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*Leo Burnett* **Memo**

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To: The PM and LBCo. Rosetta Team

cc: Susan Blohm PM-NY Gina Fawcett PM-NY  
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From: David TenBarge PM-NY Florian Pfahler

Re: Loyalty Card Conference / Washington DC June 1999

The Loyalty Card Conference in Washington is geared towards professionals involved in the development and management of loyalty programs like the AA Advantage or Hilton HHonors program. A wide range of product and service industries attended the conference including:

- Travel – American, Hawaiian, Southwest Airlines and TWA
- Retail – Federated Department stores, Macy's, Barnes & Noble, FAO Schwartz,
- Financial – American Express, Visa, MasterCard, GE Capital.
- Others – Dell, Mobile Oil, Shell, The Gap, Today's Man, Sony Music

This was the first conference geared toward building customer relationships via financial or non-financial cards. Even though the conference touched the subject of technology, the primary focus was on how to develop meaningful loyalty programs rather than on the technologies available to deliver them.

**Summary of major learnings**

- **What is loyalty?**

According to the American Heritage College Dictionary 1993 edition loyalty is

**"Feelings of devoted attachment and affection"**

- **Loyalty programs – back to the corner store – customer relationship**

Mass marketing has eliminated the once intimate relationship between merchants and their customers. As communications became impersonal and product focused, the consumer became anonymous. Over time, customers wanted to get back to a meaningful relationship with merchants, being greeted by name, being appreciated for their business. With today's loyalty marketing efforts companies are attempting to get back to that meaningful relationship, focusing on the customer to deliver value on a personal level, which in return builds loyalty.

- **Loyalty programs are a commitment**

Loyalty programs offer customers an access point to enter into a dialogue with a brand. Due to that, companies have to be ready to change their organizational approach to individual customers. For example letters, faxes, phone calls with suggestions and



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complaints need to be answered promptly and professionally. Loyalty programs are a commitment to the customer that impacts all aspects of an organization.

- **Customer focus leads to success**

Successful loyalty programs are customer value oriented. Marketers of successful loyalty programs agree that the four key customer value components of a loyalty program are:

1. Personal recognition
2. Relevant and achievable rewards
3. Convenience and simplicity
4. Value / Choice

- **The trap – Loyalty versus Frequency**

Even though designed to generate loyalty, programs often migrate into frequency programs. While loyalty programs focus on commitment, frequency programs focus on behavior. The danger with frequency programs is that customers focus on "the deal" instead of the brand, thereby necessitating brands to constantly sweeten the offer to gain a competitive advantage.

- **Where do smart cards fit in? What technology to use?**

One needs to evaluate carefully what technology best fits the need of a loyalty program. For some a punch card might be enough, for others smart cards are the way to go. If one considers that the true aspect of a loyalty program is the meaningful dialogue with the customer, smart cards will be the key to the information needed to develop and deliver that communication.

Today most companies deal with several hundred thousand or millions of customers. This requires access to and management of vast amounts of detailed information to establish meaningful relationship through individual communication. Smart cards are the device that will allow companies access to and development and delivery of that insight in a personal, relevant and instant manner.

### **Detailed findings:**

#### **Do we need a Loyalty program?**

The way companies communicate to customers is changing. New technologies permit companies to deliver tailored products and services to customer groups with similar behavior, likes and dislikes. Communication becomes increasingly personal with the individual customer at the core of the activity. The loyalty programs permit companies to build meaningful relationships with a wide range of customers, which is reflected in the increasing popularity of loyalty programs. With the number of programs in the market on the rise, the competitive pressure to provide loyalty programs is accelerating. As a result, the growing number of programs in the market will put pressure on traditional mass marketers to develop more targeted marketing tactics to avoid a disconnect with the customer base.

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### **The loyalty program commitment**

By definition, loyalty programs try to offer customers a reward for continuously supporting the brand. A relationship between the brand and the customer develops that goes beyond the benefits that the product or service delivers. Marketers have to anticipate that loyalty programs develop a set of expectations with the customer that a brand has to continuously meet to develop loyalty. This shifts the power of the relationship to the customer. With a loyalty program it is no longer communication to the customer, but a dialogue with the customer.

### **Success criteria for loyalty programs**

Various presentations touched the subject of success criteria for loyalty programs. Time and again the experience of marketers in the loyalty segment shows that loyalty programs need to deliver on the following key customer needs:

- **Recognition / personal communication**  
We know who they are, so we can acknowledge their special value to us through personal and frequent communication, a dialogue with the customer.
- **Relevance**  
Once we know what they want, we are in a position to offer something special to them. Key to any loyalty program is for rewards to be achievable (not only limited to high volume customers), aspirational and instant.
- **Convenience / Simplicity**  
We know how to make it easy, so we can prove we value their time. Simplicity in the structure will ensure continued patronage of the loyalty program.
- **Value, Value, Value**  
We know how to provide value in all aspects of the relationship, so the full experience justifies the price. If the loyalty program delivers on its promise it will build brand equity. The strong emotional contact with the brand leads customers to regard price as just one aspect of the overall brand value proposition.

