# Loyalty 2.0

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***Loyalty.***

The big—if not the biggest—marketing buzzword. There is no shortage of articles and opinions on this topic. In fact, googling the term "loyalty programs" yields about 1.6 million hits; googling "credit card loyalty programs" yields about 1.1 million.

What I won't do in this paper is rehash a lot of what readers probably already know about this topic. This is a very well-trodden area in the payments space especially, and no shortage of data exists. What I will do is to put things in a different context and even challenge some of what might be regarded as the "universal truths" about loyalty. Along the way, I will also offer a few thoughts on where we might be headed as it relates to payment card loyalty programs, specifically.

## I. The Lure of Loyalty

The lure of loyalty programs isn't hard to understand. By design, they offer a way to capture:

- Greater share of wallet
- Opportunities to cross and up sell other services
- Important information about customer behavior and preferences

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In other words, they are a tool for retaining one's "best" customers.

We've all been well-schooled to respect the economics of customer retention. A couple of renowned Harvard Business School professors quantified the impact of customer retention in a landmark Harvard Business School article published in the early 1990s.[1] Their research proved that a company that could retain **5 percent more** of its customers each year could almost double its profits. And, over five years, a company that managed to retain only 70 percent of its customers each year would lose 2 to 3 times as many customers as one that could retain 90 percent.

Loyalty programs, therefore, are regarded as the panacea for helping to find and keep profitable customers.

Or are they?

## A. The Current State of Loyalty in the U.S.

Let's take a look at the state of loyalty today—at least here in the United States.

- **Loyalty is big business**. At the end of 2006, it clocked in as a $10 billion industry overall with about 1.3 billion members—four times the total U.S. population—across 2250 separate loyalty programs.[2]
- **Consumers are schizophrenic**. The average U.S. household belongs to approximately 12 loyalty programs—yet active participation across programs is only 39.5 percent.[3] Further, forty-one percent of customers surveyed say they rarely bother to use their reward cards. This makes the CFOs smile, but perhaps is a symptom of a deeper problem.

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[1] Peter Clark, "Running and Setting up a Loyalty Scheme—What to Find Out, and How," Loyalty Library website, *at* http://www.loyaltylibrary.com/?pid=artcileDetail&columnID=&11&articleID-171 (visited May 9, 2007).
[2] Barry Berman, "Developing an Effective Customer Loyalty Program," *California Management Review*, Vol. 49, No. 1 (Fall 2006). Kelly Hlavinka and Rick Ferguson, "Quo Vadis: Sizing Up The U.S. Loyalty Marketing Industry" (2007).
[3] Kelly Hlavinka and Rick Ferguson, "Quo Vadis: Sizing Up The U.S. Loyalty Marketing Industry" (2007).

- **Redemption is low.** As a corollary to that point, reward redemption among the top nine airlines rose last year but only 8 percent of all loyal airline customers redeemed miles for flight—a pretty low redemption rate for the primary loyalty product in that industry.[4]
- **Loyalty's expensive**. Sixty percent of most marketing budgets are allocated toward devising and promoting loyalty schemes.

Looking at these statistics, a few questions naturally come to mind.

1. Are loyalty programs creating loyal customers or rewarding everyone?
2. What customers are these programs trying to attract and retain?
3. Who is actually redeeming rewards—loyal customers or price sensitive customers who may be only loyal to the price discount being offered?
4. Is there evidence to support that loyalty programs aren't simply an added layer of cost to incent people who would otherwise use the product or service without any such inducement?
5. If the mainstay of marketing is customer segmentation, why do most loyalty programs treat all customers the same and make it easy for everyone to join?

## B. Loyalty Defined

Before trying to answer any of these questions, let's step back for a minute and define loyalty. Loyalty is about making a commitment—to a person to a product—through thick and thin—no matter what. If that is the case, then loyalty programs should quite naturally be designed to create faithful customers who stay with a brand through thick and thin. If a company is really

[4] Jay Boehmer, "Card Use Energizes Reward Accrual," Business Travel News Online website, Sep. 25, 2006, *available at* http://www.btnonline.com/businesstravelnews/search/article_display.jsp?vnu_content_id=1003155616 (visited 9 May 2007).

skillful, the “holy grail” of loyalty programs is creating advocates who become evangelists for that product and brand, and help to recruit other faithful customers.

