



enhance

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for people involved in payment card marketing and product development

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Issue Twelve, September 2008

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In the news

Doors opening, doors closing

For some time now, analysts have predicted that the growth credit card market of the future will be in Islamic banking. Thus far, the challenge has been that, while the use of a card as a payment instrument is, subject to exceptions, acceptable under Shariah law, charging interest on card borrowing is not.

Recent developments in the global economy – the oil price boom, population growth, e-commerce transactions, the emergence in many Muslim countries of a financially-empowered middle class – are all spurring issuers on to find solutions which meet Shariah guidelines.

One challenge is that not all Islamic scholars interpret the guidelines in the same way, and there do seem to be some regional differences. Accordingly, approaches which may be acceptable in some markets would be unacceptable in others. Nevertheless, in countries as distinct as the Middle East and the UK, issuers are developing product configurations which unite customer needs to participate in the global marketplace with the need to observe traditional religious requirements. And, with one study suggesting that there could be as many as 6 million Shariah-compliant cards in issue by 2012¹, it looks like the race is on

Generally, the relevant authorities seem to agree that rewards may be offered on these products.

Not so in South Africa: there the High Court has ruled² that, under the Long-term Insurance Act, it is illegal to offer a loyalty programme on endowment insurance policies.

Worrying news for issuers in Turkey³: the Supreme Court has outlawed the annual card usage fees which are a major source of income for local card operators – one source estimates the value of the fee revenue stream as US\$900 million a year. Apparently, the decision was based on Government regulations in 2003 and 2006 governing the clarity of customer contracts, and was arrived at despite the fact that the card contract in question was signed before 2003.

¹ CardFlash, 21 July 2008

² www.ibcsa.org.za/newsletter.asp

³ Today's Zaman, Istanbul, 18 August 2008



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The value of loyalty

How much is your rewards programme worth?

Talk to your Finance Director, and she'll point to funding costs, customer service



expenses, marketing overheads and, if you operate the programme yourself, how best to manage the liability for unredeemed points.

Talk to your Marketing Director, and he'll identify increased sales, wider margins, and higher retention of profitable customers.

Talk to your banker, however, and you may get a very different point of view. More and more businesses with established loyalty programmes are finding that they have significant market value as assets in their own right.

Consider the examples in the following table:

Programme	Value
Nectar UK/Loyalty Management International Group	Sold to Aeroplan in December 2007 for £368 mn
Aeroplan (Air Canada)	Market capitalisation in March 2008 was C\$3.4 billion (cf. Air Canada C\$1.2 billion) (<i>Bloomberg, 12 March 2008</i>)
Air Miles Canada	Sold to Alliance Data in 1998 for US\$250 million
United Airlines Mileage Plus	US\$7.5 billion (<i>Bear Stearns valuation, 15 November 2007</i>)
Qantas Frequent Flyer	A\$3.75 billion (<i>Qantas valuation, July 2008</i>)

These instances show clearly that a well-run loyalty programme can be worth a great deal – more in some cases than the business itself. But here's the question: what's driving these sky-high valuations?

Typically, we find that the estimates of value are based on an equation which looks something like this:

$$\text{Value} = (\text{Number of members} \times \text{profit per member}) + \text{premium for desirability}$$

Let's unpick the elements in this equation:

Number of members

Figures for enrolled members are all well and good but:

- How many are active?
- What do we mean by active, and over what period are we measuring activity?

Profit per member

- How is profit calculated?
- What assumptions are made about redemption levels?
- What's the cost of a redeemed point?
- How is that cost controlled?
- Under what conditions can unredeemed points be taken to profit?
- How is member defined?



Premium for desirability

- Are the members upscale/heavy spenders/homogeneous?
- How valuable are the relationships which the programme has with its customers and suppliers?
- Does the programme have significant intellectual property?
- How well-established or dominant in the market is the programme brand?
- Does the programme have unique access to desirable communication or distribution channels?

Getting the right answers to these questions isn't necessarily a matter of increasing the asking price of your loyalty programme if the company decides to sell it – an unusual outcome, anyway, as businesses think hard before handing over control of their most profitable customers to a third party.

"The answers provide a template against which you can measure

how well your own customer relations programme is going.”

Rather, it's because getting the right answers provides a checklist against which you can measure how well your own customer relations programme is going – whether it's a full-blown, mature coalition business with millions of customers, or a more modest endeavour designed to offer your clients increased value.

