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Loyalty Programs vs. Loyalty Behavior: Do Marketers Get What They Intend?

Using Customer Advocacy and Emotional Bonding
Research Concepts to Drive Desired Loyalty
Program Business Outcomes

Michael Lowenstein, Ph.D., CMC
Thought Leadership Principal

Loyalty and reward programs classically have two basic intentions. One objective is to generate important customer profile data that can be used for targeted - even micro- segmented - marketing, promotion and communication initiatives. The other is to leverage loyal behavior among the customer base and reduce the use of or consideration of competitive products and services. To meet both of these objectives, the program, its array of components and perception of personal value need to be optimal. Are they?

The CMO Council recently conducted a study, The Leaders in Loyalty: Feeling the Love From The Loyalty Club, the key findings of which revealed that neither of these objectives was being met. The study concluded that companies sponsoring loyalty programs were just using them to deliver general discounts and perks to the mass of members, ignoring customer profiles within the database that would help provide more targeted and relevant communication and stronger value perception among program members. Only 13% of marketers in the study felt that they have been highly effective in leveraging loyalty and brand preference among club members and nearly 20% have no strategy in place to do this. Almost 30% of marketers reported that customers see little or no added value to becoming a loyalty program member, though marketers admitted that most of their program components were discounts, free products or premiums rather than better service or improved customer handling.

Very significantly, more than half (54%) of loyalty program members surveyed in the CMO Council study were considering leaving the programs or defecting from the brands and companies sponsoring them, principally due to:

1.   The onslaught of irrelevant and off-target messages, low or non-meaningful program benefits, and

2.   The impersonal treatment they receive as members.

At the same time, it has been well-established in multiple studies, such as those by loyalty program development consulting company Colloquy, that customers who participate in loyalty or reward programs are much more likely to positively communicate their experiences and recommend the product or service of the sponsoring organization than the remainder of the customer base.

For instance, Colloquy found that loyalty program members are 70% more likely to be engaged in advocacy-type activities such as positive word-of-mouth and referral compared to the general population. More than two-thirds of a program's strongest advocates will recommend the program's brand within a year; and those who are most active, i.e., using benefits on a regular basis, are more than three times more likely to engage in recommendation and word-of-mouth communication than other members. Finally, those program members who have redeemed for experiential rewards, and thus deepened the relationship between them and the sponsor, are 30% more likely to be advocates than those members who used the program for discounts and bounce-back offers.

Colloquy's studies determined that the same lack of perceived program relevance and value identified by the CMO Council carried over to the inability of marketers to identify within the program database those members most likely to be advocates for the program. Nor was there much evidence of building relationships or encouraging positive word-of-mouth. In the CMO Council study, key actions for improving club ROI included personalizing interactions and target messages (51%), increasing relevance of communications (39%), gathering more insights and intelligence (38%) and adding unique new benefits and incentives (36%).

Not every company is like leading worldwide supermarket chain Tesco, with DunnHumby as their wholly-owned customer loyalty program data analyst. DunnHumby conducts detailed evaluation of loyalty program member profiles that can be converted into more effective program components, targeted messages and promotions. However, every company with a loyalty program can get smarter about:

1. Using loyalty program member data to best effect, and

2. Designing or redesigning its loyalty program to encourage participation and leverage positive word-of-mouth and purchasing behavior.

The Good, Bad, Ugly and Opportunity Represented by Loyalty Programs

Loyalty programs are considered by many to be inexpensive methods of getting customers to come back and buy more; but, though inexpensive, they may also be ineffective and even damaging. There is a potential for disconnect, at least in terms of loyalty program design or redesign. Loyalty program members can, and ideally should, actively represent their membership through advocacy-type activity. As proven by studies such as Colloquy's, they are often far more likely to communicate with others about their experiences with the programs; the more active their program participation, the more likely they are to spread the word. But if they are disengaged with the loyalty program, or do not see the value represented by membership, these customers will become passive about both the program and the products and services it represents. They may become negative communicators or defect.

