

White Paper

A Short Review Of The Loyalty Business

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The Market – Loyalty A Moving Target

General History: The concept of brand or product loyalty one hundred years ago was simply the fact of doing good business. You knew your customers, what they liked and you said thank you to their face. Brands like John Deere, Sears, and Pioneer Seed became large American corporations because they knew their customers well and made sure they gave the customer what they wanted. After World War II modern consumer loyalty programs began to take shape. They started as frequent purchasing programs (the old punch cards – buy 10 get the 11th free). As consumers became more informed and the global markets allowed for increased choice, consumer loyalty shifted away from these simple ideas of buy a little more and we'll give you something for free. Loyalty was no longer a life long given. It was no longer “well my Dad drove a Buick, so do I.” Add in the technology boom of the last twelve years and loyalty has become the “holy grail” of sales and marketing. Keeping customers is as important (if not more) than gaining new ones. Loyalty is about getting back to the early idea of knowing your customers and getting them to adopt to your brand for life.

This same impact has come to the world of bank credit cards. In the late 1980's there was the creation of the first “bank points” program by Wells-Fargo, in an attempt to retain customers (the free toasters were working and they were losing customers). Wells-Fargo also wanted to get customers to buy additional services. In time, the idea of loyalty programs grew into credit card based approaches. With the creation of the GM card and the Shell Gas card allowing a consumer to use their card, earn points redeemable for a discount towards a car in the GM program (still going strong) and free gas or “stuff” in the Shell Gas card program. This created a loyalty bond to not only the sponsoring brand (GM) but to the card issuer as well (the bank and the association whether Visa or MasterCard). In time American Express launched Membership Rewards, now seen as one of the more flexible and highest earning potential card programs focused on the AMEX brand and driving usage to the card.

Most loyalty programs are based on the fact that a consumer will need to enroll in some type of program, there might be a yearly fee or not. Over an extended period of time (some programs look at a model of 5 to 10 years) the consumer earns points or miles that they can redeem for rewards (travel, gift certificates, etc.) or discounts off purchases or services. The flaw in this model seems to be based on the fact that, while the issuer of these points /miles want their customers (supposedly their most important customers) to earn and retain this “alternative currency” and have a high perceived value; while at the same time, they don't want you to earn too quickly nor spend your earnings too quickly (called the burn rate). Most loyalty points have no expiration (but can go void if the program is cancelled).

The other difficulty in larger loyalty programs is to determine whom to target, what behavior you are trying to drive and what you are willing to invest. In the AT&T True Rewards program, all customers were treated the same (whether you bought \$5,000 a month in phone services or \$100 a month), meaning the target was over 18 million customers. The pay out was a coupon book after multi-years with \$200 worth of discount off coupons for things like discounts on oil changes (not well received by the customers).

In all loyalty programs the transaction data, the program participant data, the purchasing data are critical to the program. It is through the data that the sponsoring company, the partners, the card issuers can understand the behaviors, the trends and the outcome of their investments in these programs.

Over the past 30 years the world has seen the growth of single airline mile programs into multi-matrix, coalition type of programs. These programs are focused on more than getting the consumer to buy more frequently. Instead attempting to build a relationship that connects the consumer to their brand and other brands as well. Just the other day I drove past a billboard for a funeral home and on the bottom of the sign was a promotion “buy a pre-paid burial plan now and earn miles on your favorite frequent flyer program.” Taking the concept of loyalty to your last major purchase.

Current Types Of Loyalty Programs: Within the loyalty arena there are a variety of programs in existence today. The goals of these programs have their own specific focus and desired results. Be aware that today there are fewer and fewer “pure” programs and you are seeing mixing of all these together - combinations. While there is still punch card, frequent shopper programs, this is a simple over view of loyalty programs in action today.

- *Frequent Flyer/Mile Programs:* These programs still exist today, and all airlines and hotel chains have some version in place. They usually do not require a credit card or payment type (while they all promote one to earn points/miles more quickly). You enroll and receive a nonpayment purchase tracking card or account. These programs are usually focused on a single brand (i.e. American Airlines, Marriott, etc.) and offer cross partnership opportunities (with a non-competing brand). Some of these programs require a yearly membership fee, or some level of purchase activity to remain in the program.