It may also help you to avoid hidden pitfalls: a bank in the Middle East bought access to its national airline's frequent flyer programme for US\$6 million. Unfortunately, when the deal had been done, it turned out that a substantial proportion of the names on the database lived outside the country and therefore were not eligible for a card programme, and that a large number of the customer files were corrupt, incomplete, or had not been updated for years.

For sure, there's real value in a well-managed client database – but you have to know how to unlock it.



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The (too often) ignored opportunity

Here are a couple of questions – and the answers.

Question 1: Are issuers constantly looking to grow their business by finding profitable new card accounts?

Answer: Right.

Question 2: Do they leave no stone unturned in their hunt for these customers?

Answer: Wrong.



One group which is consistently passed over by too many issuers is the small business. Sometimes, it's because there's a fear of bad debt (often an exaggerated fear: if small companies survive the first three years, they're usually a pretty safe bet). Sometimes it's simply not knowing how to identify them: after all, many prosperous businesses start from a home office, and quite a few, especially in the professional services field, stay that way.

But there are tell-tale signs which help you to spot these valuable customers. Look for:

- High spend on a personal card
- A mix of business expenses (office equipment, travel) and personal expenses
- Spend that stays relatively constant year-round
- Supplementary cards issued to cardholders with surnames different from the primary cardholder

All these characteristics are good predictors of potential for a business card account.

At this point, a question which often comes up is “Why bother selling them a different card when we have the business anyway?”

Three reasons: First, you have the business only as long as a competitor doesn't offer them something better than they have already. Second, if you get the value proposition right – and people running small businesses love extra benefits and services – you can charge an enhanced fee. Third, your new product will help you acquire new-to-you accounts, who will increase the customer base to which you can profitably cross-sell other banking services.

Take a look at your own data: you may be surprised at what rich pickings are out there.



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And finally...

Is your glass half empty– or half full?

A fascinating new report⁴ looks at consumer attitudes to financial and economic issues around the world.

Among the nuggets:



- In Portugal, the US, Belgium, Germany, France and the UK, 20-25% of consumers say they have no spare cash after monthly essentials have been paid.
- Among those who do have money left over at the end of the month, thrifty Asians tend to save: some 57% of Asia-Pacific respondents say they put the cash by for a rainy day. Not so in Russia: there, 68% would spend any spare money on, can you believe, clothes. More conventionally, around the world 1 in 3 of us would choose to take a holiday.
- Reassuringly, the cheerful Dutch and Danes (22% and 16% respectively) claim they have no worries at all.



4 Consumer Confidence, Concerns, Spending and Attitudes to Recession, Nielsen, June 2008

A handwritten signature in black ink that reads "Roy Stephenson".

Roy Stephenson, Consulting Editor

Consulting editor bio note

Roy Stephenson, a former VP and General Manager with American Express, is a banking and payment card consultant and a member of the MasterCard Advisors pool. He is the author of Marketing Planning for Financial Services (Gower Publishing).

Contact him at roy.stephenson@prioritycollection.com.

In previous issues of Enhance we covered:

Your best customers: How to find and influence them

The search for the holy grail: How do I make more profit from the customers I already have?

The power of data-driven marketing: Using information to build profitability

Maximise the returns from your marketing budget: What effective card marketing programmes all have in common

Coping with the commoditised credit card: Using relationships to build profitability

Business card marketing: Is there a case for product enhancement?

Conflicting signals from co-brand cards: The rules that successful issuers are following

Emerging markets: How different are they really?

Channel optimisation: 6 rules for getting the most value out of your card acquisition budget

What happened to all the good ideas?: Maximising profit the right way

Green cards: From Zero to Hero?

Vive la différence: Lose the cookie cutter!

The language of rewards: What does it all mean?

Price-led or product-led?: The dangers of focussing on price-cutting

Let's hear it for rewards programmes: How savvy issuers get value from loyalty

The world is changing – and banking is changing with it: There are huge prizes out there, if you're fast and flexible enough
Is there life beyond balance transfers?: How to stop customers walking out of the door when the interest rate changes
We have ways of making you pay: Who said that fees were a thing of the past?
Rewards: most things to most men: Just decide what behaviour you want to encourage
Keeping only the best: Reattention is a good thing – but it's not for everyone
Call it the flight to quality: Managing for the credit crunch
To charge or not to charge, that is the question: When is it right to charge a fee?
Managing for growth in a crisis: Value is the answer - for you and your customers
In tough times, be systematic: Got a problem? Think it through

Make sure your card comes out first.

Find out how to use our card enhancement products to achieve your business objectives:



email:enquiries@prioritycollection.com tel: +44 (0)20 8256 9037 www.prioritycollection.com