Too many companies belong to the Field of Dreams "if you build it, they will come" school of loyalty program development. They subscribe to the conventional wisdom that if they create what they believe, or what they are told, is a compelling program with attractive customer benefits, then the company will be rewarded with both more customers and more sales as evidence of loyalty behavior. Once built, customers may come, or they may not. They may spend more and make more referrals or they may not. Recent research by The Hartman Group, a marketing consultancy, determined that 74% of consumers agree that companies need new and better ways of rewarding loyal customers. Clearly, many loyalty programs are suboptimal in effectiveness.

For marketers who hope to build profitable word-of-mouth behavior from loyalty program members, the tools for doing so exist within the program database. They should identify the advocates embedded within their membership bases. Then, they should build relationships that reward these members for their positive word-of-mouth activity. Noted marketing Professor Philip Kotler, of Northwestern University's Kellogg School, believes that standout organizations are those that can most effectively optimize stakeholder trust, engagement and perceived personal value. In a recent Financial Times interview article, Dr. Kotler said, "They use the word-of-mouth effect of unpaid advocates - truly loyal customers - to boost their reputation. Advocates will do your marketing for you if you mobilize them, listen to them and engage them." Loyalty programs, used effectively, can be an excellent vehicle for creating and extending customer advocacy behavior.

Defining Customer Advocacy and Advocacy Measurement for Loyalty Programs

Beginning around the year 2000, major consulting organizations began to recognize that critical changes in the marketplace were likely to have profound impact on businesses, especially the shift from push marketing to dialogue marketing. The emphasis was moving toward optimization of customer engagement and perceived value. Instead of relying solely on such historic measures as satisfaction, loyalty, commitment, and recommendation, companies would need to identify and focus on something more contemporary, more actionable, and more predictive of key monetizing business outcomes, such as share of wallet. That "something" was ultimately defined as customer advocacy by consulting companies, academics and business executives: i.e., behavior driven by a strong bond with the preferred brand and active, voluntary online and offline word-of-mouth on behalf of that brand.

Customer advocacy could now provide organizations with many valuable business outcome benefits. This new consumer influence also meant that market research companies would need to evolve beyond historic methods of interpreting customer attitudes and determining how those attitudes could impact behavior, in order to incorporate drivers of customer advocacy. Some new models were created principally to evaluate emotional connection; however, in general, the market research industry has not embraced the new realities of customer decision-making represented by customer advocacy. Having identified the power of customer advocacy to influence the customer's own behavior and the behavior of others, the next challenge was to create and prove the effectiveness of a state-of-the-art research metric or framework for measuring and leveraging power of customer advocacy.

We will examine how a new customer advocacy framework can be applied to help optimize loyalty and reward program performance.

Using Advocacy Research to Design or Redesign A Customer Loyalty Program

Advocacy occurs when:

1. Customers select a single supplier from among all those they might consider, giving that supplier the highest share of spend possible, and

2. Customers informally, voluntarily and often frequently tell others about how positive their relationship is with the supplier and how much value and benefit they derive from it, without any form of compensation.

Advocacy is principally based on positive, voluntary and active customer word-of-mouth and the impression, or level of favorability, of the brand or vendor, based on experience. However, word-of-mouth is a double-edged sword; customers' negative communication, as much as praise, can have a damaging effect on other customers and non-customers, as well as on the communicating customer.

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Marketers have recognized that their number one program priority must be to acquire and retain motivated and engaged participants. In the CMO Council study, 46% of marketing executives identified this as their principal challenge. Other performance obstacles included measuring marketing value and effectiveness (42%), deriving valuable insight and intelligence (38%), delivering more personalized offers and inducements (34%), and creating more customized communications (33%). All of these key issues can be effectively addressed through targeted loyalty program advocacy research.

