In November 2004, Hurricane Frances was rushing towards the Florida coastline. Some residents were already in their cars heading inland. Much further inland in Bentonville, Arkansas, there was also much activity in the Wal-Mart office as CIO Linda Dillman encouraged staff to take advantage of the company's 'predictive technology'. With almost 4,000 stores in the US and around 100 million customers every week, Wal-Mart is continuously gathering, storing and processing billions of pieces of data about customers' needs and spending habits by store, by region, at different times of year, in changing weather conditions and during major events. So what do they buy when a hurricane's on its way? Not what you might expect. Torches, batteries and bottled gas isn't too surprising, nor maybe that beer sales showed the biggest increase. But what about strawberry pop tarts? Sales increase seven-fold on average in areas with a hurricane alert!

Based on these consumer behaviour insights, Wal-Mart trucks were soon heading for Florida with emergency supplies of pop-tarts and six-packs. And they all sold well. So Wal-Mart uses its massive database and software expertise at macro level to minimise stock-outs and

Wal-Mart rushes pop-tarts to hurricane-threatened Florida

maximise sales. As well as hurricanes, it knows what sells when the Super Bowl final's on TV, when there's a heatwave or a flu epidemic. (*Apparently, during a flu epidemic you get them in with a price promotion on Lem-Sips and make big profits on other products like fresh orange juice without any price cutting.*) But Wal-Mart doesn't use its data at micro level. It doesn't know what will make Mrs Smith buy more orange juice or what might incentivise Mr Jones to trade up to a higher margin beer. For that you need data from a loyalty scheme. And that adds far too much cost for a discounter like Wal-Mart. In the last few weeks it's added a lot more cost for Tesco.

Clubcard points doubled

On August 17th, Tesco hit the headlines in the business pages when it doubled the points earned on Tesco Clubcard to 2 points for every £1 spent, equivalent to a 2% discount. This followed an earlier initiative in May allowing customers to double the value of their Clubcard vouchers by spending them on high margin products such as health, beauty and clothing. Marketing Director, Carolyn Bradley refused to reveal the cost of the new scheme but some analysts estimated it would reduce the company's profits by £400 million per annum. Others thought it smacked of desperation following Tesco's unaccustomed loss of market share during the recession. But the doubling of Clubcard points only equals the discount provided by Sainsbury's Nectar card and still lags way behind the most generous scheme – the 4 points per £1 offered by Boots Advantage card.

Others don't offer any points or loyalty schemes. ASDA promotes '*everyday low prices*' and works very hard to be at the top of Big Four price comparison tables. Morrisons has also been dismissive of loyalty schemes, preferring in-store promotions such as '*bogofs*' – buy one get one free. But is this rewarding loyalty or disloyalty? Many traditional sales promotions are an attempt to "*buy*" market share. Most supermarkets worldwide (Wal-Mart's "*everyday low prices*" strategy is an exception) use the sales promotion budget to reward disloyal customers using a "*hi-lo*" principle. Deep discounts on some popular items attract customers to the store and sales increase, at least in the short term. But what kind of customers has it attracted? Almost certainly the switchers, continually looking for the best deals and happy to cherry pick from whichever company currently offers the lowest price. Tesco's "*core purpose*," printed on the back of the business cards of many of its executives, is "*to earn the lifetime loyalty of our customers*", but is a loyalty card the way to achieve this? Has any loyalty scheme ever earned customers' lifetime loyalty?

Successful loyalty schemes

Some loyalty schemes have been very popular. Air Miles was created during the mid 1980s by Alan Deller, Commercial Director of British Caledonian Airways and the partners of advertising agency Mills, Smith & Partners. Together they formed the Air Miles Travel Promotions Company Limited in 1986 and sold 51% of the UK operation to British Airways soon after. They attracted three million collectors in the first three months. Sainsbury's was Air Miles first supermarket partner in the UK, but when it replaced its Reward Card with membership of the Nectar scheme, Sainsbury's customers were no longer able to collect Air Miles. This was an unfortunate decision for both sides since almost 25% of the 1 billion air miles issued in 2001 had gone to Sainsbury's shoppers, but it was an opportunity for Tesco. When Tesco launched its new partnership with Air Miles in March 2002, searches online for the nearest Tesco store jumped 450% and Sainsbury's lost an estimated 1% of its sales and 60,000 customers to Tesco. And they weren't just any old customers. They tended to be affluent, mature, confident people who organised their own travel and were prepared to change supermarkets to earn their miles. Perhaps Sainsbury's should have anticipated this because Tesco was the big winner. Air Miles now has 8 million customers and 200 partners in the UK.

Air Miles soon became a generic with most of the world's airlines launching copycat schemes. But did it drive customer loyalty? Certainly Air Miles built a very loyal customer base with some people zealously, perhaps irrationally, going out of their way to chase miles wherever possible. Air Miles, and copycat schemes, also increased repeat purchase for airlines as customers put up with inconvenience, poor service and even higher prices (especially if the company was paying for business trips) in order to collect those last few miles for the family holiday. But they didn't increase the loyalty of Sainsbury's customers, nor did they increase most collectors' loyalty to the airline as opposed to Air Miles. In fact, some airlines' biggest detractors were committed members of their '*loyalty*' schemes.

