True Blue

A carefully crafted customer loyalty program can deliver life-long business relationships—and profits

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Insurance companies have struggled with a customer conundrum for years. Is the primary customer the policyholder or the distributor—or some combination of both? Even companies that clearly and emphatically answer this question may find that their policyholders and distributors disagree. Agents tend to guard their clients and begrudge perceived intrusions on the part of carriers, while policyholders often are confused about whom to contact for service, especially when technology gives them easy and direct access to the carrier yet their only personal relationship is with their agent.

A recent survey conducted by Capgemini Insurance and the European Financial Management & Marketing Association sheds new light on this dilemma. According to their World Insurance Report, 71 percent of insurance customers never or rarely (only once per year) interact with their principal distributor. By comparison, consumers typically interact with their banks more than 200 times per year. The claim for the policyholder as customer is rendered virtually moot by this statistic.

One customer strategy that is prevalent in most other industries is the use of customer loyalty programs. An ill-conceived customer loyalty program can amount to little more than an additional expense for a company, although in some industries this has become an expected and accepted defensive strategy. However, the insurance industry is unencumbered by any such standards and is free to develop creative and effective programs that serve to identify, attract, retain, and reward the most desired customers and potentially create offsetting revenue that could be more predictable and profitable than the underlying businesses.

American Airlines is credited with launching the first customer loyalty program in 1981. In fact, airline frequent-flier programs provide a good basis for pondering the problems and potential for these programs in general. A recent study among frequent-flier members, for instance, found that the top nine percent of customers who contribute the most in terms of traffic (customers who are the most loyal) also were the most dissatisfied with their airline.

This example illustrates a vital first step you must take when designing a loyalty program: recognizing that there's often a big difference between the way a customer looks at loyalty and the way a marketing manager defines loyalty.

Just as the most loyal customer isn't always the most satisfied, the most loyal customer isn't always the most profitable. Customers typically define loyalty as their tendency to stick with one brand or product despite temptations to switch. When low volume or low profit customers are loyal, however, a company's loyalty program can create expectations that they will be rewarded for their loyalty when it may not be in the company's best interest to do so.

An effective loyalty program incents profitable customer behaviors.

One study (The Long-Term Impact of Loyalty Programs on Consumer Purchase Behavior and Loyalty by Yuping Liu) has found, for example, that loyalty programs can inspire light and moderate users to increase their usage.

Another example comes from the hotel industry. The November 2008 issue of Cornell Hospitality Quarterly examined the relationship between sales/marketing expenses and hotel performance at 2,815 U.S. hotels and found “a significant positive connection between loyalty programs and net operating income”. In fact, Marriott Rewards just celebrated its 25th year by signing up their 30 millionth member. What does Marriott receive in return? The company has found that a Marriott Rewards member will go nearly 20 minutes out of his way to stay at one of their hotels.

Even TGI Fridays has gotten into the game. Its new loyalty program recently achieved 550,000 members who join for free appetizers or desserts, rebates after a certain dollar amount in purchases, or even an innovative one time “jump to the head of the line” pass. What a great way to impress a first date!

Just Reward

For insurance companies, it can be a bit more difficult to incent customers to behave profitably. Policyholders who maintain healthier lifestyles, keep their policies inforce, recommend the company to others, and purchase multiple products contribute to corporate profitability. Unfortunately, the majority aren’t likely to be particularly motivated by offers of additional insurance, health food, or gym memberships. In fact, it’s probably the least healthy consumers who are likely to be the most loyal and appreciative of their insurance policies. In response, many companies have already designed agent compensation plans that reward the submission of quality business by linking bonuses to persistency and mortality results.

Although you would think that aligning monetary compensation with desired behavior would be the most effective way to influence activity, studies show you can motivate people more by combining cash and reward incentives. In the paper “Using Combined-Currency Prices to Lower Consumers’ Perceived Cost,” Wharton marketing professor Xavier Drèze and USC’s Marshall School of Business professor Joseph C. Nunes examined the different types of currencies that consumers can accumulate and spend, such as frequent flyer miles and hotel and credit card reward points.

“You would think that if people were offered money and miles, they would always take the money, but a lot of people want miles instead,” Drèze says. “Their feeling is, ‘Money is only money and if I take money instead of miles, I’ll just use the money to pay a bill.’ There’s nothing special about paying a bill. But when they take frequent-flier miles instead of cash, they will use them to take trips and that gives them memories. That makes the miles special.”

The fact that company conventions incent successful agents to produce high volumes of business with a carrier supports this thinking since most of these agents could easily afford to take trips on their own, especially if the company raised commissions corresponding to the savings realized from not holding conventions.