It’s also clear that loyalty programs are a mainstay in the payment world. But are they really increasing loyalty and keeping the right (i.e., most profitable) customers loyal? Perhaps the most interesting question, that is also unique to the payment industry, is to whom the loyalty is being directed—so, who pays and who really benefits from existing loyalty schemes?

In the sections that follow, this paper sheds some light on these questions by examining the impact of some of the most powerful loyalty programs both in and outside of the payment industry. This paper will also draw the distinction between programs that create real loyalty and those that simply reward frequent usage through a scheme that is essentially price discounting in disguise.

## II. Do Loyalty Programs Really Increase Loyalty?

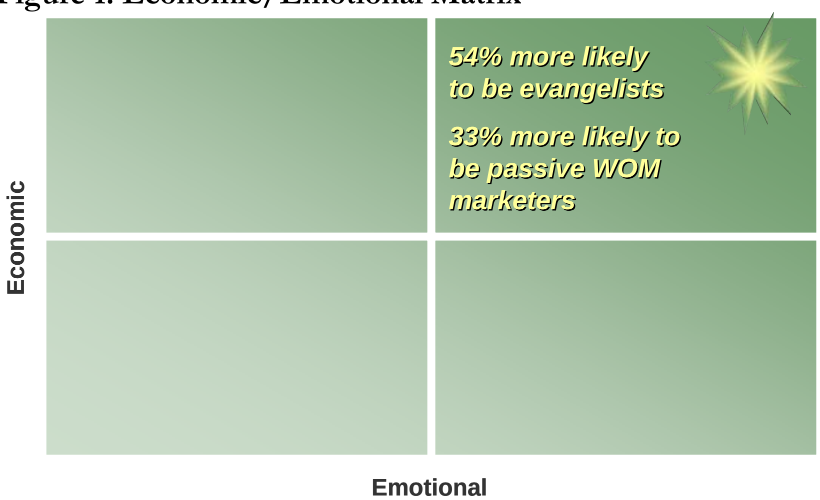
The goal of a loyalty program—universally—is to create barriers to switching—which can be economical (e.g., I miss out on getting cash back or the ability to fly the family to Europe for the summer) or psychological (e.g., I like being known as an American Express member since 1992), but are ultimately designed to enhance the customer’s trust and commitment to an organization.

The most effective loyalty programs create loyalty on two levels:

- ***Economic***: The “what I do” which is often driven by an economic incentive.
- ***Emotional***: The “why I do what I do”—which is rooted in emotion and can sometimes be completely irrational.

Why are these two attributes operating in tandem so important? Simply put, if one creates both a rational and irrational attachment to a brand—any brand—one creates very strong barriers to switching which comes with an added bonus. Remember the “holy grail” of loyalty programs mentioned earlier? Creating loyalty on these two levels—economic and emotional—produces evangelists. And evangelists are 54 percent more likely to be active word of mouth marketers (e.g., proactively talk about your brand) and 33 percent more likely to be passive word of mouth marketers (e.g., talk about you when people ask for an opinion about a product or a service[5]). **Figure 1** illustrates where an effective loyalty program falls relative to its economic and emotional impact.

**Figure 1. Economic/Emotional Matrix**




## A. The Harley-Davidson Mystique

Harley Davidson has created a loyal following that is the envy of many a marketer. Their loyalty story - HOG (Harley Owners Group) is interesting on a number of levels. HOG has more than one million members that span a variety of social and economic spectra. And talk about loyal—roughly 75 percent of Harvey Davidson customers make repeat purchases. A fair number of them also adorn their bodies with Harley Davidson hats, t-shirts, and of course, tattoos.

The Harley Davidson rewards program is simple and less about a reward and more about the prestige of being a HOG. Mileage ridden on a Harley can be redeemed for prizes, but the prizes are seemingly unimpressive (e.g., 10,000 miles ridden gets a pin and a patch). The rewards are really

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[5] Blanca Garcia Gomez, Ana Gutierrez Arranz and Jesus Gutierrez Cillan, "The role of loyalty programs in behavorial and affective loyalty," *Journal of Consumer Marketing*, Vol. 23, No. 7 (2006).

secondary to the experience and pride associated with owning and riding a Harley—showing off the pins and patches send a visible signal that one is really the "HOG's hog," so to speak.

### B. Wal-Mart's "No Loyalty" Program

As unimpressive as pins and patches may be, it is a lot more than Wal-Mart offers—that is no rewards program at all.