For our case study, we will use a wine buyers' customer loyalty program and call it the Wine Lovers Club. There are many of these programs around. They are offered by wine retailers, individual wineries, as add-ons to other loyalty programs, and as coalition or aggregated programs of multiple retailers, or retailers and other product and service providers.

This particular Wine Lovers Club (a real loyalty program whose identify will remain anonymous for our example) was introduced in 1999. As of this writing, it has 50,000 members. Cost of membership is $100 per year with a membership fee rebate beginning in the second year that is based on the amount of wine ordered in the previous year. The program has been built incrementally over time, adding elements management borrowed from other loyalty programs that they felt would make theirs more successful. It now has nearly 20 program components:

1.   Personalized winery visit (U.S., Australia, South America, Africa, and Europe) availability
2.   Points earned for every purchase
3.   Special events, at wineries and locations around the U.S., with wine enthusiasts
4.   Free shipping on wine purchases at a case level
5.   Instant discount or rebate offers
6.   Access to pre-release, specialty, and limited production wines
7.   A members-only catalog with program logo items, which are reasonably-priced wine accessories
8.   Catalog accessories, food, hampers, gift baskets also available for points earned through purchase
9.   Discounted wine storage rates
10. Free personalization of wine labels for gift-giving
11. Referral benefits (discounts, points earned whenever a referred friend buys wine or puts it into storage)
12. Tier levels, with higher points per purchase as purchases increase
13. Discounts on wine purchases increase as tier levels increase
14. Points, tier levels, and credits (usage of points) accounted for automatically
15. Benefits earned never expire
16. First priority ordering and exclusive wine selections
17. Online Wine Lovers Club community
18. Exclusive 'ask the expert' online and telephone availability

Membership has remained relatively static for several years, with about as many members defecting as joining. The program was rarely mined for customer profile data, and is minimally profitable. It generates add-on sales, but principally rewards through discounts those members who are already active buyers. Apart from management opinions, there is no real evidence as to what elements of the program will most effectively drive member advocacy, or dampen it. Market Probe's advocacy framework was applied to help the Wine Lovers Club reframe and optimize its rewards program.

Wine Lovers Club Advocacy Research Results

We applied a unique research framework to evaluate the Wine Lovers Club's array of benefits, overall perception, and loyalty level relative to competitive wine clubs where Wine Lovers Club members belonged to multiple programs, on degree of advocacy. Based on answers to four questions regarding their experience with the Wine Lovers Club (future purchase intent, recommendation likelihood, brand favorability/impression, and evidence of positive or negative word-of-mouth), club members were classified into four groups:
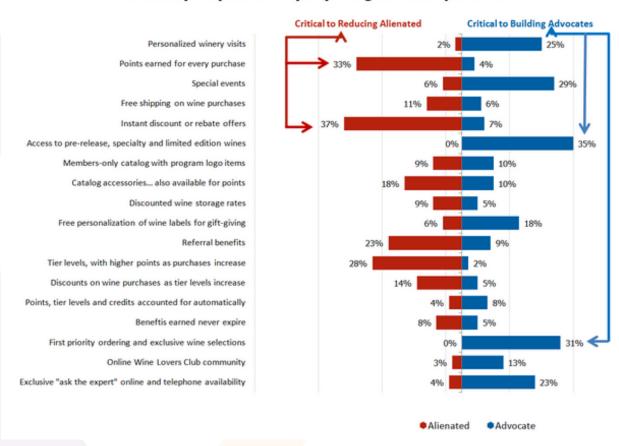
1. **Advocates** - Frequent buyers of multiple types of wine, significant use of club benefits, strong club brand recognition and favorability, active and positive word-of-mouth on behalf of the club

2. **Allegiants** - Regular wine purchasers, moderate use of club benefits, generally positive club brand favorability, infrequent (though positive) word-of-mouth on behalf of the club

3. **Ambivalents** - Moderate volume wine buyers, occasional use of club benefits, neutral club brand favorability, little evidence of word-of-mouth on behalf of the club (but more negative than positive)

