White Paper

Managing Customer Loyalty in the Auto Industry

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About the Authors

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Defining Loyalty

Loyalty can be measured at different levels: to the model, to the make (i.e., brand) and to the manufacturer. For purposes of this white paper, loyalty is measured on a scale of 0 to 100 percent and reflects the proportion of owners who return to the market to acquire another vehicle of the same model, make or manufacturer.

Why Loyalty Matters

In these days of struggling sales and overall industry turmoil, automotive manufacturers recognize the importance of spending resources wisely and focusing on areas with bottom-line impact. One such strategic focus is customer loyalty, which should be viewed as a "must" for automakers hoping to compete. Unlike other consumer products with more frequent replacement cycles, auto buyers often don't return to market for three or four years…or even longer. Therefore, loyalty needs to be an ongoing focus to ward against customer defection.

Common wisdom and empirical evidence suggest that it costs significantly less to retain an existing customer than it does to acquire a new one, making loyalty especially critical in times when corporate marketing budgets are scrutinized. Of course, while customer retention is necessary to maintain market share and sales volumes, loyalty alone won't grow these key metrics. Therefore, especially now, OEMs need to find the proper balance for spending money and devoting resources to customer loyalty vs. customer acquisition.

To help automakers tackle the loyalty piece of the puzzle, this white paper examines ways that OEMs can manage owner loyalty. Drawing on Polk's nearly 20-year history of helping automakers create, manage and improve customer loyalty, this white paper:

- Highlights evolving changes in owner loyalty trends
- Provides strategic tips to help automakers focus on and improve loyalty
- Quantifies the importance of loyalty through linkage to financial performance

Evolving Loyalty Trends

As shown in **Figure 1**, make and corporate loyalty for the industry was fairly consistent from 2001 to 2008. Even as U.S. sales were shrinking from 17.4 million in 2001 to 13.2 million in 2008, automakers and brands were able to maintain a fairly consistent level of repeat sales with their customers. On the other hand, critics would argue that automotive manufacturers missed an opportunity to increase loyalty at a time when sales were shrinking and the retention of each customer assumed critical importance.

Some makes and corporations have been able to achieve above-average levels of loyalty. For example, owner loyalty to Toyota Motor Sales has grown as the manufacturer has increased its share of the U.S. retail market. In fact, the 2009 model year represents the first time since Polk began measuring manufacturer loyalty that Toyota has surpassed General Motors, reflecting the momentum Toyota has achieved among its customer base.

Figure 1: Industry Average Make and Corporate Loyalty

Sometimes Loyalty Can Be Bought

The month-long "Cash for Clunkers" program, which ran from late July to late August 2009, had a positive effect on industry sales. Under this program, August auto sales for the U.S. exceeded one million units, the first time monthly sales exceeded one million in over a year. However, the effect on loyalty was profoundly negative, showing that consumers can sometimes be incented by generous discounts to switch from one vehicle, brand or manufacturer to another. During this incentive program, some manufacturers saw their corporate loyalty rates fall by as much as 13 percentage points in one month. These statistics indicate that loyalty can be "bought," although some experts might argue that loyalty that can be purchased is not true loyalty.

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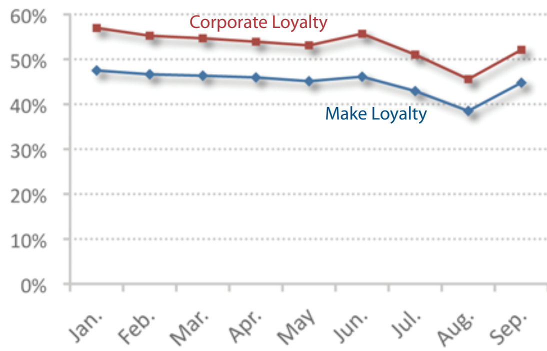
Figure 2: 2009 Monthly Make and Corporate Loyalty Rates for the Industry



Knowing that customers can be fickle, what can automakers do to manage and build owner loyalty? The next section of this white paper provides three strategic tips.