Wal-Mart's source of loyalty is everyday low pricing (ELP). Each week, 120 million people visit a Wal-Mart store. Sixty-six percent of their sales come from those who make 50 to 60 trips to a Wal-Mart store each year and who have an annual household income of less than $50,000.[6] Wal-Mart's promise of low prices and good value seems enough—at least for now—to keep people coming back without any further prodding. In a press release issued in mid-May 2007, Wal-Mart re-emphasized its focus on keeping prices low as a way to retain its loyal customer base.

But is ELP a loyalty program? I would say yes—since it is obviously creating loyal customers. Is it a rewards program? Here I would say no. ELP is Wal-Mart's value proposition, their business model, and how they differentiate themselves from competitors. This same observation can be made for the ten most powerful brands in the world as illustrated in **Figure 2**.

**Figure 2. Top 10 Brands Overall in North America**

| Brand | Rewards Program |
|---|---|
| Google | No |
| General Electric | No |
| Microsoft | No |
| Coca-Cola | Yes |
| Marlboro | No |
| Wal-Mart | No |
| Citigroup | Yes |
| IBM | No |
| McDonald's | No |
| Bank of America | No |

Source: 2007 Brandx Survey of Top Brands.

[6] Information per Walmartfacts.com (visited 9 May 2007).

It's fascinating that the results of a recent survey of powerful brands by Brandx includes only two in the top ten that use rewards to incent loyalty in one facet of its business. The large majority ranging from Google to Microsoft to IBM rely on the experience they create for their customers and the value their customers derive from the product to create emotional and economic attachment to a brand.

### C. Cards and Brand Loyalty

So, how are card loyalty programs doing at delivering loyal customers? In many ways, it is a challenge to separate the hype from the reality, but let's look at a few real data points.

Visa's credit card commitment survey in 2004 delivered some less than encouraging words on the topic. It concluded that consumers have less commitment to their credit card brand then to their brand of car insurance, potato chips, and household cleaners.[7] One reason for this result could be the abundance of card programs available to consumers and the relative ease at which cards can be had. Over half of U.S. consumers have at least two credit cards and 14 percent carry more than 10.[8]

It's easy to see why cardholders bounce back and forth between card brands. There's no penalty for having a card that is not used and consumers are bombarded with solicitations for new cards all the time. At least in the case of general purpose payment cards, they are widely accepted and there are, by and large, no barriers to using one card versus another. It is also relatively easy to switch back and forth. Ease and convenience, as a rule, drive card usage, and a recent survey of 4000 Generation X and Y consumers suggest that rewards are important but not the determining factor for use at the point of sale.[9]

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[7] Visa Finds Consumers Favor Cleaners Over Cards, *Cardline*, June 18, 2004.
[8] Experian Consumer Direct, National Score Index, March 2007.
[9] Market Platform Dynamics Generation XY Survey. Internet-based survey administered quarterly (March, June, September and December) in 2006. 4,000 people between the ages of 16 and 43 surveyed in total.

Then there's the issue of customer malaise. A recent study reports that 19 percent of customers enrolled in a credit card rewards program say they usually forget about the loyalty program points they have earned—which naturally makes the CFOs smile.[10] Of those who did not participate in loyalty programs, 47 percent said they had no interest in doing so.

Customers even seem a bit dubious about the impact of loyalty programs. Only 22 percent find retail loyalty programs effective in creating loyalty. When frequent fliers are asked about such programs, they're even more skeptical. More than 90 percent say that loyalty programs are not serving loyal customers but instead are merely a marketing tool.[11] Given that most of those who rack up points and redeem rewards are themselves infrequent travelers using airline co-branded cards for spending, they may have a very legitimate point.

Common customer complaints about loyalty programs range from a lack of supply of advertised rewards (e.g., airlines only allocating 5 percent of their inventory to the 254 million members enrolled in frequent flyer programs), to difficulty in generating sufficient points (e.g., high reward thresholds combined with points that expire on a short schedule), to promised rewards having little value (e.g., spending $30,000 to get a so-called free barbeque grill).

Point-driven reward schemes are in some ways set up to make it hard to redeem rewards—which of course helps keep program costs down overall, but also by default attracts a price-sensitive customer group. Along the way, and perhaps not surprisingly, these programs have created consumers who have become somewhat jaded by the whole rewards game.

