need to help you determine success or failure.

Remember -- with loyalty marketing, you should be trying to make something happen that wasn't going to happen otherwise. You're changing behavior and attitude among customers. To validate your efforts, long term, you must measure the changes against a control group that does not participate in your efforts.

The critical part of measurement is ensuring that what you measure is, in fact, incremental. In other words, if you measure behavior and attitude, how can you prove that the changes you've observed would not have happened otherwise?

To measure changes in behavior, look at sales per customer and the defection or retention rate. Members in your program should demonstrate higher average sales in a given period over your control group because you have achieved a greater share-of-customer and you have kept a larger percentage of your customers.

To measure changes in attitude, you should survey customers (from both your program and your control group) about their attitudes regarding your brand. Include questions that address their likelihood of defection and likelihood of recommending your brand to others. Don't go too far into probing whether or not customers like your loyalty efforts. Instead, address their feelings and intentions with respect to your brand.

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Summary

The planning process for a loyalty strategy is often haphazard. Too often companies start throwing around random tactics without considering the integration of objectives, structure and measurement. Stay on track and remain focused and you'll get through the planning stage more quickly and with better results.

CHAPTER 6 Communication Considerations

Every loyalty effort involves some form of communication. There are two broad categories of communication: marketing and service.

Marketing communication involves telling the story of both your brand and your program, and can include enrollment packages, newsletters, invitations and announcements.

Service communication, on the other hand, can involve providing a member service center to take direct calls from customers. I'll focus on marketing communication first, and I'll address service communication later under logistics.

Define Your Strategy and Brand

For starters, your loyalty marketing program should be a brand, unto itself. It should stand on its own. It should not conflict with, and it should support, all the same qualities of your overall brand. But it should go a little beyond that and express something special. You should define your program brand up front. Consider how you want your customers to feel after each marketing communication interaction with your brand. Ensure that everything you do supports the post-communication perception you wish to create. Create a brand logo and a set of usage standards and, if appropriate, a tagline for your program brand.

Getting the Word Out

Once you've got your program defined, how will you tell customers? And whom will you tell?

Some of this gets into logistics -- is your program announced or clandestine? We'll explore logistics later, but at least consider the customers you must tell and how you must tell them. And don't forget your value proposition. Make sure you know why customers should care about what you have to say and ensure that your proposition is clear and easy to understand.

While some programs solicit membership via a direct mail or e-mail invitation, other programs simply assume customers in and welcome them. Others yet are designed to avoid creating a sense of membership and instead act as a group of communication contact points over time with a consistent theme. Some

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programs are completely voluntary – advertising, collateral and web-site tell the story about the program, and customers must volunteer or self-select to become members. If you've come this far, you probably have some sense of how your program will work. Map out specifically how you'll get the word out.

If you're inviting customers to become members, consider multiple campaigns. Consider testing e-mail versus traditional direct mail. Some customers just won't understand what you're trying to tell them the first time you tell them, or they won't pay attention. Follow-up communication efforts are almost always worth the effort and expense.

If you're announcing your program to customers through the mail or e-mail, many of them (typically about two-thirds) will ignore your welcome and will have no idea that they're even members. While this may be an acceptable approach in some situations, be warned -- if you do program awareness or recall-research after a single announcement, you might be disappointed. With ongoing communication, the awareness and recall will consistently rise. Be realistic and remember that your program is a new brand. It takes time and frequency to build a memorable brand.

If your front-line employees have interaction with customers and will play a role in communicating your program, don't short-cut training and employee communication. Your customers are sure to become skeptical quickly if they find that your employees are untrained, confused, or apathetic about your loyalty program.

Welcome Kit

The way you initially announce your program will determine if a member welcome kit has relevance. If you automatically enroll customers in as members, a welcome kit may not be necessary. However, if you invite customers to join or if you have a voluntary program communicated through advertising, you must quickly and effectively welcome those customers who have elected to become members.

A welcome kit typically provides a comprehensive explanation of the benefits of membership. It also carries any required terms and conditions (more relevant for promotional currency programs). The welcome kit is your big chance to get started off on the right foot, so give it the attention it deserves and make sure that it does a good job of communicating your program message to members.

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Information Gathering

A welcome kit is also a good place to introduce an involvement device to gather useful customer information. Just make sure that it's truly useful. Don't gather trivial information assuming you'll figure out what to do with it later. Make sure you'll know where to put it (many companies have shoe-boxes full of survey responses that sit idle in a closet until they're dated), and how you plan to use it. Carefully decide the things you need to know and make sure that you can explain to your members why it's in their best interest to provide you with information you don't have about them. Finally, make sure you'll be prepared to follow through on whatever promises you make.

Information gathering may be done much more effectively in a web-deployed enrollment process. It saves the time, money and high error rates associated with taking physical enrollment applications and having them key entered.