### **The trap – Frequency programs versus Loyalty programs**

Most loyalty programs miss their target, which is to build customer loyalty. Programs that come to mind are frequent flyer programs or grocery discount cards. In these instances companies are confusing purchase frequency with customer loyalty – the ends with the means.

### **Frequency**

Frequency focuses on behavior; customers give companies a greater share of their transactions than they might have without the program, usually in exchange for accumulating miles, points or other forms of discounts. Even though somewhat successful, frequency programs miss out on the emotional and psychological factors that build real commitment. Hence customers focus on "the deal" not the brand or product relevance. As a result,

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customers are members of several competing loyalty programs, a behavior focus, which makes "bribing" the customer irresistible. Over time competing programs require greater and greater rewards, eroding brands and diminishing product differentiation. Even though sales might increase due to repeat purchase, the behavior is triggered by a focus on the rewards instead of the product superiority or brand relevance.

### **Loyalty**

Loyalty programs, however, focus on commitment. When it comes to loyalty one needs to think of soccer fans and the loyalty to their team. They paint their faces during games. They wear the club cloths even when not attending a game. No matter what the performance of their team, soccer fans will always attend a game. Most of the time this is a life-long commitment that only in rare instances is broken.

The goal of loyalty programs is to develop a similar bond between a brand and a customer. The customer feels so strongly that the brand can best meet their needs that the competition is virtually eliminated from the considered set. The customer buys almost exclusively the brand and refers to it as "his brand". Loyalty programs need to be put in relation to heart, mind and wallet share. Price is no longer the dominant consideration, but one component in a larger value proposition.

	<b>Traditional Frequency</b>	<b>Real Loyalty</b>
Objectives	Build traffic and sales	Build sales, profits and the brand
Strategy	Incentivize repeat transactions	Build personal brand relationships
Focus	A segment's behavior and profitability	An individual's emotional and rational needs, and their value
Tactics	Segmented rewards: <ul style="list-style-type: none"> <li>• Transaction status</li> <li>• Free / discounted product</li> <li>• Collateral product</li> <li>• Rational rewards</li> <li>• Rewards menu</li> </ul>	Customized recognition: <ul style="list-style-type: none"> <li>• Individual value, tenure</li> <li>• Preferred access, service "inside information"</li> <li>• Value added upgrades, add-ons</li> <li>• Emotional "trophy" rewards</li> <li>• Tailored offers / messages</li> </ul>
Measurement	Transactions Sales growth Cost structure	Individual life time value Attitudinal change Emotional response

### **Where is the market for loyalty programs today?**

Frequency programs with some "loyalty" aspects are the predominant form of customer retention programs today. From a historic point of view, marketers' efforts to generate forms of "loyalty" or product preference began with sales efforts that were designed to push the product or service at a discount with little measurement involved. Today, as marketers enter the period of customized and targeted brand relationships, true loyalty programs will emerge. Because of

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the improved customer communications and relevant marketing messages and stimuli, profitability is increased, as discounts are not the predominant motivator for the customer.

Strategy	Tactics	Profitability
Sales	<ul style="list-style-type: none"><li>• Push traffic</li><li>• No targeting</li><li>• Discounts</li><li>• Little measurement</li></ul>	Low
Targeted Promotions	<ul style="list-style-type: none"><li>• Push traffic</li><li>• Discounts</li><li>• Some measurement</li></ul>	Low -medium
Frequency programs	<ul style="list-style-type: none"><li>• Price driven</li><li>• Segmented</li><li>• Transaction based</li></ul>	Medium
Brand Relationship Loyalty programs	<ul style="list-style-type: none"><li>• Customized</li><li>• Added value to product or service</li><li>• Strengthens brand</li><li>• Supports price</li></ul>	High

**Smart cards breakthrough– It's not the technology, is the infrastructure!**

Hilton Hotel introduced a smart card pilot program in June 1997 during which Hilton HHonors members could bypass the front desk completely by inserting a smart card into a HHonors kiosk. The application allowed the consumer to check in and out, select a room based on individual preferences and receive a key, all tied into the Hilton Honors guest reward program and an airline loyalty program of choice. The card also provided full charging privileges. The value to the consumer was increased self-sufficiency, convenience and timesavings. From November 1997 through May 1998 the Hilton program was expanded to include the services of Continental Airlines, allowing customers to bypass airport check-in lines and view and update travel profile information. Pre-loading of upgrade coupons added further value to the system.