We can also observe that there is unfortunately not a lot of differentiation among card loyalty programs (see **Figure 4**). Card programs, with some exceptions, have become highly

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[10] Michael T. Capizzi, "Loyalty Trends for the 21st Century," *available at* http://www.powercard.com/misc/press/colloquy1/LoyaltyTrends.htm (visited 9 May 2007).
[11] Andrew Watterson, Scot Hornick, and Raj Lalsare, "The New Economics of Loyalty Programs," *Mercer Management Journal* (2006).

commoditized which is a vulnerable position to occupy in any market. Loyalty to a price-driven, non-differentiated service puts brands in a very tenuous state.

**Figure 4. A Commoditized Product**

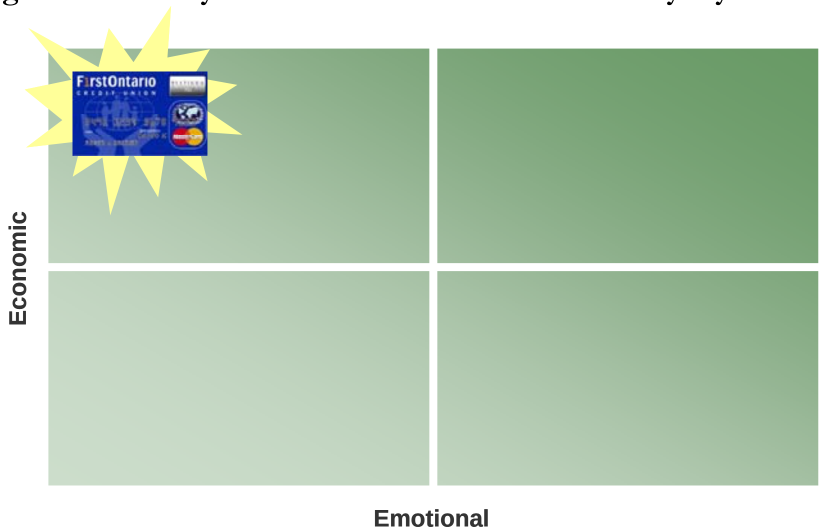
| Brand | Reward Program Details |
|---|---|
| Bank of America | 1 point for $1 spent |
| JP Morgan Chase | 1 point for $1 spent |
| Citigroup | 1 point for $1 spent |
| American Express | 1 point for $1 spent |
| Capital One | 1 point for $1 spent |
| Discover | 1 point for $1 spent |
| HSBC | 1 point for $1 spent |
| Washington Mutual | n/a |
| Wells Fargo | 1 point for $1 spent |
| U.S. Bancorp | 1 point for $1 spent |

Source: Issuer ranking according to Nilson. Program detilas per company websites.

Given the lack of differentiation, low redemption rates, and increasing dissatisfaction with rewards programs, is it possible that card loyalty marketers are operating in an environment where programs essentially cancel each other out given their relative similarity? And, one where multiple loyalty cardholders are less likely to stay loyal to any one card since they obtain a relatively equal level of usefulness from different cards all offering more or less the same loyalty benefit?

Perhaps we are. If we chart payment cards on our economic/emotional matrix (see **Figure 5**), card brands would seem to rate high on the economic axis (i.e., I use cards a lot), but fall short on the emotional axis (i.e., I am invested in the bank that issued my card and therefore use it most of the time).

**Figure 5. The Payment Card's Performance as a Loyalty Driver**




So, where does that leave us in the card space? I contend that loyalty based only on usage is fragile especially in the card business where some repeat users are really price sensitive customers who are less likely to remain loyal if a better deal comes along. The goal of card loyalty programs must be to create barriers to switching by creating economic and emotional attachments to the brand. This can be accomplished by creating situations in which rewards have relevance and meaning because they more appropriately align with cardholders' preferences or lifecycle. Examples could range from accruing rewards in order to contribute to charity, paying down mortgages, or funding a savings account. They could include diversified programs like American Express Membership Rewards program or make it possible to get front row tickets at the New York Knicks game as Visa is doing with its Signature card or give advance notice of art auctions as MasterCard is doing with its Unique Experiences program.