Air Canada's Aeroplan frequent flyer programme was so successful that its parent spun the scheme off into a stand-alone loyalty business in 2005. The Aeroplan programme was initially valued at US$2 billion, significantly more than Air Canada! Today, Aeroplan has a valuation of US$2.8 billion against Air Canada's US$0.5 billion and Aeroplan's loyalty business has expanded into a loyalty portal, offering a vast market of products members can '*earn and burn*' points on or simply buy.

Loyal to the scheme not the company

In Canada, extremely large percentages of consumers are members of loyalty programmes. Loyalty publisher Colloquy recently released the results of a survey of 2500 Canadian consumers, 87% of whom were active participants in at least one loyalty programme. (85% in the UK possess at least one loyalty card.) Nearly 50% of loyalty programme members said that special treatment is important to them, yet only 7% said that they get special treatment from their loyalty programmes. Research results such as these indicate that many consumers perceive value in loyalty programmes and use them often to earn rewards, but have less attachment to the company, Air Canada and Aeroplan being a good example. If so, loyalty schemes are driving short-term behaviour, not loyalty. Most customers are in it for the points and the rewards that come with them, not because they hold the company in high regard. The special treatment that customers crave and that they don't feel they get from most loyalty programmes has to come from a visible effort by the company to treat customers well, to demonstrate its interest in them – in fact to build its entire business model around meeting customers' needs.

Earning the lifetime loyalty of our customers

So, back to Tesco Clubcard. Is it the same as all the other loyalty schemes? Or is it building the lifetime loyalty of Tesco customers? Many people highlight Clubcard as the main driver behind Tesco's huge increase in market share since its introduction in 1995. So lets have a brief look at its history.

Clubcard was introduced after a trial at three Tesco stores (Sidcup, Wisbech and the Dartford Tunnel) ended so successfully that boss, Lord MacLaurin, told the Clubcard team: "*What scares me about this, is that you know more about my customers in three months than I know in 30 years*". He was right to give the go-ahead. Just one year later Clubcard holders were spending 28% more at Tesco and 16% less at Sainsbury's. ▶

> **What scares me about this, is that you know more about my customers in three months than I know in 30 years**

From the outset, Tesco saw the card more as a thank you than a sales promotion tool and this genuine philosophy of rewarding customers' loyalty has been the key to its success, allied to some other very clever decisions based on analysis of facts rather than gut feel:

- *Applications were maximised by making the process as quick and simple as possible and by really educating staff about Clubcard so that they sold it enthusiastically in store.*
- *Clubcard was not advertised as a 'loyalty' card. The words 'thank you', 'reward', 'every little helps' etc were used but never the word loyalty. Being loyal to a supermarket is not a selling point for customers, being thanked and getting rewards are.*
- *One of the best decisions, and one that still differentiates Clubcard from most other reward schemes, was the quarterly mailing. Instead of allowing customers to cash in their points at the checkout whenever they wanted, Tesco decided to incur the massive cost of sending a quarterly statement with cash vouchers for the value of points earned in the period. This has been very effective for three main reasons:*
  - *Customers place more value on the rewards because the physical vouchers are like being sent a gift of money. When customers habitually cash in points at the checkout to reduce their shopping bill they tend to take the reward for granted.*
  - *Behaviourally, spending vouchers is very different from using the card to reduce your shopping bill. The latter does not change behaviour. It just reduces the retailer's profit. The evidence from Tesco's trials was that if customers had cash vouchers, many would use them for special treats rather than reducing the cost of their existing shopping. Moreover, Tesco can proactively encourage this behaviour by adding promotional coupons to the quarterly mailing for higher margin products that fit the customer's basket history or lifestyle profile.*
  - *Clubcard holders have an incentive to inform Tesco of address changes. If customers can cash in rewards on demand they often don't bother, so the database decays.*

One of the main things that has distinguished Clubcard from other loyalty schemes is the depth of its data analysis. This has enabled Tesco to do things like target lapsed shoppers, customers who ignore certain departments, customers who are clearly using competitors more than Tesco etc. It also shows that 88% of Tesco's revenue comes from the most loyal 40% of customers. Using Clubcard data has enabled Tesco to concentrate promotions on those high value customers and the products they buy, attempting to deepen the most profitable relationships rather than indiscriminately recruiting new customers.

Tesco believes that marketing strategy should be simple. At its core, an equally simple idea that's written into its marketing manuals – 'reward the behaviour you seek'. As Clubcard built Tesco's understanding of where its profits were coming from, the company increasingly focused on long-term customer loyalty as its main objective, especially the most loyal 40%. Up to 2003, Tesco had spent over £200 million of its sales promotion budget on incentives for "*opportunity*" customers. By 2004, after using its loyalty card data to predict customer loyalty and sales growth long term, Tesco switched almost the entire budget to rewarding long-term loyal customers.

Are loyalty schemes worth it?