Example Programs:

Marriott Rewards:

<http://marriott.com/rewards/rewards.mi>

Added Credit Card: First USA Visa

American Airlines AAdvantage:

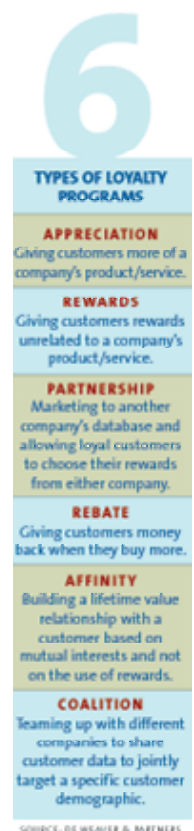
<http://aa.rewardsnetwork.com/site/homepage.jhtml>

Added Credit Card: Citibank MasterCard

Safeway Club Card:

http://www.safeway.com/club_card.asp

Most of these programs now offer some type of credit card as well, as an accelerator to earning points – also the sponsoring organization is able to make dollars from the card issuer programs (i.e. GIP, small percentages per transaction, etc.) Usually the cardholder earns some level of points for every transaction. These programs allow



other companies to buy their points/miles and use them in their own marketing programs.

Issues:

- Limited Earning Potential – even the partners they join with, if at all, are in similar fields (i.e. Hotels with hotels, etc.) not a lot of choice in earning potentials.
 - Limited Redemption Potential – most are for in-kind offerings, meaning a discount off or free nights or airline ticket (maybe a few gift certificates), causing a very focused base of only those that really love to travel or shop at that store, to be active.
- *Credit Card Programs:* These are programs where the credit card is the main focus of the program and it is tied to either the card alone, trying to build brand loyalty to the card (i.e. Membership Rewards = AMEX) or to a brand/product/company. Most of these programs require a yearly fee and you earn based on using the card. Many people who have a credit card that earns points/miles they can redeem for things they want are very dedicated to that card, and it becomes their preferred purchasing platform.

Example Programs:

American Express Membership Rewards:

<http://www.membershiprewards.com/HomePage.aspx>

GM Card:

<http://www.gmcard.com/GMCard/index.jsp>

Discover Cash Back Card:

<http://www.discovercard.com/discover/data/cashback/>

MBNA Offers A Variety Of These:

http://www.mbnainternational.com/creditcards/travel_rewards.html

http://www.mbnainternational.com/creditcards/shopping_rewards.html

Issues:

- Creates A Long Term Liability – The card issuer ends up carrying the points/miles for sometime and needs to recognize the value of these alternative currencies. They end up needing to focus on keeping the program alive, perceived valuable. Concern if the program has issues that could back up on the card brand as well.
- Keeping The Program Fresh – The ability to keep adding options and ways to earn, allowing the cardholder to stay loyal and active. Also many times the card issuer is working with a variety of “outside” resources to help manage the program, like a Trilegaint (TLS), Carlson, etc. generating costs.
- Limited Targets – If someone does not want to be associated with BassPro Shop, or Beanie Babies it limits who will want the card and use it.
- Offer Wars – Currently there are so many segmented and specific card offerings in the market that I have seen as much as 5% being offered back to

get people to adopt the card or brand. There seems to be a shift away from the idea of getting to know the specific customer desires, wants and behaviors – towards a “get with a high number.”

- *Credit Card Enrollment Programs:* These programs are less focused on a specific credit card or even a merchant brand. Instead they are attempting to create an offering that is unique in the market and gain access to individual buying behaviors. You enroll in the program (possibly either a yearly fee or a onetime set up cost), and the individual can sign up any credit card they have. When they shop at a participating merchant using that enrolled card they earn percentages – either as award points, or as other options (money toward fundraising, college education, etc.) In many ways trying to establish a brand and loyalty to this stand alone brand, not the merchant, not the bank, not the card. Again, many of these programs have recently added a credit card offering as well, in an effort to improve earnings speed and potential.