One last thought on cards and loyalty: It is interesting to observe the seemingly inverse relationship between the growth of debit cards and rewards. From 2000 to 2005, purchase transactions on debit cards jumped from 34 to 52 percent—and are expected to account for 56 percent of all purchase transactions by 2010.[12] Prepaid cards performed just as well—the total spend on all prepaid products, both open and closed, in 2005 was $165.02 billion and is expected to grow nearly 10 percent per annum to reach $236 billion by 2009.[13]

This growth occurred by and large without any reward programs to stimulate usage. The growth in this product segment came strictly as a result of the customer's demonstrated preference for these products, the product design itself (e.g., card tied to DDA accounts) and the value it delivered to the consumer. The smattering of debit card reward programs that we are starting to see pop up now are not designed to change behavior (e.g., using a debit card versus a credit card), but by and large an attempt to flip customers to a signature debit product for which a higher interchange fee can be levied.

## III. Do Loyalty Programs Help to Retain the "Right" Customers?

To understand whether loyalty programs help retain the most profitable customers, let's consider a few examples and examine the relationship between loyalty programs and profitable customers.

### A. Neiman Marcus

In 1984, Neiman Marcus introduced its InCircle program as a special recognition program offering an array of gifts to its most valued and loyal customers. The program offers reward points for every dollar charged on the Neiman Marcus card. There are three tiers of membership: InCircle, Platinum, and Chairman's Circle. There are "exclusive" events staged in the stores where members shop and receive double points and once customers reach the Platinum and Chairman's circle status, double points are accrued with every purchase.

[12] The Nilson Report, No. 865, September 2006.
[13] "Prepaid Market Forecasts 2006-2009," Mercator Advisory Group, December 2006.

InCircle members also get a first look at new shipments (translation: those items not yet on sale), which helps further boost Neiman's margins since most make a purchase or two (or three) at such events. Other perks include free parking passes, free gift wrapping, free shipping, periodic gifts and samples, etc. Program rewards must be redeemed at the end of every year or else they disappear. Redemption options range from exotic prizes, including cars and luxury vacations. Perhaps the most popular is the cash back gift card which is distributed to customers in early February—just in time for spring shopping and just after all of the winter sale items have left the store. Not surprisingly this leads to more in-store purchasing of high-margin items, more points, and the circle, so to speak, continues.

With respect to Neiman Marcus' program, the academic literature suggests that programs like these simply reward the behavior of people who would shop at Neiman Marcus anyway. There is a lot of research to suggest that consumers join clubs that reward their established behavior and patterns of shopping. But, consider Neiman's results for this program:[14]

- The average InCircle member spends about $12,000 per year in the store. (That's about 20 times what a non-InCircle customer spends.)
- There are about 100,000 of those customers who visit the store an average of 18 times a year. (Compare that with the non InCircle customer who visits only 3.4 times a year.)
- InCircle members account for about 50 percent of Neiman's overall revenue which is stunning when one considers that these 100,000 customers account for less than 20 percent of their total number of shoppers.

[14] The Neiman Marcus Group, Banc of America Securities 2006 Credit Conference, December 4, 2006, Orlando, Florida" (2006).

Judging from these statistics, InCircle not only rewards people for shopping, but seems to suggest that members shop at Neiman Marcus more frequently than they do other retailers.

### B. S&H Greenstamps

Not all loyalty programs create similar outcomes. Take the case of the granddaddy of all loyalty programs: S&H Greenstamps.

The S&H Greenstamps program was founded in 1896 by Thomas Sperry and Shelly Hutchinson to inspire loyalty at grocery stores. Stamps were given to shoppers based on the amount of groceries purchased. Those stamps were pasted into books and redeemed at centers that carried a variety of merchandise. Soon, Greenstamps' programs were everywhere—in the 1960s at its peak, nearly 80% of US households collected these stamps.[15]

Things were relatively static until one chain announced that it would offer double stamps. Naturally, shoppers—who were now a lot more mobile and could more easily visit the store across town - flocked there to get their double stamps. Not to be outdone, yet another store offered triple stamps, and then another, quadruple stamps. The end result was a complete devaluation of the stamp itself and, in turn, the customer's relationship with the grocery store. The loyalty that was being built was to the stamp and not to the merchant. After that experience, the program languished for a while. Greenstamps—now Greenpoints—was acquired not long ago by the biometric payment solution provider, PayByTouch.

