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APRIL 2009

Censustalk

The Big Sort

The 2009 COLLOQUY Loyalty Marketing Census

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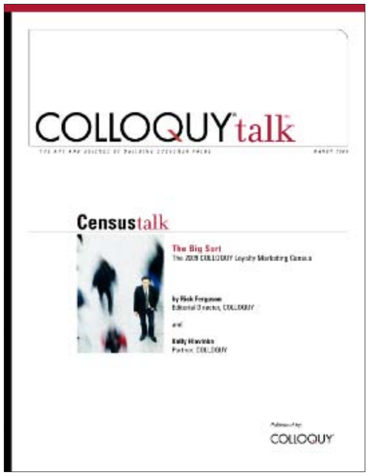


The Big Sort

THE 2009 COLLOQUY LOYALTY MARKETING CENSUS

Introduction

It all began in 2000, when COLLOQUY conducted a market-sizing study of the U.S. loyalty-marketing industry. That initial exercise led us to conduct a more ambitious study in late 2006, which in turn resulted in the publication of our first *CensusTalk* white paper in early 2007. In that study, we pegged the number of U.S. loyalty program memberships at 1.341 billion—an average of 12 programs per U.S. household. That landmark study served as the benchmark size of the U.S. loyalty-marketing industry and is still quoted by industry leaders and the business media today.

It was only a matter of time, then, until we went back to the well. This report, the 2009 U.S. Loyalty Marketing Census, represents the culmination of massive amounts of work by the COLLOQUY team to source, compile and verify membership numbers for what we believe is over 96 percent of all loyalty programs in the U.S., with the additional 4 percent of memberships estimated from a variety of proprietary and secondary research resources. In this edition, we also include for the first time Canadian program membership numbers—which makes this document the first-ever comprehensive view of loyalty program memberships in North America available anywhere.

For those interested in the bottom line, this report reveals that, from 2006 to 2008, U.S. loyalty program memberships **increased from 1.341 billion to 1.807 billion—an adjusted growth rate of nearly 25 percent since our last Census. This number translates into 14.1 loyalty program memberships per U.S. household.** In Canada, meanwhile, we counted more than 114 million active members. The good news about these numbers: More North American consumers than ever before are engaging with their favorite brands through the stimulus of loyalty and rewards programs. The bad news: **The percentage of overall *active* memberships in the U.S.—those memberships that demonstrate some type of engagement within a 12-month period—remains flat at 43.8 percent, with a blended average of 6.2 active memberships per household.** The relative ratio of active to inactive loyalty program members suggests that more than half of all program memberships are merely names in the database.

The implication for marketers is clear—the era of growing membership rolls just for the sake of growth is over. Given the bursting of the credit bubble, the severity of the current recession and the resulting pressure to control program costs, loyalty marketers must now turn away from growing program *size*, and turn to growing program *value*. In the next five years, loyalty marketers will seek to deploy loyalty data across the enterprise, devise enhanced value propositions, sign strategic partnerships, and take advantage of alternative loyalty models that turn lapsed members into engaged members, and engaged members into profitable, loyal customers. As always, these Census numbers will continue to tell the tale.

I. Methodology and Changes From the 2007 Census

Enhancements are due largely to the feedback and participation of program sponsors, many of whom routinely call us to provide the most accurate information available. Added sources and greater industry input have resulted in the greater accuracy of the 2009 Census.

In 2000, 2006 and 2008, COLLOQUY undertook a comprehensive review of loyalty program membership among consumers in the U.S. Using our existing archives of known programs across all major market sectors, we researched program web sites, company press releases, annual report filings, and third-party publications or research reports to estimate the total number of adults belonging to each program, by vertical market. We counted members, not unique individuals, allowing for the consumer loyalty junkie who belonged to 8 different programs to be counted 8 times.

When no data were available, we attempted to get it by phoning and/or emailing the company in question, most often using our existing subscriber database. When new programs were brought to our attention, we added them to the archived list and attempted to quantify membership through primary research. When the opportunity came to interview program owners and marketing personnel involved in program execution, we verified the membership counts on file. Finally, through the normal course of business within our LoyaltyOne consulting group, our Alliance Data sister companies including Epsilon and Alliance Data Retail Services, and our frequent industry appearances, we consistently strived to validate the membership counts we recorded.

Following the 2007 Census, many industry observers provided additional input. As a result, several important changes to our methodology must be noted:

- Based on information received from program sponsors after our 2007 publication date, we have adjusted the 2006 total U.S. membership count from 1,319,467,000 (the originally published number) to a revised figure of 1,341,467,000. All total U.S. growth trends are based upon the *adjusted* 2006 membership count.

- As of this new 2009 Census, the total U.S. membership count of 1,808,678,000 includes three additional vertical markets that we previously didn't compile as separate sectors. If we remove these new vertical markets, the adjusted 2009 U.S. Census total stands at 1,673,146,000 memberships. To properly compute the growth trend lines, we used this *adjusted* 2008 membership total as our data point.

- Estimates of programs per household and active programs per household are based on the true 2009 Census count of 1.8 billion members.

- Since its inception in 2000, we have continued to refine and enhance the methodology behind the Loyalty Marketing Census in order to make it the definitive account of U.S. and Canadian loyalty program memberships. These enhancements are due largely to the feedback and participation of program sponsors, many of whom routinely call us to provide the most accurate information available. Added sources and greater industry input have resulted in the greater accuracy of the 2009 Census. These enhancements do, however, present challenges to the trend analysis when making direct comparison to previous Census counts. Hence, we have adjusted our data points wherever necessary to report trends in the most consistent fashion possible.

