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THE CHANGING FACE OF CARD LOYALTY

Insight Consultancy
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Insight Consultancy
6th Floor, 2 Kingdom Street
London W2 6BD

Tel: +44 203 580 4220
www.insight-consultancy.com

What is Loyalty?

When asked what "customer loyalty" means to their business, many would say, "Loyalty Programme". But what does loyalty mean in the overall business objective particularly in the context of the payment card industry?

Many card marketers are confronted by the challenge of maintaining a loyalty programme that is likely to be expensive to upkeep, difficult to differentiate, and almost impossible to measure in terms of effectiveness.

How does one measure *effectiveness* in the broader business context? Does it mean profit, retention, or simply a "basic requirement" or "hygiene factor" because every other card issuer today has a programme of sorts in place?

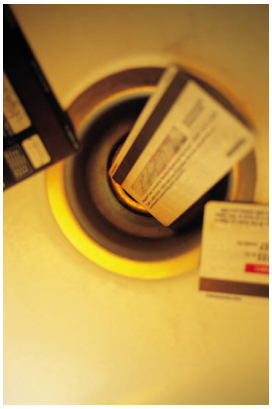
This paper explores the changing role of loyalty programmes in the payment card industry and how we might re-think the ways in which we perceive 'loyalty' with respect to the relevance of a loyalty marketing programme.

The US market is the most mature credit card market in the world and is also a useful global indicator in terms of key trends and patterns. In a Colloquy[1] census report for the US loyalty-marketing study published in April 2009, two important observations with direct implications on the payment card industry emerged from the data:

- More than half of all programme memberships are inactive, perhaps suggesting that the accelerated growth of loyalty memberships is coming to an end?
- The growth in loyalty programme membership for the financial services sector was an incredible 75% from 2006 to 2008.During this same period the mature and long-standing airline segment reported a modest 9% growth.

What these figures suggest is that although consumers are increasingly wary of loyalty programmes and have become increasingly passive, the payment card industry has been rolling out loyalty programmes in every colour and shade.

This phenomenon could be explained by the changing landscape of the credit card business model. While traditionally, issuers rely on the 'lending' model for the bulk of their revenue, the near-collapse of the financial markets in the United States is a sombre reminder that a consumer economy based on consumption with excessive borrowed funds is not sustainable.



While some of us might struggle with this change, the payment card business needs to relook at the fundamental basics of our profitability model.

Could it be that issuers have to gradually reduce their reliance on the 'lending' model to embrace the 'transaction" model? Sometimes cardholders still love their plastic, but prefer the card as a transactional device, rather than a lending device. However, increasing dependence on transactional sources of income is not necessarily an option in markets which are experiencing regulatory challenges to traditional sources of income such as interchange and foreign exchange mark up.

This change of business direction might explain how loyalty is becoming the new weapon of choice for card marketers, so much so that the effect has spilled from credit cards over to debit cards.

In Asia, credit card loyalty programmes have been in place for more than a decade. It is now almost impossible to launch a card product that does not come with a loyalty programme as a default feature. A quick check in markets such as Singapore, Malaysia, Philippines, Thailand, and India, reveals a great deal. Where rewards programmes in the US and Europe are more likely to be product-specific, many of the rewards programmes in Asia are portfolio-wide, bank-branded point's programmes. The issuers in Asia have the difficult task of running an expensive programme funded through interchange, while the role of the rewards to differentiate is reduced to mere commodity.

So, what does loyalty mean to issuers and financial

[1] *CensusTalk: The Big Sort: The 2009 COLLOQUY Loyalty Marketing Census 2009*, published 2009

institutions? What does loyalty mean to consumers? More specifically, "Why have a Loyalty Program" in the first place?

"At the end of the day, loyalty programs are really targeted advertising or marketing programs aimed at getting more customers in the store."

Shea Long, VP at Marit

Loyalty as we know it

When loyalty programmes first appeared, they were hailed as the 'killer-app' for cards. Issuers scrambled to launch card rewards from points to rebates to discount vouchers. To this day, the form of 'loyalty currency' has not changed much. Many issuers may claim to have invested vast amounts of energy and resource in card rewards in the hope they reap great returns. But one must ask what those expected returns are?