### C. Lessons from Neiman and Greenstamps

We've all heard the stats as reported by bank marketers on the relative value of rewards card customers. Today, 50 percent of all cards issued are rewards cards. That stat, coupled with the rise in

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[15] Wikipedia.org, "Green Shield Stamps" entry, *at* http://en.wikipedia.org/wiki/Green_Shield_Stamps (visited 9 May 2007).

the use of cards in general, means that these cards generate lots of usage. Therefore, lots of interchange revenue for the issuing bank—and interest charges too if balances are revolved.

But as many rewards programs are now designed, can we be sure that we are retaining the most profitable customers? Those who go to the trouble of accumulating, tracking, and redeeming rewards are probably a more price sensitive group overall—but perhaps not the most profitable customer set. More than likely, they are the 39 percent of the market that actually redeems awards. Those who avail themselves of loyalty programs more frequently are more costly to serve—since their expectations tend to be higher, they require more customer service and are the first to leave if a better offer comes along. Are we spending a lot of money to serve fickle customers?

Also, even though transaction volumes are high on rewards cards, many loyalty experts concede that it is not clear that rewards programs attract and retain members who weren't already customers. Moreover, customers often join all available programs that correlate to their existing behavior in order to take advantage of their benefits—whether it's a card-based rewards program or a retailer frequent purchase program.

Are we needlessly adding to the cost of customer acquisition and retention by spending a lot of money to cater to customers that would be customers regardless of the existence of a reward program?

Clearly loyalty programs are a mature business. At its best, they've simply become the cost of doing business. Perhaps at its worst, they are increasing the cost of serving a price sensitive and perhaps even non-loyal customer group.

The silver bullet here is data.

Using rewards programs to generate data to uncover the most profitable customer segments, then tailoring programs that create a strong economic and emotional connection is the path to loyalty 2.0.

Customers agree. Seventy-three percent of customers who are enrolled in rewards programs say that they hope that data generated as a result of their participation in rewards programs are used to develop a better program for them.[16] They are willing to give information—and in some cases lots of it—in return for a better experience.

### D. Harrah's

Harrah's is a good role model for using customer information to retain profitable customers. Its Total Rewards program, established in 1997, rewards customers on three dimensions: frequency of visit, length of play, and type of game played.

Upon visiting the casino, a customer's rewards card is placed into a slot machine or given to a floor supervisor while the customer plays. Reward credits are racked up during play and redeemed for drinks, hotel rooms, shows, etc—instant gratification while still in the casino. Customers are then segmented based on the level of rewards accrued and special offers are extended to them to entice them to return. Reward credits expire within 6 months of the last activity on the account which adds a further incentive to both rack up the points and use them—which of course means more trips to the casino.

There are more than 40 million members in the Total Rewards Program who now spend more of their gaming budget with Harrah's than the competition. It seems that Harrah's has used data to crack the code on attracting and retaining loyal and profitable customers.

## IV. Whose Loyalty Is It Anyway?

In an earlier section I mentioned that the raison d'etre for loyalty programs is to create a strong connection to a brand. But in the case of the payment card industry, whose brand **is** the

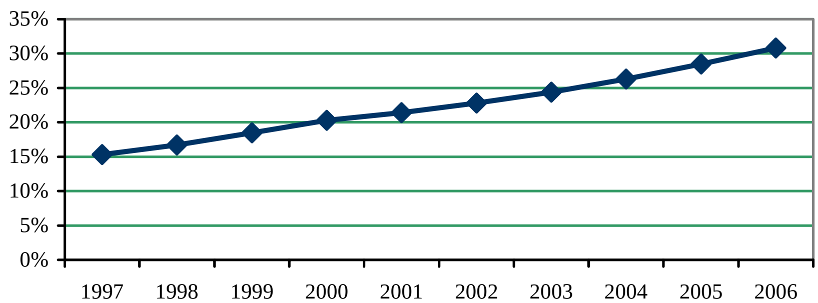
[16] Deloitte Financial Services, "Reinvent or Fall Behind: Breathing New Life into Customer Rewards Programs" (2006).

consumer connecting with and who is financing that loyalty? The answer to this question surfaces one of the most hotly contested aspects of the card loyalty business today.