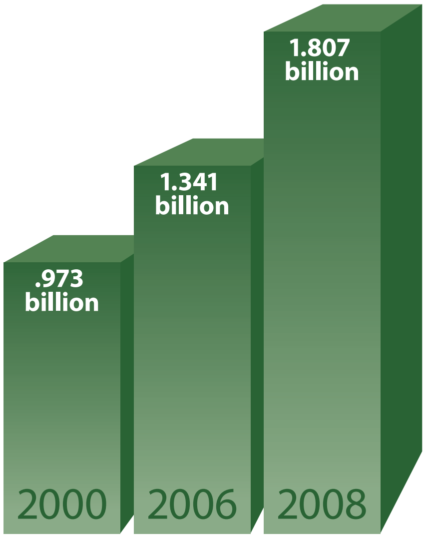
For the U.S. Census data, we confined membership counts to consumer programs only, tallying U.S. residents who were enrolled in a rewards and recognition program sponsored by at least one company. We separately listed and researched more than 1,200 sponsor firms, yielding an estimated 96.6 percent of the total U.S. loyalty program membership base. The remaining 3.4 percent we lumped together as "all other" and included our best estimate of any remaining verticals and/or unidentified programs that we did not list separately. Census counts for the 2009 and 2007 studies are estimates for the years ending 12/31/08 and 12/31/06, respectively.

II. Loyalty Reaches Critical Mass

The big news from the 2009 Loyalty Census: Despite two years of sub-par growth in GDP (Gross Domestic Product)—2.0 percent growth in 2007 and 1.4 percent in 2008—overall U.S. loyalty program memberships increased at an adjusted growth rate of 24.73 percent versus the 2007 Census. This growth translates into a compound annual growth rate (CAGR) of nearly 12 percent, which far outstrips the growth in U.S. population or GDP during this period. The 1.807 billion memberships in U.S. loyalty-marketing programs translates into an average of 14.1 program memberships per U.S. household, up from 12 memberships per household in our 2007 Census.

Since the first COLLOQUY Sizing Study in 2000, the loyalty-marketing industry has almost doubled in size, for a CAGR of more than 10.7 percent. Only during the three-year period from 2001 to 2003, at the height of the 9/11 recession, did loyalty program memberships experience less than 10 percent year-over-year membership growth.

Exhibit 1
Total U.S. Loyalty Program Memberships by Census Year

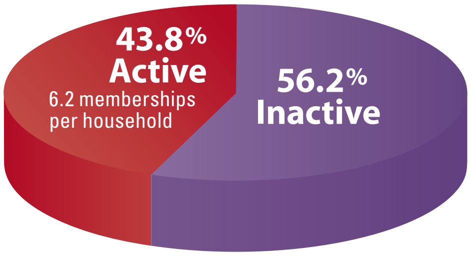


Source: 2009 COLLOQUY Loyalty Census; 2007 COLLOQUY Loyalty Census; 2000 COLLOQUY Sizing Study

And yet, overall loyalty-program activity rates remain one of the worst-kept dirty secrets in the industry. By COLLOQUY's estimates, based on a comprehensive combination of proprietary and secondary research, across all vertical industries only 43.8 percent of all loyalty program memberships are active, up slightly from the 39.5 percent blended average in our 2007 Census.

In other words, only 6 of those 14 program memberships per household are *active* memberships. The definition of an active member varies by industry; Grocers like to see frequent-shopper cardholders multiple times per month, while Apparel and Other Specialty Retailers may be happy to see their private-label cardholders four times a year. For our purposes, however, we define an active membership generously, as a membership that demonstrates at least one instance of activity within a 12-month period. Even given this very loose definition of activity, some vertical market sectors hover at only 25 percent active membership rates.

Exhibit 2
Active Versus Inactive U.S. Loyalty Program Memberships, 2008



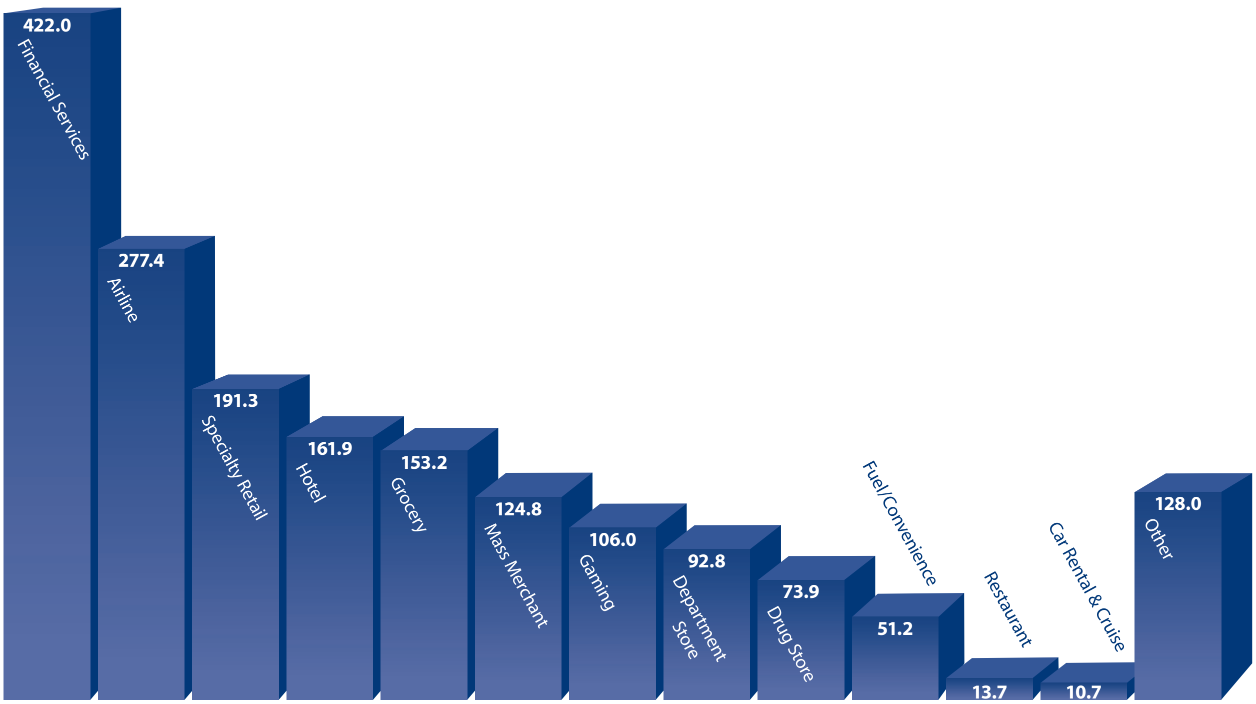
Source:
- *2009 COLLOQUY Loyalty Census: 1.807 billion program memberships; 792.8 million active program memberships*
- *U.S. Census Data: estimated U.S. households = 127.9 million*

These numbers tell us that all the problems that bedeviled the industry in 2006—bloated membership rolls, program saturation, moribund value propositions, and few attempts to mine program data to fundamentally transform the customer experience—remain problems in 2009. Given that the economy has left many long-standing consumer buying patterns in tatters, the onus is now more than ever on loyalty marketers to prove program ROI, integrate loyalty data at the enterprise level, and design value propositions that will engage customers of high current and high potential value. We must evolve our loyalty strategies, or continue to see programs brought under scrutiny by executive teams frantic to cut costs.

