

Reaching for Value: Membership Has its Shareholder Rewards

Just for fun, let's invent the perfect business. Let's see: How about an enterprise in which your customers pay you up front to create the business – including all your marketing costs – and at the same time lock themselves into buying from you for years afterward? *That* sounds pretty good.

Too late: it's already been invented. It's called the Ritz-Carlton Club.

In this unusual world, a group of purchasers pay the Ritz-Carlton Club (RCC) between \$150,000 and \$1 million each to put up a reasonably elegant hotel and condominium resort. They also pay an annual maintenance fee that runs between \$10,000 and \$20,000. In return, they get between 21 and 28 days of access to a specific unit annually, including the right to use pools, fitness facilities, and other amenities on the property.

But that's just the grubby mechanics of the deal. What do you *really* get from a timeshare? Well, first, you get predictability: a vacation with no unpleasant surprises. Second, you derive a sense of ownership, which you can't get from most other vacation options. But there's more. According to RCC, membership in the club gets access to a new and rarified world. As the RCC's web site puts it:

Your Residence or Club Suite at The Ritz-Carlton is not so much a place as it is a lifestyle – one of grace, ease and finery to which virtually all aspire yet few will ever attain.

Consider a life of permanent elevation, with every day as sublime as the most memorable day of vacation. Imagine waking every morning in the middle of the most beautiful and engaging places on earth, without a care in the world, totally free to pursue your personal bliss – knowing tomorrow will be the same way . . .

Wow! The freedom to pursue personal bliss, permanently elevated, while surrounded by finery – fantastic! Could there be anything wrong with this picture?

Well, that depends on your point of view: vacationer or investor. As noted, the purchase price includes much of the cost to RCC of marketing the development. (According to the *Wall Street Journal*, as much as 50% of a timeshare's cost goes to cover the cost of marketing.) This is one reason why the purchaser of a timeshare is very likely to lose money, if and when he or she decides to sell it. The bottom line is that timeshares behave less like real estate and more like cars or boats: They depreciate.

Beyond the bad-investment argument, one could point out that timeshares lock you into the same experience every year. What if your plans change and the weeks you chose no longer work for you? Unless you can find someone to buy or swap your weeks then tough luck; you're locked in. According to the American Resort Development Association, something like 10% of all timeshares go unused during any given year. And

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did you know that you can rent a room at the Ritz-Carlton hotel in Bachelor Gulch, Colorado, and have access to *exactly the same facilities* as the RCC's timeshare owners at that property? So why in the world would anyone put down their money to become a timeshare owner at Bachelor Gulch?

The simplest answer is, we humans need to *affiliate*. We want to belong to something, and preferably, something more sublime and more significant than ourselves. We want to believe that we're getting special access, special treatment, special handling – special *something*. And RCC, a subsidiary of Marriott International, has discovered an astounding formula for delivering exactly that specialness. It is one of the best examples of a company that, in making its best customers feel like members of an exclusive club, simultaneously delivers rich rewards to its customers and value to Marriott's shareholders.

RCC is an extreme case, but in fact, there are hundreds of "normal" businesses that have built special relationships with their customers by exploiting humans' craving to affiliate.

Retail "clubs" like Costco and Sam's Club, for example, work hard toward that goal. True, we pay our annual membership dues based in part on the cold calculation that our annual savings will outweigh that \$45 charge. But – let's be honest, here – we also enjoy the fact that our little membership card makes us special, even if there are thousands of other people who carry the same little card. When we are inside the store, there is a temptation to buy well beyond our immediate needs. The benefits for these club retailers are very high sales-per-visit and a substantial share of wallet, even with only a limited number of stores. Despite low prices, the business model delivers strong returns on capital for shareholders, in part because customers are carrying much of the inventory in their own homes.

A great example of applying this principle to business purchasers is the rewards program introduced by American Airlines, and since replicated in some form by almost every major airline. The clever part was going beyond the simple idea of giving free travel using "air miles," and having tiers of membership with different levels of status and benefits. I know successful

businessmen who earn salaries of hundreds of thousands of dollars, but still fret about whether they will make the Executive Platinum level for the following year, often taking less convenient connecting flights in order to meet their mileage goals. One colleague even flew all the way from the U.S. to Tokyo and back – never actually leaving Narita International at the other end – just to make sure he reached his mileage threshold. Why do they do this? I would argue that just as important as the occasional upgrade or other travel benefits is the feeling of being a valued member of an exclusive club, to which most travellers will never gain access. The full benefit of these airline membership programs was revealed when Air Canada spun off its frequent flier program in 2005: *The new entity, Aeroplan, has consistently had higher market capitalization than Air Canada itself* – a great example of how membership rewards shareholders.