Ongoing Communication

Ongoing communication is typically delivered in the form of a newsletter. Just make sure you have a communication strategy defined and a realistic budget in place before you get started. Many newsletter efforts die after the first issue for two reasons: 1) the company runs out of content or; 2) the company runs out of money.

The approach to ongoing communication varies depending upon whether you have a consumer or business-to-business audience. In consumer marketing, the approach typically involves telling stories about how different consumers interact with your product or service. It involves demonstrating how other people have successfully used your product or service and are better off because of it. This may sound simple, but it can be complex when you actually try to map out an editorial strategy. The bottom line is this: you're trying to leverage the passion that consumers have for your product or service by making them feel better about buying what you have to sell.

In the business-to-business world, the decision to stay with a brand, or to defect, is typically made far more rationally than most consumer decisions are made. People making business decisions are still people, but their emotions play a smaller role in their choices due to their fiduciary responsibility to their company and their career (this can become blurry with a small business that is a sole proprietorship or partnership).

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Communication in a business-to-business situation falls into one of two categories. The first involves teaching customers to use your product or service in more and different ways. The second involves sharing practical information about business that doesn't necessarily relate to your product or service, but can help them in other ways. This creates a sense in their mind that you're a real partner.

Regardless of your communication strategy, it's important to get as many members as possible to agree to accept their communication electronically. Members who opt-in to receiving communication via e-mail significantly reduce the cost of your program. Since they agreed to receive it electronically they are much more likely to read it.

Partnership Communication

Without elaborating on how to structure partner relationships, I'd like to discuss partner-related communication.

The overriding principle to reinforce is that with partner-related communication, you should control the communication. If you involve partners in your program, you must ensure that every contact point with your members displays your program brand as prominently as your partner's brand. You should also make sure that your partner's value proposition is positioned as a benefit of membership in your program.

Customers in your program will have a "trained-in" set of expectations about consistency of messaging and format, so be sure your partnership arrangements don't let them down. Establish a set of standards for partner messages and for partnership collateral materials that relate to your program.

Also, never just turn your member database over to a partner. And avoid allowing partners to execute communication related to your program. It's your brand to protect. You must ensure its integrity.

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Summary

Communication is one of the most important components of your loyalty strategy. Remember that your program is far more important to you than it is to your average customer, so the communication must be well planned and flawlessly executed. Consider all the points of contact with customers and ensure relevance every step of the way. Use on-line communication wherever possible and constantly strive to get members to opt-in to receiving their communication via e-mail.

CHAPTER 7 Logistical Considerations

There are a number of logistical considerations to review when considering a loyalty program -- especially a promotional currency program. The primary consideration for a communication and soft benefits program is whether it's announced or clandestine.

Announced versus Clandestine

Will you tell the world about your program and make it available to anyone that wants to join? Will you keep it under wraps and make your own decisions about which customers are involved? These are important considerations to be explored.

Announced

An announced program is public and allows customers volunteer or "raise their hands" to become members. An announced program is often promoted on the front line and in advertising.

With an announced program, you need to decide how the enrollment process will work. Should customers fill out a form and mail it in? Should they call? You should strive to make it as simple and as fast as possible -- phone is best for that. Allow for fax and Internet enrollments as well. Make sure you send a welcome package as soon as possible. Remember -- this is your first chance to make a good impression. Don't blow it. Is there an end date for your program? Is it perpetual? It's best to have an end date that is included in your fine print so that you can end the program relatively smoothly if necessary.

An announced program is difficult to measure because you can't isolate the impact of the program. Customers self-select themselves in and you can't hold out a random control group to measure the effectiveness of your efforts.

Clandestine

Unlike announced programs, a clandestine program can be measured because you can ensure that a random control group is held out and you can ensure that your program membership is structured the way you want it.

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A clandestine program is known only on a “need to know basis” -- only customers who are “members” or who you include in the communication and soft benefits know about the program. A clandestine program is not promoted and customers cannot volunteer to join. You decide which customers will be in, and you let them know through direct communication.

There is a subtle consideration regarding whether or not you position your clandestine program as ongoing. With a clandestine program, you can avoid making firm commitments by crafting your communication so that customers feel that it’s a pleasant surprise and will probably happen again. This approach sounds a little wimpy, but it has proven to be both effective and manageable.

Promotional Currency Logistics

The logistics behind a promotional currency program can be fairly complicated. Key considerations fall into six categories:

- Enrollment
- Fee
- Term
- Systems
- Expiration
- Partnerships

Enrollment

In a promotional currency program, customers should go through some formal process to become “members.” A voluntary enrollment process requires customers to “raise their hands” and say they want to become members of your program. The enrollment process can be handled passively, using enrollment applications at the point of sale, or wherever your customers come into contact with you. Or the enrollment process can be handled actively, using mail or phone invitations with a response device or a negative option (you’re in unless you want out).