III. The Loyalty Census, Sector by Sector

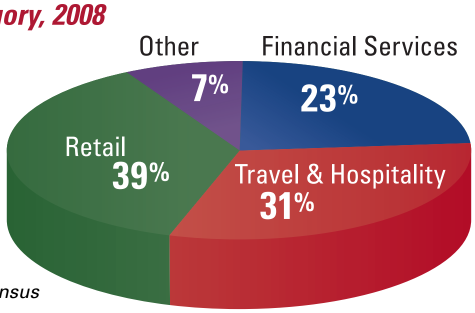
When we break down U.S. loyalty program memberships by vertical industry, we find one not-so-surprising change: The nearly 25 percent growth we documented was turbo-charged by growth in the Financial Services sector. The credit bubble, now burst, saw loyalty program memberships in this industry increase by more than 75 percent since 2006. This steep growth curve has seen the Financial Services sector rocket past the Airline sector as the largest single vertical market for loyalty programs. The Hotel, Grocery and Specialty Retail sectors also reported strong membership growth; each now exceeds 150 million total members and collectively join the Financial Services and Airlines sectors in rounding out the top 5 U.S. market sectors, in total representing 63 percent of total U.S. loyalty program memberships. Airlines, the oldest and most mature segment, reported modest growth of 9 percent since the 2007 Census.

Exhibit 3
U.S. Loyalty Program Memberships by Sector, 2008



Source: 2009 COLLOQUY Loyalty Census—memberships expressed in millions

Exhibit 4
U.S. Loyalty Program Memberships, Percentage by Category, 2008

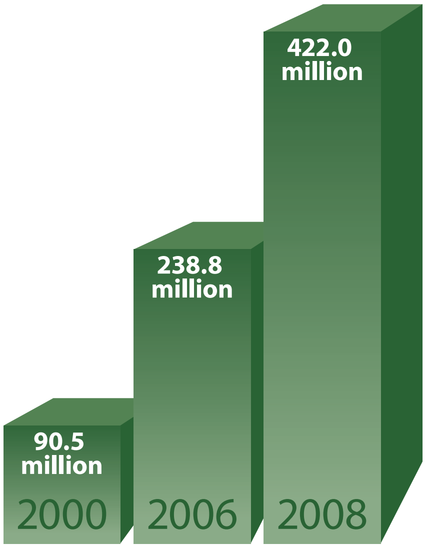


Source: 2009 COLLOQUY Loyalty Census

Note that we added three vertical industries for the 2009 Census—Car Rental, Cruise Lines, and Mass Merchandisers. Given the introduction of these verticals, it's important to note that for accurate comparison to previous Census reports, we have adjusted both the 2009 and 2007 Census totals (see the notes on methodology in Section I). Sectors aggregated into the "Other" category include Telecom, Entertainment, Consumer Products, and some regional coalitions. All programs counted are consumer-based programs only; no business-to-business (B2B) programs are included.

CATEGORY: FINANCIAL SERVICES

Exhibit 5
U.S. Financial Services Loyalty Program Memberships by Census Year



Source: 2009 COLLOQUY Loyalty Census

Census Snapshot: Financial Services

Membership 2006	238,783,000
Membership 2008	422,044,000
Percentage Change	+77%
2007 Growth Projection	↑
2009 Growth Projection	↓

The absolute explosion of credit and debit reward card programs in the U.S. was fueled by a dramatic expansion in consumer credit that finally ended in late 2008. We may nonetheless be shocked by the 77 percent increase in financial services loyalty program memberships in just two years, which makes the sector far and away the largest single sector in the loyalty-marketing industry, having seized the crown from airline programs, which led the pack in 2006. Both credit and debit card reward programs fueled this growth. Collectively, however, the category ranks third in total number of U.S. memberships at 23 percent, behind the Retail and Travel categories.

While active membership has softened since 2006, the sector remains above normal in terms of active program participation. Many industry experts reported issuer reluctance to purge existing portfolio databases of inactive cardholders; hence total memberships grew more rapidly than active cardholders. Other trends fueling this growth:

- Rewards have been the cost of entry for new credit and debit products, as multiple industry sources pin reward card penetration rates at around 80 percent of all consumer cards issued.

- Debit card reward programs have increased dramatically with the help of partner money and merchant-funded reward networks. With debit usage growing overall, loyalty-program action has increased.
- Affluent consumers have continued to be bombarded with competing card offers, meaning that members of this demographic have enjoyed unprecedented choice of rich reward card products.

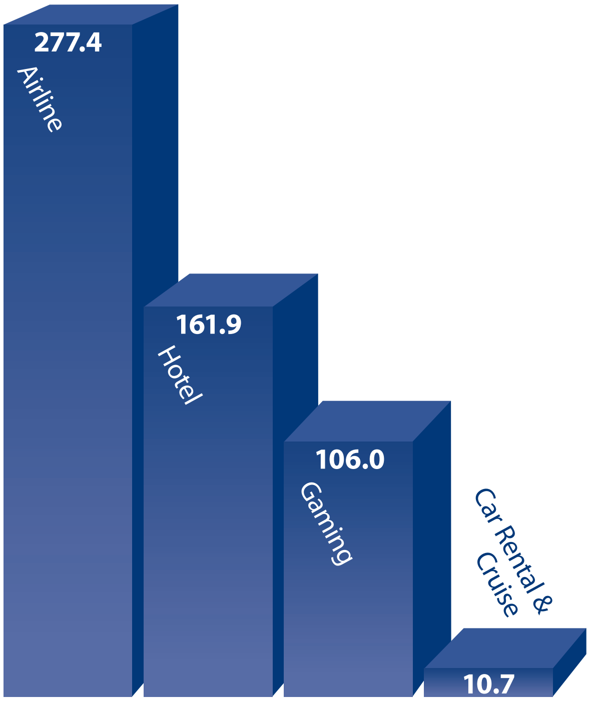
Additional forays into Total Relationship Banking, as evinced by the Citi ThankYou program, will also be put on hold until the dust settles. The Golden Age of credit card reward programs is over—at least until the banks get healthy again.