### A. Conflicting Points of View

Let's start by looking at the things from the merchant's point of view. General purpose cards account for 30.8 percent of consumer spending in 2006 (more than double the amount it accounted for ten years ago) (see **Figure 6**).[17]

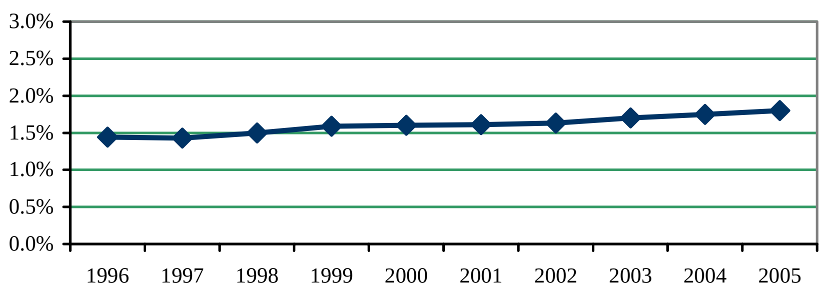
**Figure 6. General Purpose Cards Share of Personal Consumption Expenditures**




Source: The Nilson Report (various issues 1998 to 2007). PCE per the Bureau of Economic Analysis.

That's good news since it means that people are using cards to pay for goods and services—which ultimately benefits the merchant. But at the same time, interchange fees have increased too—by 25 percent between 1996 and 2005 (see **Figure 7**).[18]

**Figure 7. Visa Consumer Credit Interchange Fee Rate**




Source: Interchange rates from Visa U.S.A. Weighted by card volume per various issues of The Nilson Report.

[17] The Nilson Report (various issues 1998 to 2007). PCE per the Bureau of Economic Analysis.
[18] Interchange rates from Visa U.S.A. Weighted by card volume per various issues of The Nilson Report.

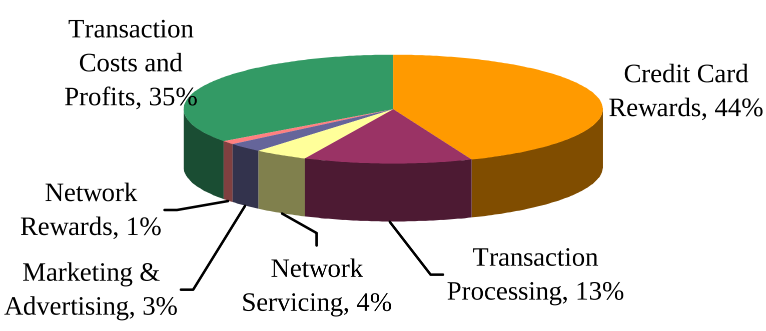
The end result is that merchants feel the double whammy of more fees as a result of more card usage and more fees because of higher interchange on those larger numbers of transactions.

So, what does that have to do with rewards programs? Issuers care about one thing: people using **their card** and using it for most of their card transactions. They don't much care where the card is used as long as theirs is top of wallet. That's how they make their money.

But merchants have a different view. They care only about customers shopping in **their store**—regardless of how they pay. That's how they make their money. And, although they recognize the positive impact of cards, they would prefer to have people use the cheapest form of payment available, which for them isn't a credit card.

The tension between issuers and merchants exists because "loyal" card usage for the merchant is limited to their physical store, while for an issuer, "loyal" card usage is anywhere the card is accepted. Merchants care about loyalty to the store; issuers care about loyalty to the card. And unfortunately for the merchant, 44 percent of the issuer's interchange fee revenue generated at the ***store*** is plowed back into rewards programs for the ***card***. (see **Figure 8**).[19] In essence merchants are financing reward programs for which they may see little, if any, direct benefit.

**Figure 8. The Source of the Tension**




Source: "A New Business Model for Card Payments," Diamond Management & Technology Consultants, 2006.

This tension is further fueled by issuers' attempts to now differentiate their card products through the use of "premium rewards cards." Programs like Visa Signature peg a higher interchange

[19] Food Marketing Institute, "Hidden Credit Card Fees," (January 2007).

fee to these cards in order to incent issuers to distribute them. Issuers, eager to build preference for these cards, sometimes waive membership fees in order to get cardholders on board. Visa has also put its muscle behind an advertising program to raise awareness of the benefits of this program and created some unique reward incentives in order to entice cardholders with a differentiated experience.

### B. The Rise of Merchant-Centric Systems

So, what's a merchant to do?