An automatic enrollment process sweeps your customers (all customers or a segment you define) into your program. This option requires that you already have a good database of customers, so it’s typically limited to companies that have direct billing relationships with customers (such as phone companies or credit card companies).

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If you use voluntary enrollment, you'll have slow membership growth but active members. If you use automatic enrollment, you'll quickly attract a large membership base but only a small percentage will be active.

Fee

If your program's benefits are good, will customers pay? And how much can you charge for your loyalty program?

Few companies have had success with fee-based programs. To command a fee, the program must immediately demonstrate value that exceeds the fee. I'm not talking about the really soft stuff either. In the bookstore category it's an accumulated reward that makes it easy for the member to do the quick math and decide to pay the fee. Likewise in the video rental category.

The good news is that once a member pays a fee, he is much more likely to consolidate share of customer with your brand since he now has a vested interest.

But don't overlook the difficulty of commanding the fee. It may sound good, but it is possible only in high utility business categories and it must be immediately apparent to the customer that paying the fee is almost a "no brainer."

Term

How long will the program run. You should pick a time period and include it in your program communication (most programs run a year). Then decide whether or not to extend it. It's good news to members when you extend your program, but if you must fold it, the published term will provide support for your exit strategy.

Systems

How will you collect and manage all the data? This is often the most underestimated and overlooked logistical consideration.

You must have a way of linking customer sales transactions to customer records. Then you must be able to translate transactions into promotional currency. Since programs like this often employ bonus options, the calculation should probably take into consideration dollar amount, date, time, and location of the transaction.

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Your system must be 100% accurate, and not the same as your marketing database. It's acceptable for a marketing database to be less than 100% accurate. A marketing database is used for your clandestine marketing operations. But a promotional currency program represents a commitment to your customers to give something back on every transaction. The system to support it must look much like an accounts payable system. The only difference is that you owe your customers, not your suppliers.

Channel Integration

Be sure that your program is consistently and effectively integrated across all channels. With many companies that is one or more traditional channels and the Internet. If your program is a promotional currency model, members should be able to earn regardless of whether they purchase off-line or on-line. Very often this comes down to fears of cannibalization within companies or "turf war" battles between the person in charge of the traditional channel and the person in charge of the on-line channel. But the bottom line is this: customers know your brand as a single brand. They don't create channel barriers; you do.

Expiration

It's a good idea to have an expiration date on your promotional currency. You can have the expiration calculation based upon when the currency was earned. For instance, points are good for 24 months after they're earned. Or you might have the expiration calculation based upon last activity. For instance, your points don't expire as long as you're active. If you're not active for 24 months, your points will expire.

There are various twists on the expiration topic. The most important thing to keep in mind is that you don't want to create a perpetual liability.

Partnerships

Partners often play a significant role in loyalty programs, but be cautious about creating a program that involves too many partners from the start. A complex structure of partnership arrangements will quickly confuse your members. It's better to ensure that it has a leg to stand on before introducing partnerships. It's also cleaner to start with few or no partners so you can get your members comfortable with your basic program.

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When you do select partners, make sure they really add value to your program. Too often, companies can enter into predictable partnerships that offer nothing unique to the customer relationship. It's important to consider each partner relationship carefully and to avoid making easy deals that your customers don't care about.

Exit Strategy

The day may come when all this must end. Prepare for it now.

You should include an end date for every program. The end date should be included in your terms and conditions. If the program must end -- for whatever reason -- you can allow it to end as noted. If the program is extended, it can be communicated as "good news."

Programs often end because of a lack of interest among members. If members are not interested, it's unlikely they'll become upset when the program is discontinued. You should communicate the end only to those customers that appear active in the program. If your program is a promotional currency program, part of your exit strategy should include creating an automatic redemption to allow all members with an acceptable minimum the option to redeem.

Service Communication

When you start a loyalty program you open a new channel of communication with customers. Customers will find ways to open new channels of communication with you. They'll call, write and fax. They'll visit your website and send e-mail messages. Plan for all this. If you don't, they'll track you down and you'll have a crisis on your hands developing response plans on the fly. It will become clear to your customers that you're unprepared and your image will suffer.

You must have two easy to access channels for service communication: telephone and Internet.

The telephone part is fairly straightforward. Establish a member call center to respond to member questions, queries and complaints. Ideally you'll make it easy for member to get their questions answered and problems solved over the web, so you'll be able to keep the call levels to a modest level. The calls will be a

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mixed bag of program-related questions/problems as well as company/brand-related questions/problems.