Strategic Tips for Managing and Building Owner Loyalty

Strategic Tip #1: Measure the Right Repurchase Behaviors

It's a cliché, but it's true: *you can't manage or improve what you don't measure*. The first step in building and maintaining owner loyalty is to ensure that you have an accurate approach to measuring it. Polk recommends a holistic household approach to tracking owner loyalty since, unlike other approaches, this method captures both vehicle disposal and fleet additions made by consumers.

Once a measurement system is in place, an organization should establish a baseline measurement of owner loyalty. From there, automakers have the foundation to track and trend loyalty over time and assess the impact of communications, incentives and other aspects of the owner experience on loyalty. It is important to avoid using campaign-specific metrics as a proxy for the company's overall loyalty score. While these are often more accessible due to the prevalence of marketing campaigns, these "micro-loyalty metrics" do not take a comprehensive view of all efforts exhibited by the automaker and its dealer network.

In the auto industry, customer satisfaction and loyalty are sometimes confused with each other. While customer satisfaction is an important metric, it is a means to an end, not a desired end result. Therefore, the industry should challenge dealer incentives paid for high satisfaction. After all, a customer may rate the experience as "highly satisfactory" but not go on to buy another vehicle from the manufacturer next time. Satisfaction, especially when it is self-reported, is not a reliable indicator of repurchase.

Polk has observed a positive trend in the industry: an increasing number of our clients are using dealer loyalty scorecards as a factor in determining dealer compensation. Since loyalty is a strategic and long-term goal, we feel that compensating dealership personnel based on consumer loyalty will yield far better results than paying for customer satisfaction.

Strategic Tip #2: Make Owner Loyalty a Cross-Functional Focus

As sales have dwindled for nearly every automaker, senior leadership has begun to focus on maintaining current customer assets. Manufacturers and dealers are finally starting to realize that loyalty is not just a metric that measures the success of a single marketing campaign.

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Loyalty Is Especially Important Today

With certain auto brands disappearing (e.g., Pontiac, Saturn), the imminent threat of these owners abandoning a corporate portfolio is high. Polk's research found a steady decline of corporate loyalty among Saturn owners once the decision was announced for this brand to be eliminated from GM's portfolio. This trend shows the timely importance of building and creating loyalty to the manufacturer when confronted with losses to rival brands. In the case of Saturn, owner defections were wins for Toyota and Honda.

Experience tells us that manufacturers are most successful at building and maintaining loyalty when multiple parts of the organization are focused on customer retention. Also, dealers tend to take loyalty much more seriously when it's a cross-functional corporate focus that is endorsed by senior leadership.

Beyond the traditional brand and marketing management owners, automakers should involve these parts of the organization:

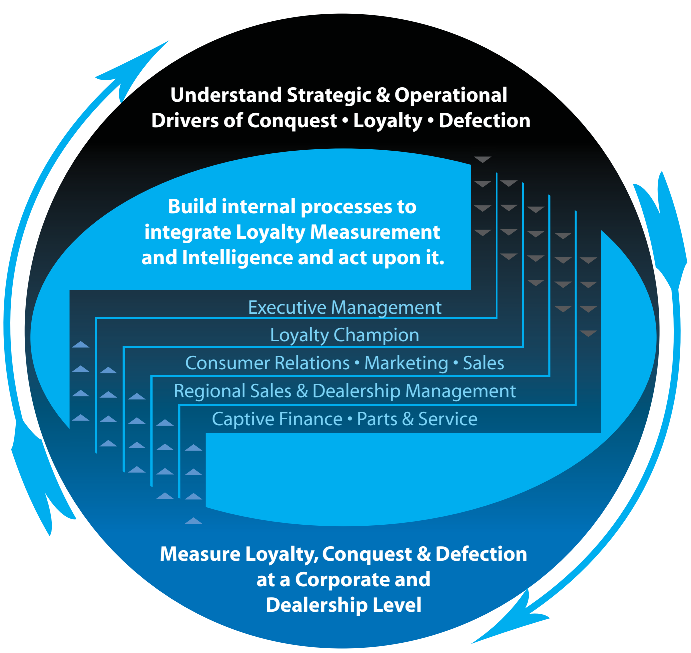
Why Dealers Should Focus on Loyalty

Less than 30 percent of owners are loyal to a dealership, based on Polk's analysis of 2008 loyalty rates across 15 brands. For a dealership, an average defection rate of 70 percent should be a great motivator to improve loyalty.

- **Captive finance** – The lease termination process is a classic example of a part of the ownership experience that can be used to improve loyalty. Many times, customers are negatively surprised near the end of their lease term when they find out that they will be monetarily penalized if they don't invest in vehicle repairs before the lease turn-in. Therefore, the lease-end process often has a negative effect on the impression that customers have of the dealership and the automaker in their final days of owning a product.

  Polk's client engagements identified an opportunity for front-line call center staff to more proactively talk to customers and make sure that requirements for receiving their lease deposit are understood earlier in the process. This investment in communication and training leads to a more favorable impression of the lease turn-in process, and can result in higher repurchase of an automaker's product.

Figure 3: Loyalty as a Cross-Functional Focus



- **Certified pre-owned/certified used** – In most cases, the primary objective of CPO operations is to convert used buyers into new vehicle buyers. Therefore, OEMs should track the experience of buying a CPO unit to understand what drives loyalty, and what will result in an upsell to a new vehicle.
- **Dealer training/regional field staff** – As mentioned earlier, manufacturer field staff are increasingly relying on dealer loyalty scorecards to help coach dealers on how to keep current customers. A customer's experience with any brand or specific vehicle starts with a dealership; therefore, improvement objectives should be established at the retail level. Based on Polk's 20-year experience in designing and delivering dealer loyalty programs, we've observed that dealer buy-in into these programs is critical. Unless dealers support the loyalty program, field and corporate personnel will have a very tough time getting scores and improvement plans embraced by the dealer management.
- **Parts & Service (P&S)** – Polk continues to see significant gaps in the strategic collaboration between staff managing P&S and new vehicle sales operations. This is a huge mistake, as good service can drive new sales and contribute to owner loyalty. In one case for a Domestic OEM, the loyalty to the company was twice as high among customers having service done by the franchised dealer network than for owners not visiting the dealer network for customer pay services.

  In prior client discussions, Polk was surprised to hear that some in the industry don't agree that sales and service business unit objectives need to be aligned and that there seems to be a lack of understanding of the fixed operations factors that drive new vehicle sales.

  Also, analysis of repair order data, which appears to be underutilized based on regular discussions with Polk's client base, reveals that service incentives may be a worthwhile investment in repurchase loyalty. For one import automaker, every dollar that the dealer or manufacturer spent on service incentives had the potential to increase customer loyalty by 0.45 percentage points, which equates to $1,575,000 in additional profits on 538 extra new vehicles sold.[1]

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[1] *"Mining a 'Hidden Asset' to Increase Brand Loyalty and Sales, Polk White Paper, August 2009*

About the Key Driver Study

The study was conducted in the Spring of 2009 on a representative sample of consumers who had purchased a new vehicle during the previous three years. The results of the study have been quantified from data collected from 550 respondents. Data have been weighted by demographics (age, ethnicity, gender and household income) and brand market share.

- **Product Planning/Product Development** – What does a major launch, product refresh or product enhancement have to do with owner loyalty? Answers to this question should provide direct input to product planners who support goals held by vehicle line executives or other brand managers. A recent customer analysis by Polk based on 28 different models showed that, on average, model loyalty increased by 24 percent after a major product redesign. And, the positive impact on loyalty lasts approximately 15 months after the quarter during which the redesign was launched. These results show that product development or product planners should have input to cross-functional loyalty teams so they understand which product attributes may influence repeat sales.