Most would respond with one or a combination of the following:

- Differentiation
- Retention/Reduced Attrition
- Increased spend

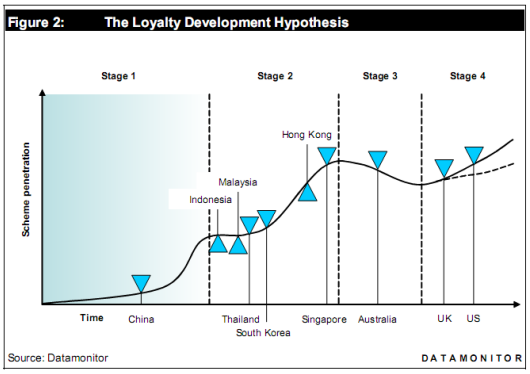
On the other hand, if you asked the same group of managers what their biggest issues with their programmes are, they are likely to be:

- Differentiation
- Relevance
- Cost
- Legacy

The deeper issues of card loyalty programmes can largely be attributed to:

1. Loss of direction, and
2. Lost of differentiation

The "Loyalty Development Hypothesis", introduced by Datamonitor relates that in mature markets with late-stage mature payment card loyalty schemes, the scheme penetration rates begin to taper off, indication commoditization of loyalty programmes.



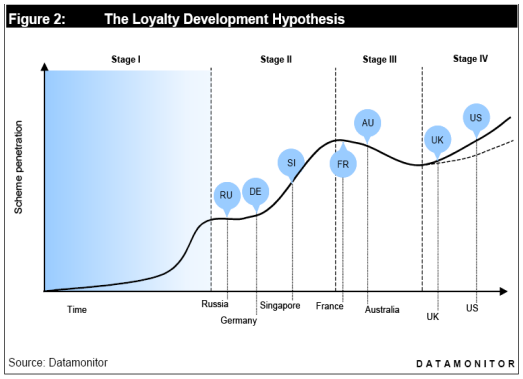


Figure 1: The Loyalty Development Hypothesis

Card loyalty programmes were originally envisioned to provide a vehicle for card companies to continuously engage the cardholders. The credit card, being a payment instrument more than a consumer product in itself, presented a challenge to marketers in building customer commitment. Therefore, loyalty programmes presented themselves as a cure-all for card marketers who quickly transposed the idea of loyalty programmes from the consumer product space to payment cards.

Many of the programmes were created with little direction or alignment with long-term business objectives. They were often launched with a great fanfare and then left to operate on auto-pilot.

Since many of these programmes are easily copied, the inevitable cookie-cutter versions of the programme soon propagate and then eventually flood the market, making what was once a point of differentiation a mere commodity.

To make matters worse, there is a common misconception that retention strategies equate to loyalty programmes. In reality, retention is an entire life cycle management process in its own right and loyalty programmes represent one of the ways in which retention strategies can be implemented.

To analyze the real issues behind loyalty programmes, we might want to take one giant leap backwards: What is loyalty?

Maritz defines 'true loyalty 'as a state where customers heavily use your products and services, serve as advocates for the brand, and resist competitive threats.

Customer loyalty means very little, if it does not translate into profitability or contribute to business objectives. In essence, loyalty marketing and loyalty programmes must make "business" sense.

Loyalty & Purpose

With the near-feeding frenzy in loyalty programmes, there seems to be an overwhelming assumption that loyal customers must be profitable customers. That in itself is increasingly debatable.

There is an abundance of available literature that points to 'loyal customers' being 'good customers'. The underlying reasoning is that:

- Loyal customers cost less to serve
- Loyal customers have a higher value of purchases and will buy more frequently
- Loyal customers are less price sensitive
- Loyal customers will make natural advocates for your products/brand
- Loyal customers are easier to cross-sell to

However, many of the studies that come to these conclusions are usually made on products and services other than credit cards. It is therefore important to remember that the studies *do not take into account, the specific nuances of the credit card customer or the buying cycle of a credit card product*.

Case in point: A long-time credit card customer calls customer services to file a complaint of negligence and bad treatment by the bank. She goes on to harass the call centre staff, the card department, followed by senior manager – an act which costs three bank staff an average of 1.5 hours each. The cause of these accusations stem from her not being the first 20 customers to redeem a free weekend hotel stay. Her argument is sound: she has been with the bank for 10 years, and has never held another credit card from another institution. She uses the card regularly and has a subsidiary card for her son. She spends an average of US$3,000 a year for the past 10 years. She is prompt in her repayment of card bills and has never revolved. She has consistently asked for fee waivers and has never paid annual fees during her 10-year relationship with the bank. In the said promotion for Christmas, one is required to spend US$1,000 over a single weekend during November, and be the first 20 persons to call in to qualify. Her account billings for the 10 months prior to the promotion amounted to US$1,000.