On the Internet, be sure to have a section on your web-site that specifically talks about your program. If it is an announced program, this section may be accessed by anyone who visits. If it is a clandestine program, you may have members only access with a password or pin required. The section should explain the program, reinforce the program benefits, potentially offer some exclusive on-line benefits, and allow member inquiries.

The on-line member inquiries may take two forms: real time inquiry and e-mail inquiry. If you have a promotional currency program it is imperative that you web deploy an interface that allows members to check their balance and activity. This will significantly reduce the number of phone calls you receive and, as a result, go a long way in helping you manage your program costs. For other kinds of questions, make it easy for members to send your program an e-mail. But beware, you must respond quickly and specifically to e-mail inquiries from members. There is nothing worse than an apparently unresponsive loyalty program.

Summary

Loyalty programs have a lot of "arms and legs". If you're not prepared to plan for and manage the details, try something else. Handling the details well won't win customer praise, but handling them poorly will create customer angst. Be sure to effectively support your program and your members on-line.

CHAPTER 8 Measuring Success

How will you know if your program has worked? Start by revisiting your objectives to see if you're getting the results you set out to achieve.

Loyalty marketing is all about improving retention and boosting share-of-customer. It's often difficult to assess your success in the short run, but it's a fact of life today that most companies with similar programs require a short-term return. There are two basic forms of measurement that can help: behavior and attitude.

Measuring Behavior

Behavior is essentially your customers' purchase behavior. Increased purchase behavior from a customer should result in increased share-of-customer. Behavior is also a measurement of your customers' defection (or lack of defection) rate.

Behavior measurement requires a comparison between members of your program and a random control group of customers not in your program. At times, this is easier said than done, but if you cannot logistically structure your measurement this way, you'll have to conduct periodic research among members to see if they think their behavior has changed because of your program. Here are the key elements to look at for short-term behavioral measurement. These elements should be compared -- members versus a control group:

Average sales per member. This actually tells it all, but you'll have to look at the next element to separate the impact of share-of-customer versus retention. For instance, if the average sales per customer in the program is higher (and we hope so) versus the control group, the average may be higher because all customers are spending more, or more customers are at least spending something.

Number of customers with no activity. This is probably an indication of defection. If you can separate the statistics on this group versus customers with activity, you can isolate the impact of your program on each of the two key objectives: retention and share-of-customer.

On a longer term basis, you should establish a lifetime value model, which incorporates attitudinal survey data to derive a customer's intent to defect. The intent to defect along with an expected stream of profits from a customer provides the foundation for a lifetime value model. This is definitely the long-

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term approach to measurement but this approach is usually too much of a “high road” approach to pass the test in most companies. Early on, you should strive for a combination of short-term and long-term measurements to satisfy your organizational requirements.

Measuring Attitude

Customer attitudes are also important because they precede customer behavior. In other words, how customers feel today will have an impact on how customers act tomorrow.

I suggest developing a battery of questions to assess intent to buy again, intent to defect and intent to refer other customers. These questions should be asked at least twice in a twelve month period and ideally should be asked of a random sample of customers in your program and a control group. The results should be compared to measure the extent to which the program subconsciously changes customer attitudes about your brand.

Most companies have ongoing tracking studies, which are executed on a regular basis and measure the evolving attitudes and perceptions of customers. The questions I’m suggesting can typically be incorporated into an existing research effort or they can be done separately.

Summary

Make sure you consider measurement up front. Know how you’ll declare success or failure and build the right mechanisms to support your decisions. Changes in behavior may occur gradually, so measure attitudes as well. Remember – today’s attitudes drive tomorrow’s sales.

THE FINAL CHAPTER Conclusion

Loyalty marketing is more than just a program – it's a business strategy. The implementation of loyalty programs in the travel industry helped start a trend toward the investigation and implementation of loyalty strategies in most industries.

The promotional currency model – made popular in the travel industry – is one very popular loyalty option. Although it's popular, the promotional currency model is not automatically right for your company or industry. Explore all your alternatives and conduct an economic reality check before simply assuming that earning customer loyalty requires giving something away.

Planning your loyalty strategy requires a rigorous and focused methodology. Define your objectives and get consensus in your organization before proceeding too far. Without a clearly defined set of objectives, you'll certainly drift and you'll wind up with an ill-defined group of loosely related tactics. Make sure you've considered how you'll measure success. Too often, companies launch loyalty efforts without well-defined success criteria.

Communication is the key to an effective loyalty strategy. If you do nothing else, develop a comprehensive communication plan to deliver relevant content to your best customers.

Be sure to think about the integration of on-line and off-line communication. Using on-line mechanisms to support member inquiries and drive member communication can make your program more cost-effective and member-friendly.

Finally, don't overlook the details. These initiatives are complex. Customers aren't necessarily impressed when you handle the details well, but they're almost certainly disenchanted when you don't.

About the Author

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