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LOYALTY IN A COLD CLIMATE

It must be one of the biggest marketing mistakes since the crash – and it's an opinion that's heard too often: "We can't afford loyalty now".

At first glance, it's not an unreasonable attitude:

- Margins – especially in payment cards, under pressure from regulators, self-serving retailers and show-boating politicians – are getting ever tighter
- New distribution channels are upending long-established business models (fully one sixth of UK retail sales now happen online[1])
- Even better-off customers are more price-driven (Waitrose Woman now shops at Lidl)
- Serial bargain hunters are driven by daily deal promoters…

….there are many reasons for abandoning loyalty.

But it's a mistake.

Why? Because there's a continuing confusion between loyalty and rewards. And this isn't mere pedantry. Properly defined, rewards programmes are only a subset of customer loyalty – and customer loyalty, precisely because of those pressures on profit, is actually needed now more than ever.

That said, there are legitimate questions to be answered: Whose loyalty? How is loyalty defined? How is it captured? At what cost? What role should rewards play – if any?

Whose loyalty?

Certainly not the loyalty of the serial bargain hunter. Rather, we should target the most profitable customers. At the extreme, Waitrose should be happy that its shoppers hunt for cut prices in Lidl – provided they buy the high margin products at Waitrose. Early rewards programmes (call them Loyalty 1) got this wrong: they focussed on sales. Many still do. Loyalty 2 focusses on profit.

But figuring out who is the most profitable customer – and then "engaging them" as the jargon has it – means data: internal (what bought, how profitable), and external (who bought).

For internal data, retailers are often in a far better position than financial services institutions, many of whom are still battling with product silos and heritage systems. But for external data, the boot is frequently on the other foot: although my local shop knows me by name, Morrison's has no idea who I am – yet I spend 20 times more a week with them.

And that, of course, is precisely the reason why Tesco are committed to the Clubcard, and why Sainsbury's participate in Nectar. It also explains why, at a rather more rarefied level, Burberry have invested in the Customer 360 programme, which can tell an assistant what a customer in Brazil last bought on a stopover in Paris – and what they are saying about Burberry on Twitter. These and other

[1] IMRG/The Economist 2 September 2012

retail initiatives are outstanding examples of how data can build profit: the surprise is that they're not more common.

The other dimension to profitability is time: hence the recent focus on Customer Lifetime Value. This is one of those concepts that are splendid in theory, but rather harder to pin down. For example, how do we define "supermarket customer"? By store location? By the brand above the door? Locals in my small village have the choice of two equidistant Sainsbury's and a Sainsbury's Local, one Tesco store and a Tesco Express, a Morrison's and an Asda. How do we define "customer lifetime"? By time at this address – assuming we know it? By average time between moves? If so, how do we deal with new store openings by competitors?

Rather more usefully, the time dimension also means the need to identify customers who have the potential to become profitable in the future – or profitable customers who may be defecting. The classic route is to profile existing profitable or defection behaviours and spot likely matches. Once again, we arrive back at the need for data.

How to define loyalty?

The meaning of customer loyalty will vary from organisation to organisation, and from industry to industry: a retailer might measure it by % of category spend, a card issuer as share of wallet. One vehicle distributor measures loyalty by whether his customers for new cars bring them to him for servicing. A general definition that has been popular is Recency, Frequency, Value – a useful approach, but it still needs the profitability overlay.

However the business defines customer loyalty, it will need data to measure it.

How to capture loyalty?

Too often, winning customer loyalty has been understood as offering rewards. But beach towels won't do the job any more. The appeal of Air Miles type rewards flights has been badly damaged by low cost carriers – and, in the UK, BA's retreat to serving the South East only. Cashback is costly (no breakage), easily copied and difficult to cancel. What to do?

First, get the basics right: price, product, positioning, location, service. If these are broken, no customer initiative will help. Then identify your most attractive customers. Figure out what would motivate them to do more business with you. Overlay robust basics with benefits chosen for their relevance, not to the undifferentiated mass, but to the specific target segment: in the US, American Express offers ZYNC cardholders a choice of nine rewards packages from lifestyle through green to charity. Other issuers are experimenting with "Create Your Own Reward" offers.

Use technology: providers now offer solutions which make instant rewards at POS hassle-free (as just one example, take a look at FDI's Offerwise), generate redemption or service suggestions based on location and/or previous shopping baskets (think Google), dispense with the need for traditional payment cards, store points and miles on mobile phone apps (Passbook, for instance).

But a word of caution here. Apple, who mostly get technology right, haven't built m payment capability into the iPhone 5. Amid all the noise about the limitless capabilities of smartphones, many cooler heads now argue that the future of NFC lies, not so much in pure-play payments, but rather in marketing and loyalty – creating value for both consumer and merchant.

The power of social media to boost business has been over-hyped (though there's no doubt it can be a powerful force for damage): still, it's a proven way of linking customers with similar interests, especially where they share an over-riding higher-order motivation. Creative types are using social media channels to bring together collectors who use their points for charitable or environmental purposes.

Too often, the Cinderella at this party is recognition. Frequent flyers value upgrades and the ability to check in at First Class counters almost as much as free flights. Emirates cabin crew surprised and delighted a colleague by remembering his reading preference for golfing magazines… and became his number one airline choice. Instead of retailers' disingenuous trick of having shoppers do all the work at self service check outs, would it be so difficult to have Gold Speed lanes for the most profitable customers?

The common foundation for all these options? Data.

At what cost?

Whatever makes sense. If a programme costs £1 mn and generates incremental profit (from wider margins and increased revenue) of £2 mn, it's worth doing – provided no other use of the money offers better ROI.

Rather more controversial is the "merchant-funded rewards" concept. At one extreme, there's the view that this is a none-too-subtle attempt by cash-strapped banks to shift the cost of their rewards programmes on to their merchant partners. Conversely, it's argued that banks can share valuable spend data with merchants, transforming their understanding of their customers, and that this is worth paying a premium for.

Certainly, there are examples in Europe of merchant-funded programmes that have failed to deliver value sufficient to retain the merchants they recruited, and of programmes that just weren't able to enrol heavy-weight merchants in anything like the numbers needed. But lessons have been learned: the payment networks are now coming up with powerful case studies showing real business benefits for merchants from data sharing. Issues covered include a wide range of retail profit drivers – store location, customer share, opening hours and product mix; intriguingly, they also throw valuable light on the questions around customer definition mentioned earlier. On this basis, merchant-funded programmes make commercial sense. Once again, we see the power of data, both internal and external.

What part do rewards play in all this?

Times are tough. That makes attracting and keeping the most profitable customers even more important. Knowing who those customers are and what makes them profitable calls for information. At one level, if they did nothing else but generate transaction and customer data, rewards programmes would pay their way. If it can be shown that they also generate plus profits, then they're so much the more attractive.

Down in the forest, we sense something is stirring…..