Example Programs:

eScrip:

www.escrip.com

Added Credit Card: <https://www.yournewvisa.com/escrip/images/eScripEPER.gif>

uPromise:

<http://www.upromise.com>

Added Credit Card: <http://www.citibank.com/us/cards/cardserv/upromise/>

Rewards Network (formally iDine):

<http://www.rewardsnetwork.com>

This discount dining and hotel program can also be attached to other loyalty card programs, turning this into a way to earn more points.

Value Back Network

<https://secure.valuebacknetwork.com/>

This is owned by Card Commerce, one of the processors of the transactions.

Tricordia

<http://www.tricordia.com/>

Issues:

- Difficulty In Getting Merchants On The Program – National merchants are not 100% supportive of these programs. They feel that they are just discounting purchases to existing customers, gaining very little from being in the program. National merchants feel that they are just discounting their business and have a hard time accepting that there is a value to the program.
- Grouping Of Small, Local Merchants - Most of these credit card enrollment programs have a grouping of local, smaller merchants and few national chains. Most national chains offer a frequent shopper club card already (and they may link this to one of these programs) Local merchants are willing to

participate because they usually have limited marketing programs and they look at this as a way to compete with the larger chains and build loyalty. This is both a plus and a negative – in that it gives a sense of a smaller, more localized program – but can miss out on larger travel and shopping concepts. (Be aware this is not true for the Rewards Network because they have a different model, where they pay the restaurant or hotel up-front cash.)

- Larger Players Already Have A Card – When a Marriott issues their own credit card they have a very hard time accepting the idea of allowing ANY card to have the same earnings potential. They see this as a cross purposes approach, and there is also growing concern on “double dipping” via their card signed up in one of these programs.
 - Costs Of The Transactions – These programs require a middle processor, between the banks, the card issuers that is able to go through hundreds of thousands of credit card transactions looking for a specific cardholder account and a specific merchant transaction. There are really only two companies offering this service today, and they also are merchant processors as well – GRS, Golden Retriever Systems and Card Commerce. The third player, Order Trust, went out of business because the cost to operate and the lack of program growth made their model unprofitable.
- *Something Different - Stand Alone National & Branded Loyalty Programs:* These are programs that are focused on either a branded product with a specific focus or loyalty concept, most likely tied to a branded credit card. Vesdia is an example of this approach. There have been other attempts to set up a national loyalty program that is focused on creating either a universal loyalty currency (i.e. WebMiles, AirMiles, Netcentives – which have all failed and are now out of business in the U.S.) or specifically focused on the reward approach and working back to a card or web platform.

The sad fact is that a lot of these programs have failed because of either the overwhelming cost to launch and manage them, or the difficulty in attacking either grocery chains or national merchants. Plus the fact that the consumer was asked to do a great deal. Vesdia has something a bit different, where it has set up a variety of ways to earn – but the earnings are focused on a either saving for college, retirement or fundraising. One way to look at it is a single reward with many ways to earn.

Example Programs:

Vesdia BabyMint, NestEgg, etc.

www.Vesdia.com

Community Smart:

<http://www.communitysmart.com/>

This is a program that is directly tapped into the MasterCard transaction stream, and also allows for easy set up and reporting of merchants in the program. This can be a stand alone loyalty card OR be tied to an issuing bank credit or checking card. Its goal is to focus on smaller community merchants and add national over time. The focus is on fundraising, but it can also be applied as a loyalty program.

First Community Smart Program: Summit State Bank
<http://www.summitstatebank.com/community.htm>

AirMiles Canada:

<https://www.airmiles.ca/>

When the U.S. program collapsed in 1995 the Bank of Montreal pick up the Canadian rights and continued the program. This is not widely known; the Bank wanted this low key in the market. The program took off in Canada and is still very successful. The business is now set up as a stand alone business, called Loyalty Management Group, which manages the AirMiles program and sells loyalty services as well.