Our prediction

While we were right on the money when we predicted dramatic growth in this sector in our 2007 white paper, we must nonetheless be the bearers of bad news: at least for the short term, the party appears over. The recent move by American Express to pay unprofitable cardholders $300 to close their accounts is emblematic of the new reality for credit card marketers. At least until the recession ends, consumer credit will be hard to come by, with many consumers accustomed to automatic approval for new card products finding themselves turned down by issuers. Regulatory changes may affect reward program budgets, and we will likely see portfolio consolidation and even some players put out of business. Issuers will continue to slash program benefits and increase program fees. Additional forays into Total Relationship Banking, as evinced by the Citi *ThankYou* program, will also be put on hold until the dust settles. The Golden Age of credit card reward programs is over—at least until the banks get healthy again. Card issuers will turn from growing their portfolios to retaining their most profitable and credit-worthy customers.

CATEGORY: TRAVEL AND HOSPITALITY

Exhibit 6
U.S. Travel and Hospitality Loyalty Program Memberships, 2008



Source: 2009 COLLOQUY Loyalty Census—memberships expressed in millions

Collectively, the U.S. Travel and Hospitality category has lost the crown as the largest single sector for loyalty program memberships, as it now stands second to the retail category at 31 percent. For this iteration of the Census, we have broken out Cruise Lines and Car Rental as a separate Travel sector. This new snapshot provides a comprehensive look at the size of U.S. Travel loyalty program membership rolls.

Census Snapshot: Airlines

Membership 2006	254,425,000
Membership 2008	277,410,000
Percentage Change	+9%
2007 Growth Projection	↔
2009 Growth Projection	↔

Airline frequent-flyer program memberships grew by 9 percent since our 2007 white paper, which was on the high end of our projection of single-digit growth, but still in line. The following trends fueled this modest growth:

- Generation X and Millennial business travelers continue to join airline programs at a rate that currently outpaces the exodus of retirement-age Boomers. Many of these travelers now join multiple programs, which erodes loyalty to a single airline but further inflates membership rolls.
- Until recently, the credit bubble continued to drive memberships as consumers took up airline co-branded credit card products.
- The lucrative sale of airline miles to issuers and other program earn partners continues to drive airlines to get as many consumers earning miles as possible.
- Airlines continue to attempt to control liability and add burn options with the introduction of online malls, auctions and other initiatives that have enhanced the programs' value proposition beyond earning free flights.

The bursting of the credit bubble will mean fewer co-branded credit cards in use, which will certainly result in program attrition. But we're also seeing signs that the airlines are finally serious about applying program data on an operational level to transform the customer experience.

Our prediction

Despite lower fuel costs, the Airline industry had a dreadful 2008 and will likely have a dreadful 2009. Lower earnings always put increased scrutiny on the value of frequent-flyer programs (witness US Airways CEO Doug Parker's recent bad-mouthing of airline programs to the press), and some airline executives no doubt wish that they could time-travel back to 1981 and prevent American Airlines from launching the *AAdvantage* program in the first place. But airline mileage sales are still so lucrative for many airlines—in some cases, the airline makes more money selling miles than they do flying planes—that it's hard to imagine these programs scaling back any time soon. The bursting of the credit bubble will mean fewer co-branded credit cards in use, which will certainly result in program attrition. But we're also seeing signs that the airlines are finally serious about applying program data on an operational level to transform the customer experience. We predict continued flat single-digit growth in this sector and a renewed emphasis to leveraging program data at the enterprise level.

Census Snapshot: Hotels

Membership 2006	92,463,000 (published)
Membership 2008	161,896,000
Percentage Change	+26% (adjusted)
2007 Growth Projection	↑
2009 Growth Projection	↑

Additional data gathered after our 2007 survey revised our Hotel program membership count upward. That post-publication revision, when compared to our 2008 membership count of 161,896,000, gives us our adjusted growth rate for this sector of 26 percent—a healthy growth rate, particularly when compared to the growth in Airline programs. Trends fueling this growth:

- Road warriors frustrated with the devaluation of airline miles, and with the increasing fees and restrictions associated with flight reward redemptions, migrated *en masse* to Hotel programs, which are comparatively richer and burdened with fewer fees and restrictions.

- Hotels are arguably the most retention-oriented industry we profile—the Hotels know that 80 percent of RevPAR (Revenue per Available Room) comes from 20 percent of their customers, and there is no better vehicle for building relationships with these customers than the loyalty program. In most cases, there is significant commitment to these programs at the enterprise level.

- Hotels have made tremendous strides in leveraging program data to drive the on-property experience and increase communications and offer relevance. Consumers are flocking to these programs because the value for participation is apparent.

We weren't surprised to see our double-digit growth projections for this sector come true. But don't expect the party to continue—it's now hangover time.

Our prediction

The Hotel industry as a whole absolutely cratered in the second half of 2008, with steep declines in RevPAR and room demand driven by cuts in corporate business travel. 2009 will probably be worse, at least in the first half of the year. Bad times inevitably lead non-believers in the Finance department to cast a skeptical eye on Hotel loyalty programs, and we may thus see a short-term reduction in program funding by some big players. Despite these pressures, however, the industry is united in its belief that reward programs continue to offer the best platform for retaining profitable customers. When the rebound occurs, pent-up demand for business travel will see Hotel program operators leading the charge to build value-added customer relationships.

Census Snapshot: Gaming

Membership 2006	77,660,000
Membership 2008	106,043,000
Percentage Change	+37%
2007 Growth Projection	↑
2009 Growth Projection	↔

A dramatic shift in Gaming industry revenue occurred over the past few years, as some of the largest Gaming companies began to make more money from selling hotel rooms, meeting space and restaurant meals than they did from the slot machines. This shift has seen players such as Harrah's and MGM Mirage complete the transformation from casino operators to true hospitality companies. Much of this transformation was driven directly by their loyalty-program data, as company analysts were able to develop true 360-degree views of customer spend that allowed them to target offers by demographics, geography, casino play, and entertainment spend. Other growth trends:

- With the big players having already maximized their programs, much of the membership growth in this industry has been driven by regional players and Native-American casinos. Growth has accelerated at the top of the industry also, but merger and acquisition activity has dampened growth somewhat.