Strategic Tip #3: Understand (and Act on) Key Drivers of Loyalty

Understanding that customer loyalty is important (and organizing staff around this objective) is the first step; knowing what to do to build and maintain it is the critical second step. A number of factors, including product attributes, customer relations and financial issues, affect customer loyalty. Which of these drivers of repurchase are most important to customers? Where should OEMs focus their efforts to improve customer loyalty and stop defection to the competition?

In early 2009, Polk conducted an analysis to determine how customer perception with a number of product-related, customer relations and monetary factors shown in **Figure 4** affects repurchase intent, a proxy for loyalty. We looked at which factors were most important in driving loyalty for automotive consumers overall, as well as for two sub-groups: luxury vs. non-luxury vehicle owners and vehicle owners by brand origin (Asian, Domestic and European).

To quantify the impact of each factor on customer loyalty, we looked at how an increase of 5 percent in favorable customer perception of a specific factor, e.g., fuel economy, would positively affect repurchase intent.

The findings of this study provide strategic input for sales, marketing and communication strategies geared toward creating and maintaining loyalty based on what is most important to specific customer groups.

Product Quality, Fuel Economy and the Customer Experience Are Consumer "Hot Buttons"

Polk's analysis showed that the number one driver of consumer repurchase is perception of product quality. A 5 percent improvement in customer perception of the vehicle's quality would result in a 1 percentage point increase in repurchase intent, the highest of any measured loyalty driver.

Consumers' perception of fuel economy is almost as important as how they feel about product quality in terms of driving repurchase. These findings show that messages about product quality and fuel economy should be part of communication to existing vehicle owners before they are in-market to buy their next car or truck. An increasing number of product messages have centered on fuel economy and efficiency, so our recent findings likely reflect the heightened awareness, and arguably "trained behavior", of new vehicle shoppers to evaluate this attribute.

Loyalty is not influenced by communication and marketing alone. The customer experience is also a key driver, according to Polk's research. Improving the customer experience – beginning with the sales process and continuing throughout the customer relationship – will go a long way toward building loyalty.

Monetary factors are less important to customer loyalty than many other attributes, indicating that focus on cost savings and deals is not going to lead to higher loyalty of existing customers.

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Figure 4: Factors Affecting Loyalty

Product-Related	Customer Relations	Financial
• Product Quality	• Sales Process	• Purchase Price
• Quality of Workmanship	• Communications	• Availability of Incentives
• Fuel Economy	• Maintenance Service at Dealership (where applicable)	• Finance Options
• Safety		• Monthly Payment (where applicable)
• Comfort & Convenience		• Cost of Ownership (not including monthly payment)
• Performance		
• Ride & Handling		

Figure 5 below shows the relative impact of all measured drivers on repurchase intent, a proxy for loyalty.

Drivers of Loyalty for Owners of Luxury and Non-Luxury Vehicles

Manufacturers that sell both luxury and non-luxury vehicles need to understand the differences in what's important to each group of customers. Taking a loyalty strategy that works with non-luxury owners will probably not work with luxury owners based on the results of our analysis. For instance, a company like Toyota may not be able to rely on a "one size fits all" approach and transfer knowledge about what drives loyalty to the Lexus brand to the mainstream Toyota brand.

Luxury owners care most about the performance of their vehicles, which makes sense since several luxury vehicles tend to sell based on promises of performance (e.g., for over 30 years, BMW used "The Ultimate Driving Machine" as its core tagline). A 5 percent increase in favorable customer perception of vehicle performance would cause repurchase intent to go up by 2.55 percentage points. Perception of product quality is another key driver of loyalty for luxury vehicle owners, who expect high quality for their investment in a higher-end car or truck. These findings show that communication to existing luxury vehicle owners (and to non-luxury owners who might be ready to move up to a luxury vehicle) should include messages about performance and product quality.