According to Jeffrey A. Diskin, President and COO of Hilton HHonors worldwide, the program generated very positive results with their customers. However, the primary objective of the Hilton pilot was to test technology and gauge customer feedback to be ready for customers who arrive at the hotel with smart cards in hand. Even though the program is currently on hold, Hilton plans to introduce it again as soon as the distribution of smart card readers suggests the smart card market to pick up momentum.

**What does this mean for Rosetta?**

Project Rosetta is definitely a step in the right direction given the emerging trend of companies establishing closer ties to consumers. It will enable adult smokers to "experience Marlboro Country" in a new way, offering us the opportunity to further deepen loyalty to the brand. However, due to the current value proposition to the consumer, which is driven by the limited

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test market environment, Rosetta is predominantly a frequency card with some loyalty aspects.

<b>Tactics</b>	<b>Frequency programs</b> Segmented rewards:	<b>Loyalty programs</b> Customized recognition:
	<ul style="list-style-type: none"> <li>• Transaction status</li> <li>• Free / discounted product</li> <li>• Collateral product</li> <li>• Rational rewards</li> <li>• Rewards menu</li> </ul>	<ul style="list-style-type: none"> <li>• Individual value, tenure</li> <li>• Preferred access, service "inside information"</li> <li>• Value added upgrades, add-ons</li> <li>• Emotional "trophy" rewards</li> <li>• Tailored offers / messages</li> </ul>

<b>Rosetta tactics</b>	<b>Frequency</b>	<b>Loyalty</b>
Free pack first card use	X	
Guaranteed free pack 20 <sup>th</sup> card use	X	
Instant product match & win	X	X
Individualized receipt communication		X
Birthday free pack		X
Occasional instant free pack surprises	X	

One major aspect of focusing on the "loyalty" in loyalty programs is that it builds barriers for entry for the competition. Frequency programs can be copied. It took Sheraton three weeks to copy Hilton HHonors. What if RJ Reynolds decides to copy project Rosetta? Did we create a special value to build barriers to entry? Do we provide a true loyalty program that stimulates customers to virtually remove competitors from the consideration set?

#### Considerations to increase the loyalty aspect of project Rosetta

- **Transaction data analysis**  
Smart cards provide marketers with a wealth of transaction data. Through data analysis and segmentation we will be able to identify aggregate groups with similar behavior. These insights can be used for increasingly relevant and targeted messages to the individual adult smoker.
- **Personal recognition**  
Personalized dialogue with the consumer at all levels. We know who they are so let's show them that we appreciate their business. Communication could be personalized via receipt and direct, as well as with all other ongoing direct efforts.
- **Emotional "trophy" awards**  
Rewards can be targeted to the individual consumer according to their "preference profile", their likes and dislikes. These insights can be gained through an adult smoker dialogue via reader and direct.
- **Targeted special events**  
The Marlboro card can provide access to special events, from concerts and backstage

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action to movies and parties. Marlboro gets you further than any other Tobacco brand.


- **Extend the reach of the card**  
Increase the appeal of the card to adult smokers by providing a reward system that stretches across all products offered by Philip Morris and PM affiliated companies. Usage of the card could be tied to a points or miles system. Transactional data would reveal key lifestyle data for unprecedented insights into adult smoker buying behavior, one of the key aspects for targeted and relevant marketing communication strategies.
- **Continuous monitoring**  
To ensure success we will have to constantly monitor and question the program in terms of delivering value to the adult smoker:
  - ✓ Did we maximize the value proposition to the customer?
  - ✓ Does Rosetta use the power of the technology to tailor communication to core groups in a meaningful and relevant way?
  - ✓ Is there an emotional bond to the brand that the loyalty program delivers?
  - ✓ Do we carry "dead weight", adult smokers who don't use their card at all?
  - ✓ Could we do a better job in segmenting the incentives to core groups?
  - ✓ Is the program truly simple and convenient?

#### Summary

Rosetta is an outstanding opportunity for Philip Morris to gain a competitive advantage by delivering value and personal recognition to adult smokers like no other tobacco brand. However, loyalty is a complex combination of emotional reactions (trust) and rational decisions (value), a by-product of a competitively superior relationship between the customer and the brand. It is also a long-term commitment, it must be earned, and it can't be bought.

The Marlboro Card will be a lifestyle product. It will also be the first smart card program by a company that does not control the retail environment. As such we are early adopters in new territory, we are defining the business model. To quote one conference speaker: "To build a loyalty program takes a brave pioneer, innovation and vision"! With Rosetta we have the chance to set an example in the industry based on a tradition of innovation and superior marketing at Philip Morris. By adhering to industry do's and don'ts and continuously monitoring our progress we will reach our objective: building loyalty by enabling adult smokers to Get More From Marlboro than from any other tobacco brand, providing a superior brand experience through relevant rewards and personal recognition.

Please feel free to call with questions or comments



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