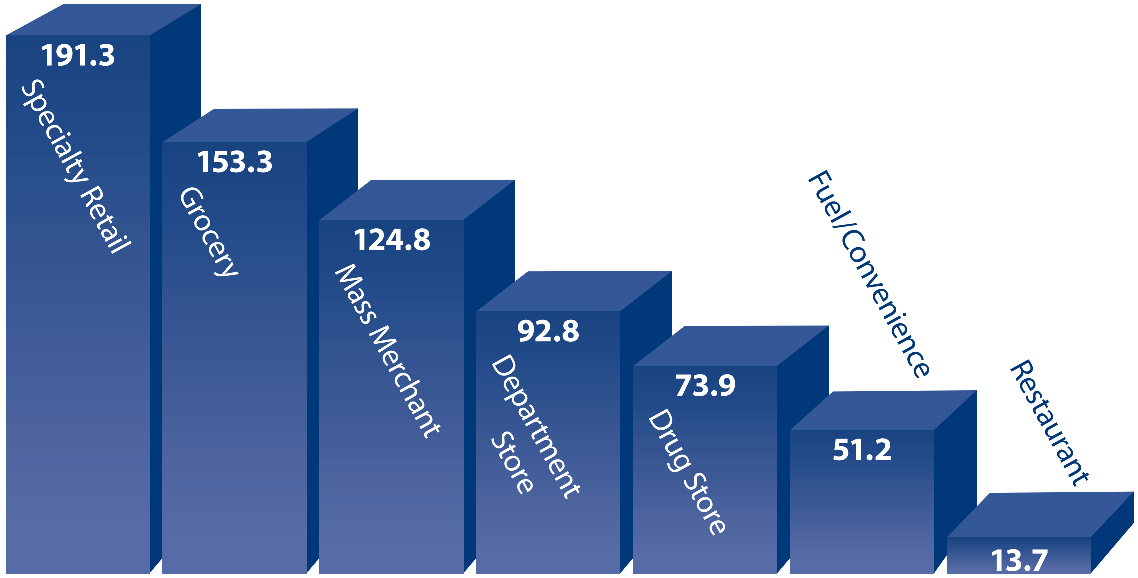
- Expanded reward content and state-of-the-art data-mining have kept Gaming programs top-of-mind with members, which makes activity rates in this sector among the highest in the Travel and Hospitality category.

Our prediction

We weren't surprised to see our double-digit growth projections for this sector come true. But don't expect the party to continue—it's now hangover time. With the recession devastating the Las Vegas economy, image-conscious corporations ending junkets to Vegas and Atlantic City and consumers pulling back hard on the leisure-spending throttle, gaming companies will be happy to live with what they have in terms of membership rolls, which will result in flat growth over the next few years. Still, catering to best customers is built into these companies' DNA. The industry leads the world in practicing enterprise loyalty, and we expect that lead to remain.

CATEGORY: RETAIL

Exhibit 7
U.S. Retail Loyalty Program Memberships, 2008



Source: 2009 COLLOQUY Loyalty Census—memberships expressed in millions

Collectively, the sectors and companies that make up the Retail Category now compose the largest chunk of U.S. loyalty program memberships at 39 percent. Most of this growth has been driven by the Specialty Retail sector, which has ridden the credit bubble to drive private-label credit card activations and to launch multi-tender loyalty programs. Grocers, meanwhile, continue to evolve their value propositions away from two-tiered pricing. In our 2007 white paper, we predicted that the next loyalty battleground would be in Retail, and we're happy to report that we were right. With the Travel category in maturity and the Financial Services category likely to contract, we expect retailers to be at the forefront of innovative loyalty-marketing solutions for years to come.

Census Snapshot: Specialty Retail

Membership 2006	137,473,000
Membership 2008	191,339,000
Percentage Change	+39%
2007 Growth Projection	↑
2009 Growth Projection	↑

The current economic climate may spell short-term doom for many venerable Specialty Retail brands, but in terms of the loyalty-marketing industry, the sector had a great couple of years since our last Census predicted double-digit growth. Whether through multi-tender vehicles, private-label or co-branded credit cards, Specialty Retailers are fighting back against Wal-Mart and other Mass-Merchant Discounters by using loyalty vehicles to build emotional bonds with their best customers. Other trends driving this growth:

For Specialty Retailers, loyalty marketing makes good business sense—provided that retailers pursue a multi-tender, multi-channel, highly-segmented, enterprise-wide customer strategy. The next few years will see Specialty Retailers focus heavily on customer-centricity and improving the customer experience.

- Best Buy continues to lead this sector with their best-in-class *Reward Zone* program that rewards members in a multi-tender and multi-channel environment. Other major brands such as Borders and DSW also launched new programs during this period.
- Price pressure from Mass-Merchant and Discount Retailers has forced this sector to innovate in order to retain share of customer. Specialty Retailers know that customers will trade some price elasticity in exchange for a real relationship based on personalization, relevance and trust.
- The past few years of easy consumer credit led Specialty Retailers to drive consumers to private-label credit cards, many of which have now evolved to include rich loyalty and reward benefits. Despite the competition from general-purpose credit cards, the private-label card has continued to thrive.

Our prediction

The past year has seen several name-brand, national-footprint Specialty Retailers close their doors, and more retailers are likely to fall by the wayside in 2009. Brutally heavy discounting over the holidays allowed retailers to keep pace with sales at the expense of margins, and consumers have become so price-conscious in this environment that any sale price less than 70 percent off is considered chump change. That said, we're still bullish on this sector. For Specialty Retailers, loyalty marketing makes good business sense—provided that retailers pursue a multi-tender, multi-channel, highly-segmented, enterprise-wide customer strategy. The next few years will see Specialty Retailers focus heavily on customer-centricity and improving the customer experience. Data captured from loyalty programs will help drive enterprise-level initiatives that help Specialty Retailers steal market share from the discounters.