Issues:

- Critical Mass – There seems to be an issue around the ability to either have a large enough selection of merchants OR in the case of the fundraising concepts enough charities involved.
- Communications & Brand Building– These programs require a great deal of constant reminder communications to keep the award and the possibilities to earn in front of the participants. At the same time there is a need to build a brand.
- More In Market Shopping Opportunities, Less Web – What the market wants is the ability to use the cards in market and earn based on their buying (whether the actual consumer goods or the merchant location – no clipping of UPC codes, etc.) The issues of the past have been about the variety of merchant POS environments and how to track transactions. Some of these technologies seem to be breaking the data collection barriers. Early many of these programs were able to get a grouping of web affiliate programs going, but web shopping is still a small percentage of overall shopping.
- Everyday Spending – The need for gas and grocery options in these programs. Also an easy way to buy your Pepsi and earn as well. Making it easier all around (merchant, consumer, and manufacturer) to earn and build loyalty.
- Merchant Fears – Many of the national merchants believe that these programs are just discounting the cost of their business and that they are not getting the direct loyalty tie in. They still do not have a strong sense of the return and value on these programs.

The Loyalty Players: There are a few different groupings of support businesses and players in the loyalty market. Many have only recently grown into recognized businesses. The loyalty industry is mostly a behind the scenes industry, fragmented in many ways. There are also the card material providers (i.e. the physical card and program material producers, gift card companies like Value-Link, etc.) and such, but they have not been covered in this document. Instead I focused on the hardcore loyalty industry.

- *Loyalty Program Managers* – These are companies that provide full service support, from program design, set up and management, awards, communications, etc. These are turn key to one stand alone element providers. These players have a lot of focus on the rewards and communications within a program (because they makes healthy markup).
 - Trilegiant Loyalty Solutions (TLS):
<http://www.trilegiantloyalty.com/index2.html>
 - Carlson Marketing:
http://www.carlson.com/corporate_marketing.cfm
 - Frequency Marketing Inc. (now owned by Alliance Data Systems):
<http://www.frequencymarketing.com/>
 - Maritz Loyalty Marketing:
<http://www.maritzloyalty.com/loyalty-programs.html>
- *Loyalty Technology & Data Support* – With the advent of CRM technologies and the philosophy around customer relationship management the old “database shops” that supported consumer programs have given way to CRM based businesses. The core of this is still the same, data collection, data processing and reporting.
 - Alliance Data Systems:
<http://www.alliancedatasystems.com>
 - Data Core Marketing
<http://www.datacoremarketing.com/>
 - SAS:
<http://www.sas.com/solutions/crm/index.html>
 - Siebel:
<http://www.siebel.com/>
- *Transaction Experts* – These are companies that act as service providers in crunching through all the credit card data to allow the loyalty program to understand the purchasing transactions.

- GRS – Golden Retriever Systems :
<http://www.goldenretrieversystems.com/loyalty.html>
- Card Commerce:
http://www.cardcommerce.com/loyalty_overview.html
- *Loyalty Knowledge Experts* – These are businesses that focus on the overall approach, concepts and programs dealing with loyalty, less with program management.
 - Peppers & Rogers – 1to1 Marketing (now owned by Carlson Marketing):
<http://www.1to1.com/>
 - Colloquy:
<http://www.colloquy.com/>
 - Loyalty Matrix:
<http://www.loyaltymatrix.com>
 - Loyalty Works:
http://www.loyaltyworks.com/consumer_loyalty/
- *POS Transaction Processors* – These are businesses that either are in the gift card transaction business or credit card processing business that have loyalty based offerings or products. Most of these are not full service loyalty program companies, instead more focused on the card transactions. These are usually targeted at smaller stand alone merchant (one merchant not a group) opportunities.
 - Ernex:
http://www.ernexinc.com/loyalty_programs/loyalty_programs_real_time_points.asp
 - DataMark Technologies:
<http://www.datamarktech.com/prod-loyal.htm>
 - Smart Transactions:
http://www.smart-transactions.com/loyalty_programs.html
 - Repeat Rewards
<http://www.repeatrewards.com/whatis.html>
This is an example of a smaller, web based loyalty program available to merchants; there are a few of these in the market as well.
- *Loyalty Rewards* – While most of the players above offer some level or have involvement in rewards as part of what they do (i.e. TLS, Carlson, etc.) there are some that focus only on the rewards elements of loyalty programs.