Auto manufacturers and dealerships should pay special attention to the sales process for owners of luxury vehicles as it is a significant driver of re-purchase. Given the relatively higher price-points commanded by premium or luxury brands, these brands need to cater to their unique set of buyers with customer service that's far above average.

Polk has consistently seen that luxury owners have the highest level of loyalty among vehicle segments, regardless of model, brand or corporation. While the average owner loyalty for any given vehicle segment is 37 to 38 percent, 47 percent of returning luxury owners stay with the luxury vehicle segment. In one way, they demonstrate an "I've made it and I'm not moving down" attitude.

Brands Hoping to Conquest Owners Need to Understand Loyalty Drivers

In the current competitive market, sometimes building loyalty of existing owners isn't enough. A concurrent area of focus is conquesting. Polk's analysis provides some insights that illustrate how the factors that contribute to repurchase vary by consumer group as defined by the brand origin of their vehicle: Domestic, Asian and European. Therefore, Domestic OEMs wanting to conquest current owners of Asian brands, for example, would be wise to understand what is most important to this consumer segment so that they can target them appropriately.

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Figure 5: Impact of Measured Loyalty Drivers

Percentage Point Improvement in Repurchase Likelihood for a 5% Improvement of Customer Experience with these Drivers

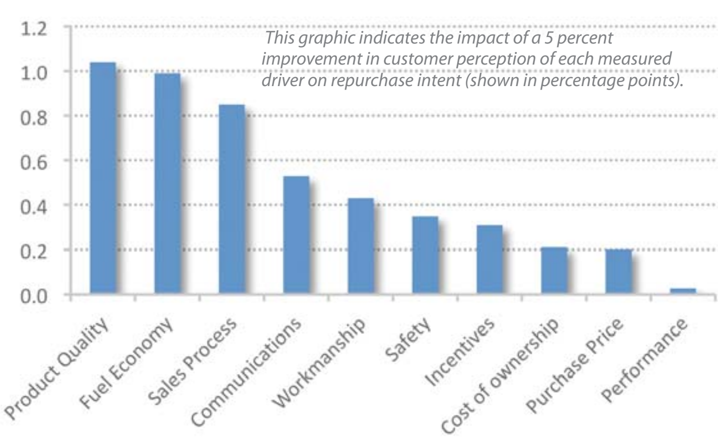
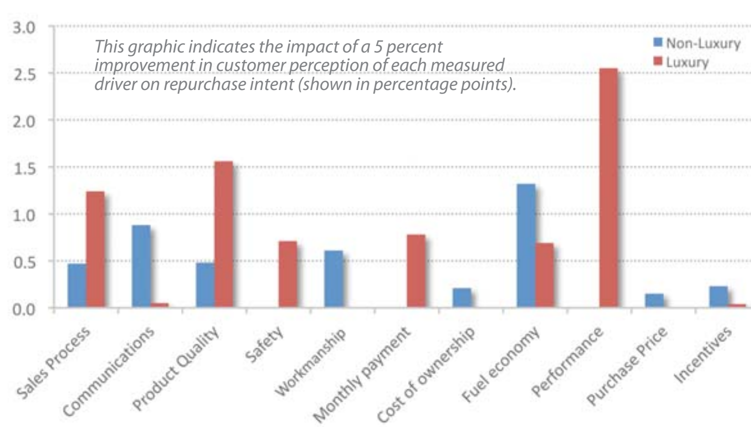


Figure 6: Key Drivers of Loyalty for Luxury and Non-Luxury Vehicle Owners

Percentage Point Improvement in Repurchase Likelihood for a 5% Improvement of Customer Experience with these Drivers for Luxury and Non-Luxury Owners



- **Current owners of Asian brands:** As compared to owners of Domestic and European brands, owners of Asian brands are much more concerned with fuel economy. Therefore, non-Asian OEMs wanting to win over these customers should emphasize this attribute. Interestingly, other factors linked to value are not that important to drivers of Asian brands. Incentives and the monthly payment are two drivers with negligible impact on loyalty.