> *"Customer loyalty means very little, if it does not translate into profitability or contribute to business objectives."*

As you can see, this customer is clearly loyal (almost 11-year tenure with the bank with no other competing cards in her wallet), and most likely costing the bank more to keep (high cost of maintenance) and least likely to be profitable (the estimated income from this customer to-date amounts to $32,000 X 1.5% = $480).

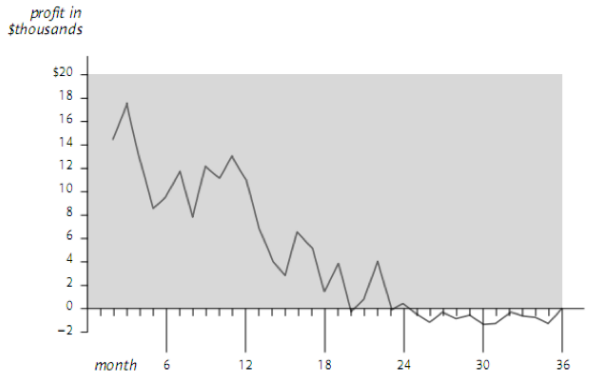


Figure 2: The Cost of Keeping Customers On

An extensive empirical study carried out by Reinartz & Kumar in 2002 studies the profitability of customers over time. In one company studied, many non-loyal customers are very profitable initially.[2]

But profitability reduces as the buying activity reduces and stops, while marketing investment in these customers continues. So, loyalty in the form of *longevity* should not be confused as a proxy for profitability.

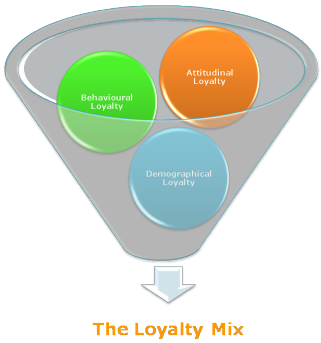
For the card marketer, loyalty should *not* be recognized as a concept with a singular dimension, but as a combination of Attitudinal Loyalty, Transactional Loyalty, and Demographical Loyalty.

Attitudinal loyalty looks at the basic level of emotional attachment and is best represented by a customers' longevity with the company or use of the product. These are usually esoteric and intangible emotions that can translate loosely to 'tenure' and advocacy in the payment card context.

Behavioural loyalty concerns itself with transactional behaviour; this has been exhaustively dealt with in RFM theories (RFM stands for *recency*, *frequency*, and *monetary value*). In the case of payment cards, it is of course considered in terms of billings, transactional volume.

Demographic loyalty refers to the measure of loyalty response that is typical of the demographic profile of the customers. This is based on empirical studies that customer of different demographic profiles will respond with varying degrees of loyalty. For example, a younger person is more likely to switch cards than an older cardholder.

Together, these three types of loyalty form the *loyalty mix* (see **Error! Reference source not found.**). The loyalty mix is a measure of **True Loyalty** – customer behaviour that should bring about profitable business, customer advocacy and cost efficiencies.



Card marketers seem to have a tendency to lose sight of the business objective of loyalty. Loyalty plays an important role in card marketing, but it is most-often misaligned with overall business goals.

Figure 3: The Loyalty Mix

It is important that loyalty schemes are designed not just to retain cardholders but also to promote profitable behaviour. Many loyalty programmes have failed in the past as they have actually increased the unprofitable behaviour (i.e. transacting versus revolving). A good example of this is when UK issuers started offering 1% cash back deals in the mid 90s.

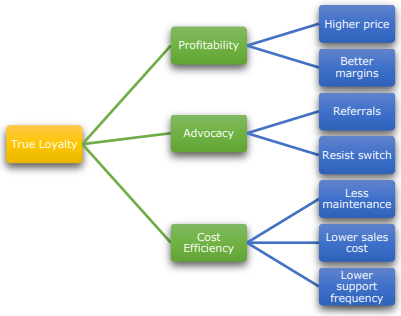


Figure 4: Business Drivers for True Loyalty

In a market where revolve rates are the largest single driver of credit card profitability, the scheme not only became unsustainable once interchange rates reduced, but also drove cardholders to move day to day spend onto their cards which in turn

[2] *The Mismanagement of Customer Loyalty* by Werner Reinartz and V. Kumar, *Harvard Business Review*, circa 2002

drove revolve rates down.