The popularity of rewards programs is well documented. A recent customer loyalty study conducted by First Data found that 76 percent of consumers belong to a credit card rewards program and 89 percent have used the program at least once since signing up. Air Miles, a travel rewards program in the U.K., found that 96 percent of consumers are members of a rewards program and 64 percent belong to three or more. In addition, more women than men were likely to be members of multiple programs (72 percent of women versus 51 percent for men) and multiple programs were most popular among older consumers (46 percent of 18-29 year olds, 56 percent of 30-39 year olds, and 67 percent of the 40+ age group).

This data highlights another valuable benefit of rewards programs: in addition to influencing customer behavior, rewards programs also are an excellent tool for identifying and attracting certain types of customers. A fascinating example of this can be found in a study of luxury car owners conducted by MicroMass Communications. Luxury car owners have traditionally formed strong attachments to their cars—a bond that's often compared to a marriage. Throwing marketing dollars at consumers who have already made up their minds is a waste. Fortunately, it's relatively easy to identify those customers who are loyal, those who are likely to defect, and those who are undecided. According to MicroMass, the undecided group represents 63 percent of all current owners and leasers and motivating these "fence-sitters" is the key factor in getting them to buy or lease a car.

Interestingly, the undecideds are also motivated by very diverse factors. For example, the Status Seekers group was motivated more by image, while the Confident Pragmatists group was indifferent to public perception and preferred quality, safety, and service. Obviously, a marketing message that would appeal to one group would simultaneously turn off the other group. Therefore, by delving deeper into the demographics and psychographics attained through their loyalty programs, luxury car companies were able to not only identify the valuable undecided buyers, but also tailor their messages to appeal to the very diverse motivations of the different groups.

Customer loyalty programs also can be an effective means to identify dissatisfied customers. For example, Allegiance's Pulse of America survey of bank customers found a significant decline in customer engagement for Wachovia and Washington Mutual customers prior to the recent bailout. In the third quarter of 2008, customer engagement for WaMu dropped from 31 to 21 percent and Wachovia dropped from 36 to 26 percent—the equivalent of millions of customers disengaging themselves from their bank.

And a JD Powers survey of customer satisfaction for auto insurers found that although 85 percent of customers claimed to be loyal, more than one third shopped their insurance coverage. Of the customers who defected from their insurer, only one third intended to switch when they started looking. In other words, there was an opportunity for insurers to retain two thirds of consumers who switched carriers. Unfortunately, only 30 percent of defectors indicated that their previous carrier made any effort to keep their business. It's easy to see how a well constructed customer loyalty program could have helped identify customers with a tendency to shop, successfully persuaded satisfied customers to not shop, and also helped retain some of the customers who decided to switch.

What does this all mean to insurance companies?

I can't think of an industry more in need of customer loyalty programs than ours—for both policyholders and agents and distributors. Agents and companies too often compete rather than cooperate when it comes to customer service, and our consumers are only too happy to limit their insurance interactions to as infrequently as possible. On the other hand, most agents are adamant about their position as customers of their insurance carriers and are very receptive to programs that recognize and reward their loyalty and quality of business. As a result, agents are a natural fit for these types of programs.

On the other hand, since there is a tendency for the least healthy/least profitable consumers to also be the most loyal, it's important for carriers to choose incentives creatively so that they effectively motivate other classes of customers. For example, I have written extensively in past articles about the value of insurance companies partnering with other industries such as schools, day cares, grocery stores, and public transportation firms. Customer loyalty programs would certainly be an ideal means to promote those partnerships. In addition, for companies focusing on ethnic markets, frequent-flier miles could be an extremely attractive perk to help bring separated family members together. This is especially true for modest and middle-income market companies since their customers are unlikely to accumulate frequent-flier miles using more traditional means.

One factor that makes an insurance company loyalty program challenging is that, although our underwriting files contain significant and specialized demographic information about our insureds, due to privacy considerations most of it can't be used for marketing purposes. As a result, carriers will have to explore alternative means to capture informative demographics to identify key factors about their customers.

Obviously, it costs money to initiate a customer loyalty programs. In a business with thin and uncertain margins to begin with, it's difficult to justify adding an additional layer of expense. That's all the more reason it's important for companies to not only develop their loyalty programs with the intention of generating more profitable business, but also to have the means to measure their results over time.

For evidence that customer loyalty programs can actually be profitable one has only to look at the airline industry. Air Canada spun off its frequent-flier program in 2002 and the program ultimately became more profitable than the airline itself. Although Qantas Airlines had to postpone an IPO of its frequent-flier program because of the downturn in the economy, the airline had divulged some of the economics behind the program in preparation for the planned spin-off. Analysts at JP Morgan valued the offering at AU$ 2 billion based upon first half profits of AU$ 62 million on revenue of AU$ 399 million. Expectations are for earnings to increase 75 percent in 2009 and ultimately offset weaknesses in the company's core business.

Although it may be a tad optimistic to expect an insurance company's program to produce such lofty results, the popularity and effectiveness of customer loyalty programs in virtually all other industries is well documented.