Census Snapshot: Grocery

Membership 2006	124,442,000
Membership 2008	153,323,000
Percentage Change	+23%
2007 Growth Projection	↑
2009 Growth Projection	↔

Grocery loyalty programs also enjoyed healthy double-digit growth since our 2007 white paper predicted as much. The growth was driven largely by such new initiatives as Kroger's *1-2-3 Card* and by other Grocers expanding household penetration of their traditional two-tiered pricing cards. While Wal-Mart remains the dominant Grocer in the U.S. through its Every Day Low Price (EDLP) retail model, Grocers big and small are fighting back with a renewed emphasis on shopper data and customer-centricity. Other trends fueling this growth:

- The shift away from two-tiered pricing and toward promotional currency continues, led by Kroger and regional players such as H-E-B. Grocers who undergo this transformation see renewed interest in their programs, which leads to increased activity rates.
- Speaking of activity rates, the definition of an "active" member in this industry is changing. In the old model, every customer used the two-tiered discount card, which drove active rates to near 100 percent. Very little of that activity was

tracked at the individual shopper level. Now, some Grocers are targeting offers by customer segment and enjoying redemption rates of up to 50 percent—versus typical coupon redemption rates of 1-3 percent. Now *that's* the definition of an active membership.

- Enrollment also spiked during the summer 2008 gasoline crunch, when Grocers scrambled to include gasoline discounts in their loyalty value propositions. Some Grocers, such as Biggs and other SuperValu brands, have converted their programs into a full gasoline discount-based program value proposition.

Affinity and lifestyle clubs are proliferating, grocers are adding such new partner benefits as charitable and green options, and there is ample evidence that Grocers are finally embracing the power of shopper data to create differentiated and profitable customer relationships.

Our prediction

We can't predict continued robust growth in terms of overall membership numbers—after all, with more than 153 million program members and only 127 million U.S. households, pretty much every household that wants to participate already belongs to multiple programs. But we can certainly predict a spike in program activity, as Grocers across the U.S. re-dedicate themselves to customer-centricity. Affinity and lifestyle clubs are proliferating, Grocers are adding such new partner benefits as charitable and green options, and there is ample evidence that Grocers are finally embracing the power of shopper data to create differentiated and profitable customer relationships. Look for all of this activity to continue—and look for a renewed emphasis on coalition and partner models of loyalty, as Grocers look to enhance their value propositions while sharing program costs.

OTHER RETAIL SECTORS

Mass Merchants (2008 Membership: 124,800,000)

For the most part, Mass Merchants follow Wal-Mart's lead in EDLP pricing and tend not to operate sophisticated loyalty-marketing programs; most retailers in this sector operate discount programs tied to a payment device. We also include paid-membership wholesale clubs such as Sam's Club and Costco in this sector. Target's "Take Charge of Education" program is one of the few examples of a Mass Merchant attempting to differentiate themselves. While discounters tend to benefit during a recession as consumers become more value-conscious, in 2008 the only Mass Merchant to see an appreciable increase was sector leader Wal-Mart, with February same-store sales up 5.1 percent thanks to increased sales of groceries and health care products. Target, by contrast, saw a 4.1 percent decline during this period as consumers cut back in Target's core apparel and home goods product categories.

Department Stores (2008 Membership: 92,805,000)

The recession has been particularly hard on this sector as most of the big players find consumers pulling way back on luxury goods, apparel and home goods spending—the category experienced double-digit declines in same-store sales throughout 2008, and Fitch ratings give Saks, Nordstrom and Neiman Marcus a negative outlook for 2009. In the short term, investment in loyalty programs will suffer, mainly because most programs are still tied to store credit cards and most of those portfolios are in dire shape. Still, once the recovery begins, we expect that the smart players will exhibit renewed focus on improving the customer experience, and that focus will depend on effective use of shopper data. Macy's continues to make strides in this area, while the CEOs of both Neiman Marcus and Nordstrom continue to publicly support their respective reward programs. Those Department Stores left standing during the recovery will lead a new round of innovation.

Drug Stores (2008 Membership: 73,876,000)

We're quite bullish about this sector, despite the economy; while most retailers are experiencing double-digit declines in sales, sales at retail pharmacies increased 1.5 percent last year. Drug Store operators have consolidated during the decade, and now realize that the loyalty program is the best device for tracking individual behavior. CVS/pharmacy continues to be the front-runner in loyalty marketing, with real-time point-of-sale delivery of product coupons and offers based on previous spend at both the category and brand level. Both Walgreens and Rite-Aid have publicly expressed their desire to build stronger customer programs, and the sector will continue to lead innovation in both real-time point-of-sale (POS) technology and data-driven marketing programs.

Fuel/Convenience (2008 Membership: 51,243,000)

While the Fuel/Convenience retail sector understands in principal the need to identify customers, track their spending and build relationships with them, the industry continues to be hampered by low margins, small transaction sizes and brutal credit card interchange fees, all of which prevent them from migrating away from the typical fuel-discount programs tied to co-branded credit card use. The summer 2008 gas crisis drove membership in these programs, but overall activity rates remain among the lowest in retail. The bright spots include Speedway's *Speedy Rewards* program, which enjoys a growing, enthusiastic membership base, and the several regional programs targeted to long-distance truck drivers and fleets. There's great potential in this sector—particularly if one of the big players joins or helps launch a national coalition—but as long as this sector is tied to consumer credit, it will continue to struggle to develop meaningful loyalty value propositions.

Restaurant (2008 Membership: 13,877,000)

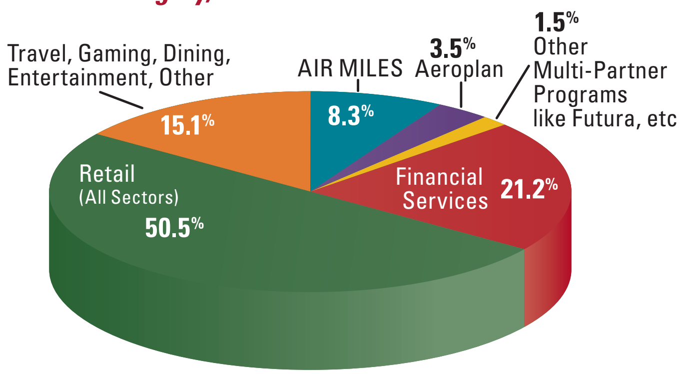
Given the potential for quick-service restaurants to innovate with real-time POS systems, and for casual and fine-dining chains to innovate with soft benefits, we remain eternally surprised that there never seems to be any loyalty-marketing progress in this sector. There are several examples of successful regional programs, and the T.G.I. Friday's *Give Me More Stripes* program keeps chugging along, but otherwise the activity in this sector is sparse. Starbucks remains the sector loyalty leader in quick-service, but the recession has hit the company hard and poor earnings may curtail further investment in the program. Restaurateurs, when will one of you step up with a truly innovative loyalty solution?