Relevance and Invigoration

So, does loyalty have any relevance in the payment card world? The answer is yes but to what extent? Perhaps it is time for card marketers to consider that loyalty must be managed scientifically, with the understanding that a loyalty strategy goes beyond a cookie-cutter loyalty program.

Optimising by Segment

As we have seen, not all customers are created loyal. This is because, all customers are different. Strategically segmenting customer for different loyalty initiatives is the first step to an effective program. One of the more innovative segmentation strategies was introduced by Reinartz & Kumar. This simple yet elegant model draws from the underlying belief that managing customer loyalty should take into consideration the company's need for profitability, and the differences in customer characteristics. Hence, differentiated loyalty marketing tactics applied to different customer types.

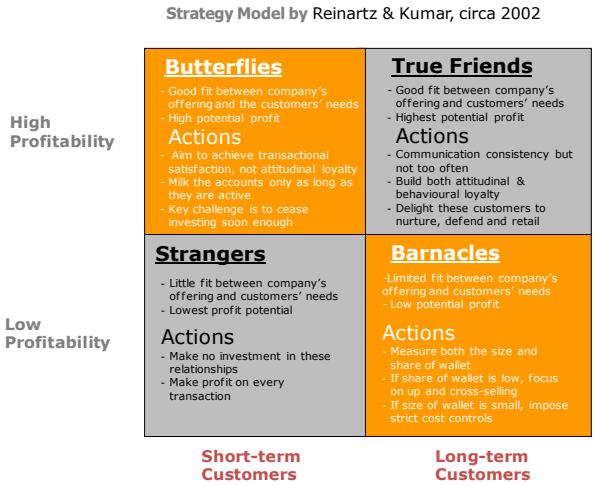


Figure 5: The Strategy Model

As the model details, the four archetypical customer categories are Barnacles, Strangers, Butterflies, and True Friends (see **Error! Reference source not found.**). In the context of credit cards, these customer types can be easily translated to customer segmentation, using a combination of behavioural, attitudinal, and demographical attributes of a cardholder (see **Error! Reference source not found.**). Segmented marketing actions will ensure that money is spent on the right customers, and we are reminded that "*it is okay to drop customers, when they are not worth keeping*."

Rewarding by demand

A company's need for profitability requires that we apply differentiated tactical approaches to different segments of customers, at the same time, a loyalty programme must be attractive to customers or the desired results will not materialize. The most important aspects are that of the *reward structure* (the 'how') and the *reward currency* (the 'what') involved.

There are three (3) important consumer attributes to assess a program: Aspirational, Attainability, Relevance.
These three must strike a delicate for the programme to be successful. An attractive scheme is where one would aspire to earn the rewards; the effort needed must be just right, and the rewards, relevant.

Aspirational – Cardholders must find the reward something they would aspire to. The perceived value of the reward goes beyond monetary terms. This is true particularly when the affluent segment is involved. In many cases, *aspirations* could mean less tangible but emotionally engaging things such as exclusivity, brand affiliation, etc.

Attainability – The most common complaint among cardholders have about their card loyalty schemes has to do with attainability. We should do away with programmes where one needs to accumulate thousands of points for months before a toaster oven can be redeemed, or where one needs to be a perpetual revolver, paying full interests and fees to earn enough air mileage for a short-range return ticket.

Relevance – Relevance of the reward structure and reward currency is one of the least discussed topics among loyalty marketers. And yet, it is also the one attribute that most determines the success or failure of schemes. Loyalty marketers must remember that what works for one person, say, points, may not work for another, who prefers direct rebates or miles.

Understand priorities

Loyalty can serve a multitude of purposes, but as with all things, one must decide on priorities. Desirable effects should reflect the true nature of the marketers needs. One way to prioritise is to choose between the Shackle Effect (retain profitable customers) or the Reward Effect (rewarding behaviour). These two objectives are not mutually exclusive, but each works to solicit different results, depending on the business environment and customer segments. Together with the *Strategy Segmentation Model*, appropriate tactical approaches can then be developed for the desired goals.

Beyond Card Loyalty

Payment cards have been at the forefront of loyalty initiatives in the financial services sector for years. Part of reasons for this has to do with the nature of payment card products. Of all consumer banking products, payment cards possess product attributes and characteristics most similar to consumer goods. So, it is cards that have benefited most from the sophistication of consumer marketing, and in many ways have been a main driver of growth over the years.