  Additionally for owners of Asian brands, the customer relationship is of critical importance, as evidenced by the importance that vehicle owners place on both the sales process and ongoing communications.

- **Current owners of Domestic brands:** Fuel economy and product quality are the primary driver of loyalty for owners of Domestic brands. Another product-related quality with a high impact on loyalty is workmanship.

  Incentives are a primary driver of repurchase intent, something not seen with either owners of Asian or European brands. Owners of Domestic brands may have become conditioned to generous incentives because they have been so commonly used by the American manufacturers. One implication is that other brands hoping to conquest current owners of Domestic brands will need to emphasize pricing and value in order to make these buyers feel they are receiving a great deal.

- **Current owners of European brands:** Owners of European brands make their repurchase decision based on different factors than owners of either Asian or Domestic vehicles. The key driver for this group by a wide margin is product quality. Workmanship, a closely related attribute, is the second more impactful driver of repurchase intent.

  While the purchase price of the vehicle is more important to drivers of European brands than to owners of either Asian or Domestic ones, other monetary factors do not influence loyalty. Improvements to fuel economy and the monthly payment would not influence loyalty for these owners.

Why Loyalty Matters: the Financial Impact

For too long, loyalty has been viewed as a "nice to have," not a critical business need. Today, automakers are starting to realize that loyal customers are their most important strategic asset due to the impact of loyalty on the bottom line. Some of Polk's recent work with smaller-sized OEMs shows that a one-point increase in loyalty (which is a very ambitious goal to increase over the course of a one-year period) can translate to over $2 million in profits for that firm.

Another way of looking at the financial benefits of creating loyalty is to assess the relationship between market share and loyalty. Polk assessed the relationship between brand loyalty and a brand's market share for 2008 (a year we chose to get a sense of how the market behaved prior to the atypical automotive landscape seen in 2009).

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Figure 7: Key Drivers of Loyalty by Vehicle Brand Origin

This graphic indicates the impact of a 5 percent improvement in customer perception of each measured driver on repurchase intent (shown in percentage points).

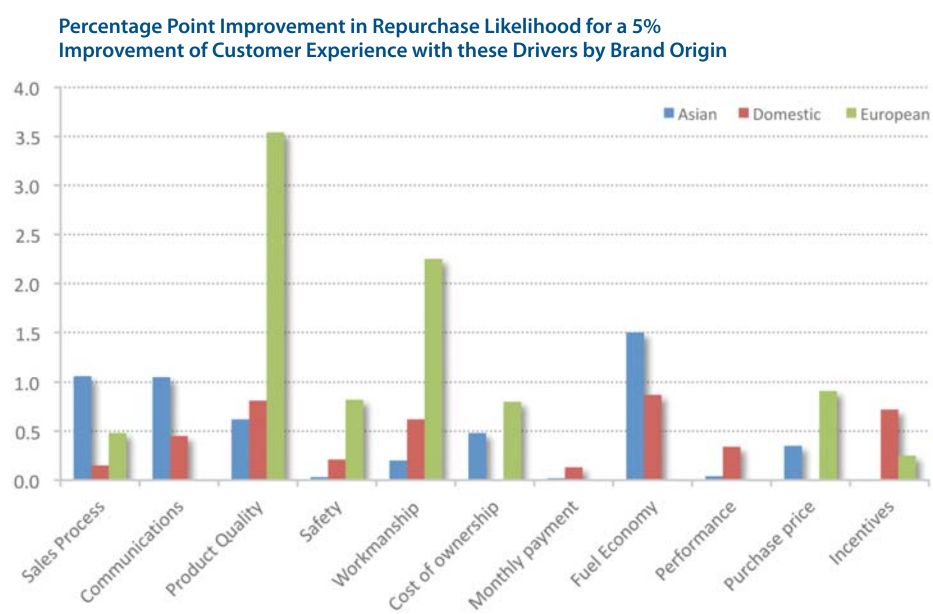

Figure 8: Relationship between Brand Loyalty and Market Share (2008)

Note: Market shares are based on Polk's personal retail vehicle registrations.