Given the potential for quick-service restaurants to innovate with real-time POS systems, and for casual and fine-dining chains to innovate with soft benefits, we remain eternally surprised that there never seems to be any loyalty-marketing progress in this sector.

IV. The Canadian Difference

The 2009 COLLOQUY Census marks the first time we measured the Canadian Loyalty market. While we used the same methodology in Canada that we used in the U.S., at least one significant market difference between the two countries is worth pointing out. While the U.S. marketplace is dominated by proprietary programs, Canada is dominated by a true national multi-merchant coalition loyalty program, the AIR MILES Reward Program, and a strong partner airline program in Aeroplan. The charts below outline loyalty-program penetration in key coalition and consumer sectors in Canada:

Exhibit 8
Canadian Loyalty Program Memberships by Market Category, 2008



Source: 2009 COLLOQUY Loyalty Census

Census Snapshot: Active Canadian Program Members 2009

AIR MILES	9,500,000
Aeroplan	4,000,000
Other Multi-Partner Programs	1,701,500
Financial Services	24,315,800
Retail (All Sectors)	57,850,000
Travel, Gaming, Dining, Entertainment, Other	17,288,000
Total	**114,655,300**

Other key findings from our Canadian research:

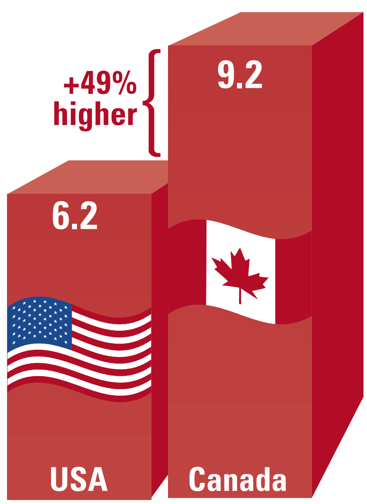
- There are more than 114 million loyalty program memberships in Canada. While the overall number of programs per household is higher in the U.S., our Census reveals that active participation per household is significantly higher in Canada—9.2 programs per household versus 6.2 in the U.S. Research conducted for our 2007 *SegmentTalk* white paper likewise revealed that individual active participation in loyalty programs is significantly higher in Canada—86 percent active participation by consumers in at least one loyalty program versus 57 percent in the U.S.

- Active loyalty program participation in Canada is driven to a significant degree by coalition membership. The AIR MILES Reward Program enjoys 9.5 million collectors across Canada. The Aeroplan partner program likewise has significant penetration with 4 million members. Coalitions are very consumer-friendly—because the same points can be earned across a network of sponsors in virtually every category (AIR MILES has more than 130 sponsors in their network), it is very easy for the consumer to remain active and earn points, which keeps the program top of mind. Coalition participation exerts a "rising tide" effect, pointing up the value inherent in loyalty programs in general, which translates into active participation in multiple programs in most households. Most Canadians know and enjoy playing the "loyalty game."

- Besides the coalition sponsors, Canada boasts high penetration of proprietary programs in most market sectors. Retailers such as Canadian Tire, HBC, Sears and Shoppers Drug Mart operate programs with millions of members; Best Buy also recently launched *Reward Zone* in Canada. In the Financial Services sector, debit card reward programs are far less prevalent than in the U.S. due to different operating rules and regulations north of the border, but Canadian banks enjoy heavy penetration of credit reward card products—that's in addition to AIR MILES card products offered by American Express and Bank of Montreal, and the Aeroplan cards offered by AmEx and CIBC. Active participants also exist in the Travel, Gaming, Dining and Entertainment sectors, with more than 17 million members in Canada represented in these segments

- In terms of future growth projections, it's safe to say that Canada is a far more mature market than the U.S. Arguably, Canada is second only to the U.K. as the most mature, most penetrated, most sophisticated loyalty market in the world. Growth in Canada will come not in terms of new member acquisition—although Millennials will continue to join programs as they enter the adult workforce—but rather through effective data-mining to enhance the value proposition for existing members and win the share-of-customer battle. Canadian loyalty marketers have already won the battle for consumer interest. The next battles will be fought as part of a zero-sum game for consumer spend.

Exhibit 9
Canadian Versus U.S., Loyalty Program Active Memberships by Household, 2008



Source:
- *2009 COLLOQUY Loyalty Census: 792.8 million active U.S. program memberships; 114.9 million active Canadian program memberships*
- *U.S. Census Data: estimated U.S. households = 127.9 million*
- *StatCan: Canadian households = 12.437 million*

V. Lessons Learned From the 2009 Census

With the loyalty-marketing industry still enjoying 25 percent growth in two years, despite a recession that may prove to be the deepest and longest on record since the 1930s, loyalty marketers in every industry will be under pressure from their executive teams, boards and shareholders to deliver maximum return on program investment while controlling costs. Ironically, what is normally the loyalty marketer's greatest advantage—the ability to measure, on nearly a dollar-for-dollar basis, the return in customer lift and retention—exposes us to even greater scrutiny during these challenging times. It's easy to hide poor returns behind a mass-marketing strategy that may provoke awareness and buzz—but little else—or a discount strategy that can boost quarterly sales at the expense of margins and long-term relationships. Loyalty marketers, however, can be undone by the very nature of the enterprise as executives continue to scrutinize your very transparent returns. To help, COLLOQUY humbly offers these best practices to guide you through these troubled waters.

Given how many organizations still narrow measurement of a loyalty program's value to its pure marketing impact, it's wise to trade a little member acquisition for offers that reach and influence current members with high current value or high potential. It may be time to trade your hunter's bow for the farmer's plow.