Truth be told, not much right now. That's one of the reasons that merchants have expressed such an interest in alternative payment systems. But as appealing as no interchange is to merchants, consumer adoption isn't guaranteed—at least not yet on any kind of a large-scale basis. Cardholders don't like carrying cards that can't be used. They've also been trained to get rewards, even if they don't use them. And without the interchange to fund rewards programs, it's up to the merchants who use these new systems to figure out how to fill that gap in a way that resonates with the consumer.

Some merchants seem to see the merits of doing just that and are embracing new programs. GratisCard, for instance, is a no interchange credit card product which recently launched a pilot program with the Philadelphia Flyers. Any season ticket holder using the GratisCard to make that purchase got an autographed jersey. Even with the cost of the jersey, the Flyers still saved a significant amount on each transaction. Customers seemed to like it too—they got a "goodie" with some value right away instead of having to accrue points over a long period of time.

We're also starting to see alternative providers who shun rewards per se but offer instead a good experience for customer and merchant. BillMeLater is a no interchange, no rewards, online payment alternative. Today, more than two million customers have been assured of a secure and convenient option using this alternative. Given BillMeLater's strict credit scoring process and user demographic, merchants also know that they are assured of having a high valued customer shop on their site.

Banks are also starting to see the wisdom of getting banks and merchants together to build reward programs. Citibank, AM South, US Bank, and Chase are all early pioneers. The idea of merchant coalitions, like Nectar in the United Kingdom, LaSer in France, and others are also helping to further a direct connection between card transactions and merchant traffic. Perhaps one of the earliest examples of merchant/payment method alignment is eBay and PayPal which creates loyalty for both buyers and sellers through its ease of use, security and growing acceptance by the seller network.

## C. MasterCard/Best Buy

The MasterCard/Best Buy Rewards Zone card is a more recent example of a merchant/bank partnership. Launched in 2002 as a store-based/points-based frequent buyer program, the Rewards Zone card was integrated with the store's customer centricity program in order to segment specific customer segments according to profitability two years later. The program proved successful—sales averaged 7 percent higher than usual and close rates rose by 6 percent.

In September of 2006, Best Buy announced that HSBC would begin issuing the Best Buy Reward Zone program MasterCard as another way for Best Buy to recognize and reward loyal customers. It provides automatic enrollment into the Reward Zone program. Purchases made with the Best Buy Reward Zone program MasterCard card earn 4 percent on Best Buy purchases and up to 2 percent on purchases made at the more than 24 million locations MasterCard is accepted.

More and more of these creative partnerships are emerging, especially as there is evidence that more and more of the emerging payment alternatives are gaining traction. Of course, the big question is what happens to loyalty programs when interchange fees are reduced. That might not happen next year or even the year after, but it is a likely scenario. One can be sure that bank marketing executives have already started to think about what other things can be done to keep customers in the fold. It's probably no accident that many of the next generation loyalty programs are designed to broaden the number of relationships that cardholders have with the issuing bank itself.

## V. Final Thoughts

Mobile as a payment form factor and electronic wallets have the greatest opportunity to disrupt the rewards programs that now exist. These devices not only allow issuers to bid for top of wallet positioning but will allow the delivery of tailored rewards to the cardholder for instant redemption at the point of sale. Ease of use and convenience—two of the fundamental reasons that customers use cards in the first place—will ultimately make this an attractive reality for merchants, banks, and cardholders.

If the goal of loyalty is to drive commitment and faithful behavior of profitable customers, then I'd like to suggest the following "four E's of loyalty" as a way to think about building effective programs:

1. **Engage Your Customer.** Build an experience, not a program. There's a huge difference between programs that incent usage in exchange for points and actually build a loyal following. The key is to use data to create a differentiated program that offers something of value to your high-margin customers. Use those programs to reward loyalty.
2. **Make It Easy.** Keep customers engaged by offering rewards that are easy to get. Instant gratification, reasonable reward thresholds and even expiration dates keep customers engaged at the same time it helps keep costs under control.
3. **Create Exclusivity.** Not every business wants every person as a customer, so why should loyalty programs make it easy for everyone to join, reward all customers

and offer the same reward structure for all? Create programs that reward the behaviors that drive profits and emotional attachment to your brand.

4. **Earn Their Trust.** At the moment of truth, you must come through. One of the reasons that redemptions are low is that rewards are too hard to redeem. That keeps the CFOs happy but defeats the purpose of creating loyalty. If you really don't want people to redeem rewards, then you are better off closing down your program and finding other ways to keep customers loyal, engaged, and satisfied.