Given the very high cost of in-house loyalty schemes (in Tesco's case vouchers worth around £400m each year, 11p on each physical card and 15 million letters to Clubcard members four times a year), are schemes like Clubcard and Advantage worth the investment? Many loyalty experts and business leaders say that loyalty schemes encourage repeat purchase, but that's not the same as loyalty. It's still just a transactional relationship not an emotional one, and true loyalty has to encompass the emotional dimension.

Harvard Business School summarises customer loyalty in terms of the 3Rs:

- *Retention*
- *Related sales*
- *Referrals.*

Clearly there's sometimes, but not always, an emotional element in recommendation, although customers do often rationally recommend a good deal as well as the more emotional memory of a great experience. The Leadership Factor has always maintained that satisfaction is an attitude but loyalty is a behaviour. Tesco, very sensibly, doesn't get hung up on esoteric debates about whether loyalty is emotional or rational, it just focuses on why it wants its best customers to be loyal. Because it wants them to spend more, especially on higher margin products (and services like Tesco Personal Finance). How does that happen? By customers visiting Tesco more often, using competitors less often, buying a wider range of products in Tesco and, icing on the cake, becoming less price-sensitive and upgrading to higher quality, higher margin options. All behaviours. Tesco uses Clubcard to 'reward the behaviours it seeks'. If customers feel satisfied with the value they've had from Tesco or, less likely, if they've had some great emotional experience from a really helpful member of staff, they may recommend the company to friends. But the lion's share of what Tesco wants is in those behaviours. So who cares if it's real loyalty or not? The end result is the same.

And there's another massive and growing advantage of loyalty schemes, especially in-house ones where the company owns all the data.

Analytics and computing power

Some people now argue that the real value of a loyalty scheme is linked to our increasing ability to crunch vast volumes of demographic, situational and transactional data, which is leading to a new analytically-driven era. A Boots Advantage card application form asks customers for their employment status, number of children, spectacles or contact lens usage and, if

they are pregnant, when their baby is due. The Clubcard form does put its questions about dietary preferences and who you live with in an "*optional*" information box, but most people fill it in. This computing power allied with the vast amount of data collected over the years allows Tesco and Boots to make insightful, personalised recommendations to move very specific customer behaviours closer to their objectives. For example, Tesco found that bird feeders were bought by a high concentration of serious organic shoppers. "*The sales data would make you believe there is only a tiny market [for bird seed and feeders], whereas Clubcard data implied that, actually, there was a big potential market,*" says Crawford Davidson, now Marketing Director of Tesco Personal Finance but previously involved with Clubcard. "*If we stocked them more and told customers about them, would they buy them? The answer is yes, and, in fact, you can sell more elaborate bird feeders and bigger bags of bird seed.*"

In December 2006 Tesco offered 80,000 customers up to one-third off their Christmas shop, sending them a £5 gift card and a voucher offering them a further £18 off if they spent £70. Competitors described the offer as 'madness'. But was it? Tesco was using Clubcard data to target customers who, despite being regular Tesco shoppers, obviously did their main Christmas shop elsewhere. The offer illustrates Tesco's increasingly sophisticated use of Clubcard data, enabling it to specifically target and incentivise people who are clearly using competitors more often or for specific purposes – something that's impossible for rivals without a loyalty scheme to do. Tesco can analyse when individual customers shop, how they pay and even how many calories they consume. If customers buy less than a week's worth of calories they must also be shopping with a rival. If they shop at an out-of-town store late at night they almost certainly own a car. The data can be used for tailored promotions and to sell relevant new products and financial services to specific customers. Tesco's list of company values starts with the goal to 'understand customers better than anyone'. That might explain a lot about their success. S

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Most admired loyalty scheme: Tesco Clubcard
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STOP PRESS

At the end of September, Sainsbury's announced a multi-million pound investment over five years in a coupon-based loyalty scheme, giving customers money-off coupons at the till for hundreds of branded and own-label products in what will be its biggest investment in customer loyalty since it launched its Nectar card in 2002. Coupons will be generated on the spot through stand-alone printers installed in all of Sainsbury's 535 supermarkets. Over 60 leading brands including Unilever, Proctor & Gamble and Heinz have signed up to the scheme. Clearly a response to Tesco increasing the value of its Clubcard points over the summer, it seems to be another escalation in loyalty card wars – great for customers but maybe not so good for suppliers' profits.

Maximising customer loyalty

So what lessons can we learn from this article about maximising customer loyalty? For me, the four most important are:

1. Any long term scheme or ad hoc actions to improve customer loyalty must be a genuine reward not a sales promotion. Our research shows that having their loyalty rewarded is very important to customers, but most think it doesn't happen much. Tesco's philosophy of Clubcard being primarily a thank you is spot on.
2. The more relevant and interesting the rewards are to customers the more they will value them, the more they will see the rewards as a genuine thank you from the supplier and the more it will motivate them to remain loyal.
3. The scheme must make an impact. One of Tesco's best Clubcard decisions was to incur the very high cost of the quarterly mailings. Cost yes. Cost-effective? Definitely. The 'cash in your points whenever you feel like it' approach of many competing loyalty schemes means that many customers take them for granted.
4. If you are going to invest in anything to improve customer loyalty, make sure it passes the Tesco test – '*reward the behaviour you seek*'.