- **Find the sweet spot.** Clearly, given these bloated membership rolls, big is the enemy of great. For every loyalty marketer in every industry, there is a temperate zone where your program is big enough to reach critical mass, but still small enough to allow you to focus your reward dollars where they can have the most beneficial effect in terms of changing customer behavior. If your organization is 100 percent committed to the enterprise loyalty vision, there is great value in broad-based enrollment to glean insights and transform your operations to be more customer-centric. Given how many organizations still narrow measurement of a loyalty program's value to its pure marketing impact, it's wise to trade a little member acquisition for offers that reach and influence current members with high current value or high potential. It may be time to trade your hunter's bow for the farmer's plow.

- **Explore partnerships.** There is no better way to enhance your loyalty value proposition than to seek out and form partnerships with like-minded companies who want access to your membership in exchange for shared program costs. An enhanced value proposition will naturally engage a much larger percentage of your bloated membership rolls. The good news is that there are a variety of partnership models available to you. You can seek earn or burn partners for your own program, play as a partner in another company's program, or join a regional or national loyalty coalition program. Partnership models enhance the value proposition for sponsors, partners and consumers—there's something in it for everybody.

- **Practice Enterprise Loyalty.** While certain companies and sectors are making great strides in extracting value from the customer database, overall program engagement rates remain flat at 40 percent precisely because marketers still aren't exploiting the loyalty-marketing database to transform the customer experience. Loyalty-marketing success is no longer defined solely by response rates, but is now also defined by your success at recognizing and acting on customer value and potential at every customer touch point: in-store, online, through the call center, and at the point-of-sale. Increasingly, the winners in every industry will be defined by their ability to leverage customer data at the enterprise level.

- **Nurture your Champion Customers.** COLLOQUY's recent white paper *The New Champion Customers* revealed that loyalty program members are 70 percent more likely to be active recommenders of your products and services than non-members. The next challenge for loyalty marketers will be to identify and nurture these word-of-mouth champions. Give them the tools and platforms to advocate on your behalf, and reward them for their advocacy. As loyalty marketers develop the tools and methodologies to identify and build relationships with this new customer segment, loyalty ROI will depend not only on a customer's individual spend, but also on the amount of spend that customer brings in through her own network or through your formal referral program. Champion Customers are worth their weight in gold.

Exhibits Presented in "The Big Sort"

The Authors

As COLLOQUY Partner, **Kelly Hlavinka** directs all publishing, education and research projects at COLLOQUY, where she draws on her broad experience as a loyalty strategy practitioner in developing articles, white papers and educational initiatives. An acknowledged expert in the theory and practice of loyalty marketing, she also regularly contributes to *DM News*, *The DMA Insider*, *DIRECT* and *BrandWeek*, and is often cited by publications such as *Newsweek*, *Advertising Age* and *Smart Money*. Kelly is a featured presenter at many industry conferences and has taught loyalty workshops and webinars around the world. She previously launched and managed COLLOQUY's strategic consultancy, working with clients such as Lennar Homes, MGM MIRAGE, Eddie Bauer, Best Buy, HP Software and Visa International. Prior to joining COLLOQUY in 1996, she held marketing positions with Buyers Choice (now The Polk Company), database marketer ACS, and Equifax Consumer Direct.

As Editorial Director for COLLOQUY, **Rick Ferguson** is responsible for all COLLOQUY publishing, educational and research projects. An acknowledged expert in the theory and practice of loyalty marketing, Rick has published numerous articles and white papers describing the characteristics of marketing programs that seek to change customer behavior. He has been quoted as a loyalty expert in the *Wall Street Journal*, *The New York Times*, *Guardian UK*, *Fast Company*, *USA Today*, and MSNBC.com. He serves as a contributor to *The Journal of Consumer Marketing* and *Chief Marketer* magazine. Ferguson has been a featured presenter at industry conferences sponsored by the DMA, NACS, FTMA and Terrapinn. As a key member of the COLLOQUY faculty, he has delivered educational workshops and webinars on the principles, practices and technologies of loyalty marketing in the U.S., U.K., South Africa, Malaysia and Singapore.

For more COLLOQUY white papers and studies, visit www.colloquy.com/whitepapers

The Publisher

COLLOQUY comprises a collection of publishing, education and research resources devoted to the global loyalty-marketing industry. **COLLOQUY®** has served the loyalty-marketing industry since 1990 with over 30,000 global subscribers to its magazine and www.colloquy.com is the most comprehensive loyalty web site in the world. COLLOQUY's research division develops consumer and B2B research studies and white papers including industry-specific reports, sizing studies and insights into the drivers of consumer behavior. COLLOQUY also provides educational services through workshops, webinars and speeches at events throughout the world and is the official loyalty-marketing partner of both the Direct Marketing Association and the Canadian Marketing Association. COLLOQUY also operates The COLLOQUY Network, a global consortium of practitioners certified in COLLOQUY's proprietary methodology. *COLLOQUY* magazine subscriptions are available at no cost to qualified persons at www.colloquy.com or by calling 513.248.9184.

COLLOQUY is owned by **LoyaltyOne** (formerly Alliance Data Loyalty Services), which works with more than 100 of North America's leading brands in the retail, financial services, grocery, petroleum retail, travel, and hospitality industries to profitably change customer behavior. Through a team of businesses, each specializing in a loyalty discipline, LoyaltyOne designs, delivers, and manages a suite of loyalty marketing services—consumer data, customer-centric retail strategies, direct-to-consumer marketing, loyalty consulting, and more. In addition to COLLOQUY, the companies include:

- **LoyaltyOne Consulting** is comprised of a group of internationally-recognized practitioners who design and implement loyalty-marketing strategies for Fortune 1000 clients.
- **The AIR MILES® Reward Program** is Canada's premier coalition loyalty program. More than 9 million active Collector accounts, representing approximately two-thirds of all Canadian households, actively participate in the Program.
- **Direct Antidote** is a loyalty-marketing agency specializing in data-driven creative campaigns that transform customer behavior to deliver on short-term return on investment, while building profitable relationships for life.
- **Precima** is an advanced analytics firm that translates retail customer data into critical insights to better align marketing, merchandising and operations strategies with shopper needs.

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