Another example from the travel industry is Hertz. With its #1 Club Gold system, Hertz is masterful at transforming the rental-car experience from purely transactional to affiliative. Think of the wallet card (which doesn't actually do anything except help you keep track of the special Club Gold 800 numbers), the annual update of your personal profile, the thank-you notes accompanied by discount coupons, and – best of all! – the tote boards at the check-out area with your name in lights. Once a business customer gets used to this experience, the prospect of shopping around for car-rental deals and standing in line with the "ordinary people" becomes far less appealing.

While there are plenty of examples of businesses who have learned to exploit our craving to affiliate and feel special, there are many more that have yet to tap the benefits of this. Speaking from my personal experience, I'd point to the auto dealership from which I've bought my last four cars. They have no idea who I am – even after I tell them. Similarly with the local wine store, where I used to buy reasonably good bottles of wine in reasonable quantities, not just for home consumption, but also as gifts for family, friends, and professional colleagues. They never noticed me, except to ring up my order. And maybe it's just me, but when was the last time your cable company made you feel special?

On a professional level, it is not unusual to find clients do not even know who their best customers are. Even if they *do* know their best customers, the recognition they extend to them may be purely transactional – for example, taking the form of a slightly higher discount tier.

What's the prescription? I can see four lessons:

- **Know who your best customers are.** Just knowing who your best customers are is a great first step. *They* know that they are among your best customers. Just telling them that you noticed them will start to score points. If your products are sold through distributors or independent dealers, you will need to find ways to gather end-customer information. If you have multiple locations, you will want to aggregate customer spending across all outlets. For example, Harrah's Entertainment credits the continued success of many of its older casinos to the fact that each can draw premium members of its Total Rewards program who may have originally signed up at any one of its dozens of locations across the country.
- **Make those customers feel valued.** There are obvious tactics – discounts, private sales, and so on – but there may also be less obvious ways to make your customers (individual and corporate) feel valued. Can you favor them with allocations, when shortages arise? Can you give them access to a special customer service line? Can you give them personalized training in how to use your product? Can you deploy a representative on-site at your key customer's production facility? Human nature being imperfect as it is, the initiatives that will be most appreciated are those that are not available to everyone. For example, when the next hard-to-find electronic gadget causes stampedes at holiday time, shouldn't Best Buy and Circuit City set aside part of their allocation for their very best customers? (Do they know who their best customers are?) On the flip side, is it any wonder that Apple's most enthusiastic customers – the ones who stood in those long lines – felt betrayed when the price of the iPhone was cut from \$599 to \$399 just a few months after its release?

- **Help customers affiliate.** Let's assume that you're already engaging the left side of your customers' brains: the calculating side. Now think about how you can engage their right/irrational/emotive side. As with any good club, one of the best ways to do this is by having members get together with each other. In consumer products, think about Nikon cameras with its one-day Nikon School programs, or BMW with its Performance Driving School. Taking advantage of today's virtual communities, it could be as simple as providing a message board on your website for your customers to post comments and photos of how your products are used. If your customers are businesses, think about ways you can bring them together through "customer advisory boards" or other peer-to-peer events where they can provide feedback to you, but also exchange ideas with other customers (and hopefully have a good time doing so). Customers will learn from other customers about why they buy from you, and will reinforce their sense of membership and community based on your products.

- **Deliver on your promises.** Of course, these ideas will accomplish little if you do not deliver on customer expectations. A big part of Ritz-Carlton's success is the company's rigorous attention to every detail that makes a stay in one of their resorts special. If you make your best customers feel like members, their expectations will naturally be even higher. That's a good thing.

In today's competitive world, delivering higher customer satisfaction is a prerequisite for long-term success. By treating your best customers like exclusive members of an elite club, they will take the time to help you correct mistakes, reward you with repeat business, and reward your shareholders with increased long term value.

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