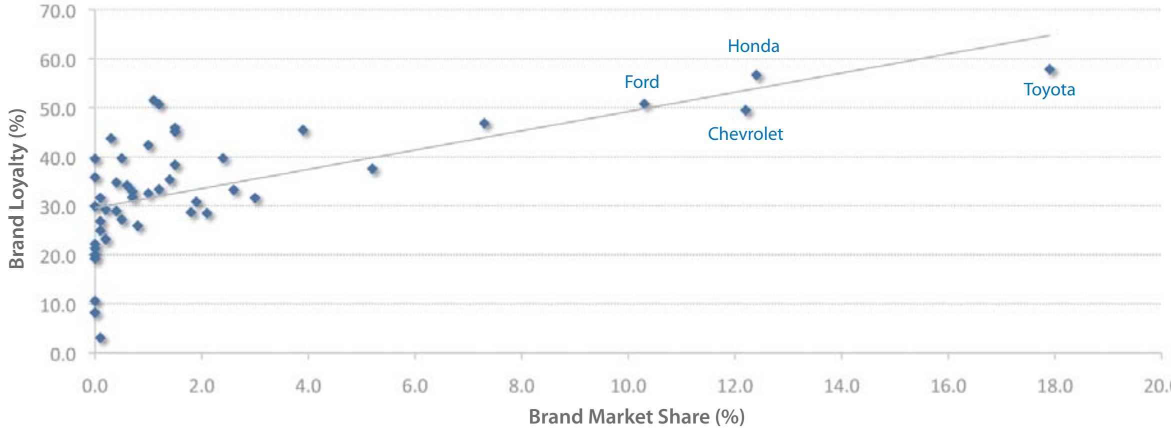

Figure 8 shows that there is a generally positive relationship between loyalty and brand market share. While it is not a "one to one" relationship for every brand, this figure tells us that market share *leadership* has something to do with a firm's owner loyalty. The few outliers on the "edge" of the line in Figure 8 imply that market share dominance is tied to brand loyalty. Market share leader Toyota held the top loyalty spot, while Honda was number two in both areas. These two brands have seen growing sales (up until 2009 which was a tough year for all brands) and both have certainly benefitted from momentum built among past customers.

Hyundai, which was 7th in market share and 9th in loyalty in 2008, is another example of the close ties between loyalty and market share. Possessing the third highest personal retail market share in 2008, Chevrolet also had the 6th highest brand loyalty in the U.S.

There's some debate in the industry about whether market share leads to loyalty, or whether the inverse is true. Regardless, the financial impact of building a loyal customer base cannot be ignored by automakers hoping to compete. "Profitable market share" is a commonly used term by auto executives to convey some of their corporate goals. Being profitable requires efficiency and investments in keeping current owners is one way to fuel such efficiency.

About R. L. Polk & Co.

R. L. Polk & Co. is the premier provider of automotive information and marketing solutions. Polk collects and interprets global data, and provides extensive automotive business expertise to help customers understand their market position, identify trends, build brand loyalty, conquest new business and gain a competitive advantage. Polk helps automotive manufacturers and dealers, automotive aftermarket companies, finance and insurance companies, advertising agencies, media companies, consulting organizations, government agencies and market research firms make good business decisions. A privately held global firm, Polk is based in Southfield, Michigan with operations in Australia, Canada, China, France, Germany, Japan, Spain, the United Kingdom and the United States. For more information, please visit **www.polk.com**.