- Catalina Marketing
http://www.catmktg.com/retail_services/index.html
While focused on coupon management and promotions, the fact is this is an on the spot consumer reward or incentive focused on price discounting.
- Heritage Marketing & Incentives (HMI, Inc.)
<http://128.242.56.125/staging/main/mi/index.html>
- The Gift Certificate Center, A Hallmark Company:
<http://www.giftcertificatecenter.com/>
- American Airlines Certificates:
<http://www.americanairlinesincentivetraavel.com>
Here too is an example of a brand taking their loyalty program, turning it into a product and offering it to other programs.
- Rewards Network (formally iDine) Also A Stand Alone Program:
<http://www.rewardsnetwork.com>
This discount dining and hotel program can also be attached to any loyalty program.
- Lacek Group – Focused On Partnership Marketing (and other services):
<http://www.lacek.com/>

While this is not a complete listing and review of every player and every type of loyalty service out there, it does give a good sense of the type of players in the market today.

Thoughts On The Current State Of Loyalty Programs: Loyalty is big business, globally. There are a variety of forces at work, worth keeping in mind:

1. *Is It Valid?:* There needs to be a major push to prove and document the hard facts and results of loyalty based programs, by all those benefiting from, using and selling within the loyalty industry. Not in academic terms or generalities. Because the industry is so fragmented it is hard to create a clear picture of the results and benefits. This same fact is true within the incentive industry as well. This idea that “it makes senses” or catch phrases like “it costs 4 times more to get a new customer vs. keep an existing one” are not the solution. Loyalty needs to look at areas like safety programs or direct mail and learn the value in working as an industry to test, document and report results across the industry in a way that allows everyone to understand it. Loyalty needs to bridge out of the “mythical” and into the business management mainstream.

No one has shown that a consumer will stay with a program for many years and remain loyal to the sponsoring companies or card. While frequent flyer programs are coming up on 30 years, the clear understanding of the correlation between loyalty, the program and the results do not show (most airlines are in financial difficulties – except Southwest Airlines, who offers the simplest loyalty concept in the market; travel eight round trips and earn a free ticket). Loyalty needs to be

relevant to the entire business, just like operations, a call center, sales, marketing, IT, etc. It touch's all these areas within a business, and thus these areas need to embrace and comprehend the value in what loyalty means and the value of a program. It needs to move from gobbledygook academics to clear results.

2. Program Funding? With the recent decreases in both debit and credit card interchange rates (which helped fund many programs) and the fact that loyalty programs that are selling points/miles cannot carry the cost of an entire program. The industry needs to better understand the model of how and whom makes what within a loyalty relationship. What seems to be happening is, with a proliferation of programs the shift is now on to pricing and attempting to create lower and lower costs. What impact will this have on the customer experience? Who owns the customer and gains the benefit? What does that benefit mean to whom, over the long term?
3. Merchant Buy In & Paranoia – As the availability and reach of loyalty programs and card based programs grew the merchants were sometimes not at the center of thinking. The fact is that most card issuing banks, even the card associations (Visa & MasterCard) are more focused on their needs and idea of success (the member banks). The merchants are seen as a necessary evil within the transaction process. The merchant needs to be looked at completely differently. The programs need to start with both the merchant needs and the consumer desires. Today, most national merchants do not have a strong belief in card registration programs, or programs not suing their cards or that they are the center of the entire program (the anchor).

Issuing banks are focused on the cardholders and the companies' brands that are represented on the cards. Whether MBNA, BankOne, National City, the focus is on there own program needs. The addition of merchants could be seen as window dressing, but nothing substantial is in the mix for the merchant. Many merchants look at joining these programs less about the loyalty but more about the marketing and exposure value. This does not build a long term commitment, and that is why we see merchants come in and out of programs, based on the whims of marketing budgets.

4. Coalition Or Not To Coalition – There has been a need to establish a combination of both national and local community coalition programs. Allowing a consumer to buy and gain a benefit (whether for themselves, a charity or a combination) while generating a benefit for the sponsoring businesses (including the card companies, the merchants and the transaction companies). In a way, the idea of creating a national loyalty currency that can be shaped by the different communities and merchants (so that competitors are not forced to accept each others points/miles) and make earnings easy. From gas, to groceries to buying a car the ability to establish long term loyalty and change core buying behaviors. Not an easy task (or cheap). Some of the recent newcomers, like Community-Smart are steps in that direction.