4. **Alienateds** - Infrequent wine buyers, very little use of club benefits, low to moderate club brand favorability, generally negative word-of-mouth on behalf of the club

By our definitions, segmentation showed that The Wine Lovers Club had about 12% Advocates, better than some competitors and poorer than others. It also had 38% Allegiant members, an attractive segment capable of stronger sales, deeper relationship, higher brand affinity and engagement, and more active and positive word-of-mouth. Similar to findings of the CMO Council's study, the loyalty program also had a total of 51% Ambivalent and Alienated members who were minimally engaged and had the potential for negative communication and defection.

	Wine Lovers Club	Lowest	Highest
Advocate	12%	5%	20%
Allegiant	38%	29%	51%
Ambivalent	21%	7%	29%
Alienated	30%	26%	39%

Once the advocacy groupings were established, a multivariate technique we define as swing voter analysis (below) was applied. Some of the Wine Lovers Club program components, such as benefits that never expire, discounts, free shipping, and discounted storage rates, were found to be one-dimensional relative to other loyalty program elements; that is, expected and non-leveraging. These features did little to drive loyalty perceptions and continued member patronage, and may even be causing some damage. Other components such as referral benefits, points increases and increased discounts as tier levels rise, and a catalog with club logo items, might be described as driving negativism because they were compromising the concept of exclusivity and lifestyle extension that were core to the club's concept and value proposition.

Advocacy Impact of Loyalty Program Components

Program Component	Critical to Reducing Alienated (Alienated)	Critical to Building Advocates (Advocate)
Personalized winery visits	2%	25%
Points earned for every purchase	33%	4%
Special events	6%	29%
Free shipping on wine purchases	11%	6%
Instant discount or rebate offers	37%	7%
Access to pre-release, specialty and limited edition wines	0%	35%
Members-only catalog with program logo items	9%	10%
Catalog accessories.... also available for points	18%	10%
Discounted wine storage rates	9%	5%
Free personalization of wine labels for gift-giving	6%	18%
Referral benefits	23%	9%
Tier levels, with higher points as purchases increase	28%	2%
Discounts on wine purchases as tier levels increase	14%	5%
Points, tier levels and credits accounted for automatically	4%	8%
Beneftis earned never expire	8%	5%
First priority ordering and exclusive wine selections	0%	31%
Online Wine Lovers Club community	3%	13%
Exclusive "ask the expert" online and telephone availability	4%	23%

● Alienated ● Advocate

The most favorably perceived and leveraging program elements were those seen to have real meaning and enriching, personal significance for members. These included the winery visits, special events, access to pre-release and limited production wines, first priority ordering and exclusive wine selections, and the 'ask the expert' online and telephone availability feature. These club program components were synched with members' life styles and self-perceptions, and advocacy research found them to be both attractive and differentiated.

The Wine Lovers Club of the Future

From 1987 to 1996, American Express' cardholder recruitment tagline was "Membership Has Its Privileges," promising exclusive elements of differentiated, personalized value to anyone who held an Amex card. This campaign was award winning, and a high-water mark for American Express' growth. This has direct application to what the Wine Lovers Club could be in the future.

Wine is a high-end consumable, and those who have strong involvement in wine see it as an extension of their life-style. The Wine Lovers Club's promises and components needed to reflect benefits with differentiated and personalized value to members. As a result of using member advocacy research and swing voter analysis to optimize its components, The Wine Lovers Club was able to emphasize those five elements that had the greatest personal interest to current members and which would most effectively attract financially attractive new members. Simultaneously, the Club was able to eliminate key negatives: six costly and confusing components. The net result was a program that was more streamlined, more engaging and considerably more profitable.

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866.649-6556   813.936.4000

Rest of World   Outside USA

contact@beyondphilosophy.com

www.beyondphilosophy.com

550 North Reo Street, Suite 300
Tampa, Florida 33609