With the advent of new technology and growing commoditization of loyalty schemes, many marketers in cards and financial services seek to look beyond the confines of *card loyalty programmes* for areas of new development and the 'next big thing' in loyalty marketing.

The power of ONE

Relationship Rewards - The retail and airline sectors have been relatively successful in maintaining customer interest and participation in their loyalty schemes. This is largely because the customers of these sectors are identifiable due to the *singular* nature of the products and services involved. Whereas a payment card is more than often an instrument by which customers utilize to *consume* retail and airline products. In recent years, several financial institutions in the US have gone beyond the confines of the card product and developed relationship programmes: Citibank (Thank You network), Bank of America (Keep the Change), etc. Banks have begun to focus on customer-centric management practices. The major step taken is to overcome the issues of silos within the bank, and building the right infrastructure to identify, recognize and market-to a customer who is likely to have different product holdings with the same bank. The sophistication of loyalty schemes presents the banks with a unified platform to address this. Although there are managerial and technical difficulties today, it is very likely that the banks will gradually move towards a holistic approach in customer-centricity.

Unite and conquer

Merchant-funded Rewards - In the mature card markets in Asia such as Singapore, Malaysia, Philippines and Thailand, the banks have been pursuing merchant partnerships to deliver value to their cardholders.

In many instances, these marketing programmes are managed separately outside of the loyalty framework. Collaborative in nature, these programmes are co-funded by the coalition of merchants with the bank acting as a conduit for the merchants to market to their cardholder base. The programmes range from the straight forward direct discounts at the point of payment, special price-offs and offers, to clever RFM type campaigns delivered through the banks payment terminal (POS). These schemes offer cardholders a greater attraction and relevance because the partnerships are built with reference to customer-merchant pairing. Granted that these schemes can sometimes result in 'price wars' among card issuers (in terms of the value of merchant offers), there are nevertheless many ways to play the game to stand out in the crowd. As the transaction model takes greater precedence over

the lending model, this may be the most direct way to alter cardholder spending behaviour.

Harness to win (Communication and Fulfilment)

Technology has redefined communications and the way marketing can be executed. The consumer goods and retail sector is once again the first to harness the power of technology-enabled communications to full capacity, deploying social networking tools for WOM marketing and brand building. Financial institutions can learn from these technologies to benefit from expanded channels of communication and fulfilment in loyalty strategies.

Real-time Point-of-Sale - *Instant gratification* has become a staple in customer demand and not merely a nice-to-have. Technology has offered us new ways to deliver and administer loyalty schemes. As payment device, the card is only physically present at the point of payment. This very nature is unlike that of other consumer products. Where in-store purchases are e made with a card, the moment of payment is a unique moment to deliver value to cardholders. There are many providers of technology today that allow instant delivery of rewards in points, offers, and monetary rebates. This mode of communication allows the cardholders to be actively engaged in loyalty schemes and provides them tangible interactive experience with their card. For the issuer, the bank-merchant-cardholder relationship provides a strong case for merchant-funded initiatives. When executed correctly, real-time point-of-sale technology provides an opportunity for cost-savings in rewards fulfilment.

Social media community and opt-in communication - Cardholder communication forms the single largest cost component in card marketing. It is also one of the least understood and poorly measured. With the advent of social networking technology and the internet, the consumer world is increasingly one that demands customized communications in channel, delivery and frequency. This is the utopia of customer advocacy where the user determines the form, channel and even the content of the communications. (Recall the beginning of the whitepaper where customer advocacy should be a key value driver for customer loyalty.) It is low cost and self-served, provided that the infrastructure is in place. Consider statement inserts – the most direct and *tangible* form of cardholder communication. What if the cardholder is able to customize the look and feel, and makes her own decision on what information she requires and the format and channel (e.g. paper, email, sms, Tweets) through which she receives them? (Just like how she customizes her own Facebook page?) Imagine that the bank informs her of a new promotion that she enjoys so much, she creates a Facebook fan page for it, writes about it on her 1,000-views-per-day blog, and tweets about her experience to her 500-odd so followers on her Twitter updates. This scenario will not be too far away or hard to imagine, and customer advocacy will form the cornerstone of loyalty communications.

The Last Word

All too often, loyalty programmes are used as a band-aid for anything from bad product design to poor marketing.

Let us not fall into the same trap.